Dependent finance in East Central Europe: Between Repression and Close Embrace

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Paper prepared for the 2019 EUSA International Biennial Conference, May 9-11, 2019, Denver, Colorado
Panel 6D European political economy of finance and financialisation (1)

First Draft

Abstract

The Great Recession of 2008 has highlighted the specific vulnerabilities and dilemma of peripheral countries: while they have to rely on external sources to finance development and project credibility, the very dependency on external financial sources makes them very vulnerable. This raises two questions: How do peripheral countries cope with this dilemma especially after major crises; and which are the conditions, means and constraints that shape state actions meant to discipline dependent finance and peripheral financialization? Our paper addresses these questions on the basis of three cases of peripheral finance on Europe's eastern periphery: Hungary, Romania and Latvia. The paper explains the varieties of policy responses in these countries, ranging from financial nationalism to further embrace of peripheral finance with three factors: the role of finance in the respective growth model, ideational changes, and institutional capacities to implement changes.

1. Introduction

The "finance and development" literature on the comparative political economy of financial systems has brought to the fore distinctive aspects of financialization outside the capitalist core. The question here is how subordinate financialization (financialization under condition of (semi) periphery) has generated sources of vulnerability for semi-peripheral economies in Europe and elsewhere (see Bortz and Kaltenbrunner 2018 for a recent overview). Peripheral countries appear to be in a bind. On the one hand, they have to rely on external sources to finance development and project credibility (Grittersova 2014; Epstein 2017), while on the other hand, the very dependency on external sources makes them very vulnerable, a vulnerability that has increased with the recent wave of global financial liberalization and deregulation (e.g. Becker et al 2010; Bonizzi 2013). At the most general level, two issues appear salient in this tension: how peripheral countries cope with this dilemma especially after major crises; and the conditions, means and constraints that shape state actions meant to discipline dependent finance and peripheral financialization.

Our paper seeks to address these broad issues by focusing on East Central Europe (ECE) after the global financial crisis (GFC), an extreme case of economic dependence in general as well as of dependent finance and peripheral financialization. Not only that production and export sectors in ECE are dominated by transnational corporations, but the region also has among the highest share of foreign-owned banks globally (Bandelj 2011, Nölke and Vliegenthart 2009; Epstein 2017; Ban 2019). As a consequence, ECE has been very hard hit by the GFC. Almost all ECE countries had accumulated unsustainable current account deficits before the crisis, experienced significant capital outflows during the crisis, and entered deep recessions, with all three developments linked to the malfunctioning of their transnationalized financial sectors. It is therefore not surprising, that it is in this region where resurgent post-crisis nationalism has exhibited one of Europe's earliest and most salient political manifestations.

The anti-finance and anti-dependence rhetoric of the region's economic nationalist forces notwithstanding, we see puzzling patterns of continuity and change in dependent finance and financialization. Specifically, while some of the critical elements of dependent finance (in-group financing of the local subsidiary from the non-resident orchestrating company) and financialization (loan portfolios reliant on credit to households rather than non-financial firms) proved to be resilient in all countries, others (high foreign ownership in finance, substantial share of forex lending, interest rates subject solely to market decisions and/or rules-based central bank interventions, self-imposed ban of sovereign debt monetization) saw important declines or even complete rollback in some countries but not in others.

What explains these patterns of stability and change among the pillars of finance(ialization) and across countries? For answers, we focus on three cases that have been hardest hit by the GFC, and had to turn to the IMF/EU for bailouts: Hungary, Romania and Latvia. Given their painful experiences, governments in these countries had every reason to reconfigure dependent finance and decrease their vulnerabilities. Hungary is the country where the most radical change has taken place but even here, dependent finance was only selectively pushed back. At the other extreme sits Latvia, where financialization has further consolidated ten years since the country's financial meltdown. Romania appears in the middle, albeit increasingly converging with Hungary. As the next section shows, the comparative analysis of these cases yields a number of intriguing empirical puzzles whose solving generates new insights about attempts to roll back dependent finance.

Our answers focus on the interaction of three factors. The first is the makeup of state-finance relations under the local growth regime: Hungary and Romania had incentives to push back against financializing banks because these were not central to the countries' foreign led growth model, whereas bank-based finance is a central tenet of the Latvian entrepôt economy. While alternative sources of development finance are therefore a necessary condition for pushing back against bank-based financialization, they are not sufficient. Rather, as we also show, the second factor is that governments need to experience the rise of financial nationalism to read the situation as problematic and reorganize politics around the new interpretation. Finally, we show that not all financial nationalists can achieve what they want. Instead, by underscoring the importance of market backlash against its own debt, we show that only those with solid state capacity (the capabilities and mandates of the revenue service and the central bank) can.

The paper is structured as follows. The next section briefly presents the state of the art and introduces our research question and puzzles. Section 3 discusses our analytical approach. Section 4 shows how different growth models, and, concomitantly state-finance interactions, have shaped change and continuity in peripheral financialization after the crisis. Section 5 hones in on the role of ideas and institutional capacity in pushing back against dependent finance(ialization).

2. Puzzles of dependent finance and financialization in East Central Europe

East European "dependent market economies" (Nölke and Vliegenthart 2009) have a strong reliance on transnational companies for financing production. As these authors write, "[g]iven the extremely huge volumes of FDI, TNCs prefer to hierarchically control social subsidiaries from their headquarters as an alternative mode of finance and governance rather than to accept financing by international capital markets and outsider control by dispersed shareholders (…), or to accept financing by domestic bank lending as well as retained earnings and insider control by networks of concentrated shareholders" (Nölke and Vliegenthart 2009: 677). ECE also have a high share of foreign ownership of banks in the region (Epstein 2014). Finally, East Central European countries assume a low position in the international currency hierarchy. Macroeconomic policies are therefore heavily constrained and there is the risk to commit the "original sin" of not borrowing in their own currency, leading to currency mismatches and limited abilities to pursue countercyclical monetary policies (Eichengreen et al. 2003).

The dominance of TNCs in financing production came with surging current account deficits due mostly to the repatriation of profits (Becker et al. 2010). Also, transnational banks have not adequately contributed to the financing of local firms and have chosen instead to provide pro-cyclical consumer and mortgage lending (Bohle 2018). In addition, transnational finance capital can act as a transmission belt for risk in the parent country, with downgrades of state and corporate bonds in parent economy reverberating almost mechanically in the host economy (Gabor 2010; 2013). Having currencies that are low in the international currency hierarchy means heightened exchange rate risks, with financial instability risks attached to them (Bortz and Kaltenbrunner 2018). Overall, while the ECE is not highly financialized by many of the conventional measures of the financialization literature derived from the study of Anglo-Saxon financial systems and generally has "shallow" financial markets, the region exhibits forms of financialization, such as impatient capital, the significance of carry trade operations and risky lending to homeowners, consumers and government, rather than to the productive sector (Hoffman 2012; Johnson and Barnes 2015; Bohle 2018; EIB 2018).

These vulnerabilities reached a climax during the GFC. Three East Central European countries were particularly hard hit and had to turn to the IMF and EU for a bailout. Hungary was the first country do so. Prior to the crisis, the country had accumulated unsustainable public and current account deficits, and its banks had lent mostly to households and in foreign currencies. In October 2008, its currency and stock markets started to plunge, credits dried up, and its banking sector faced a liquidity crisis resulting from the turmoil in the foreign currency swap market (Aslund and Dombrovksis 2011). Shortly after, Latvia turned to the IMF. The proximate cause of Latvia's troubles was a run on its largest domestic bank, Parex Bank. In addition, the countries' foreign owned banks had been engaged in reckless foreign currency lending, and Latvia's current account deficit was among the highest globally (Blyth 2013). In 2009, Romania followed suit. As in Hungary, rapid increase in external borrowing has left the country vulnerable to the turmoils in financial markets (Voinea 2013), and exposed to exchange rate volatility, with a run on the local currency orchestrated by the main transnational banks (Gabor 2010). The crisis also exposed the vulnerabilities stemming from dependence on TNCs in the productive sectors. FDI inflow into manufacturing sharply contracted from 2009 (figure 3 below).

All three countries thus had strong incentives to decrease the vulnerabilities stemming from dependent finance and peripheral financialization. Yet, there is puzzling cross-national as well as sectoral variation in the policies that governments have pursued to address the vulnerabilities. Table 1 presents a bird's eye view of this variation.

Table 1: Continuity and Change in dependent finance and subordinate financialization after the crisis

	Finance of Production Dependency on TNCs	**Financial Institutions** Ownership, funding priorities, riskiness of lending	**Currency risks and original sin** Indebtedness in foreign currency, monetary (and fiscal) policies
Hungary	**No change:** attracting FDI remains major priority	**Drastic change:** partial renationalization of banks lending programs for SMEs de-financialization of mortgage markets Taxes on banks and financial assets adopted and maintained	**Drastic change:** Monetization of public debt, "domestication" of private debt (abolishment of forex loans, incentives for increasing the share of domestic bond holders in the local currency) Orthodox fiscal policy on the spending side Heterodox fiscal policy on the revenue side (sectoral taxes on finance based on assets not profits)
Romania	**No change:** attracting FDI remains major priority	**Partial change:** No renationalization of banks lending programs for SMEs Partial definancialization of mortgage markets Taxes on banks and financial assets adopted but subsequently diluted	**Partial change**: Market-based government debt regime Conservative monetary policies Expansionary and increasingly wage-led fiscal policy Forex lending somewhat discouraged but not banned
Latvia	**No change:** FDI in manufacturing was never a priority	**Very limited change**: definancialization of mortgage markets in the foreign owned banking segment continuity of high risk business model in the domestically owned banking segment	**Limited change**: Euro accession limits currency risks and original sin, but euro accession was a logical continuity of fixed exchange rate) Orthodox monetary and fiscal policies

Sources: authors' compilation based on Johnson and Barnes 2015; Orenstein and Appel 2018; and our own analysis.

An additional difference between the three countries – and between sectors - stems from the sources of change, or more precisely whether business ("markets") or the state have the upper hand in initiating patterns of change and stability. In Hungary, politics *with* markets has prevailed in the sphere of financing production, with the government and TNCs in close collaboration. In contrast, change in the sphere of financial institutions and the currency have been brought about by politics *against* markets. Following Johnson and Barnes (2015), we call the Hungarian strategy "financial nationalism". While financial institutions, currency risks and the "original sin" of borrowing in a foreign currency (Eichengreen and Hausmann 2003) have been addressed in a most determined fashion by partial re-nationalization, the same is not true for dependency on transnational finance in production.

Romania is a related case of partial financial nationalism. As in Hungary, while the government has closely collaborated with TNCs to preserve dependent finance in the sphere of production, the government has challenged dependent banks on nationalist grounds, albeit more incrementally than the Hungarian "big bang". However, these policy measures have not been supported by a more nationalist course in central bank policy and revenue administration. Most importantly, whereas the Hungarian central bank monetized debt, perhaps the most important form of sovereign debt definancialization and financial repression according to the literature (Reinhart and Kirkegaard 2011), this has not happened in Romania.

Finally, Latvia has implemented the fewest changes, and some of the changes were de facto a logical continuation of previous policies, such as the switchover to the euro. While this step has eliminated the currency risks and reduced the problem of original sin, paradoxically, it is exactly this step which has allowed the continuity of financialization in Latvia. In Latvia, furthermore, business interests had the upper hand in all three spheres.

This presents us with a number of puzzles that lend greater specificity to the research question. First, why have supposedly economic nationalist governments disciplined dependent finance but not dependent manufacturing? Specifically, why has financial rather than economic nationalism prevailed in Romania and Hungary? This raises the question whether bank-based finance is different from production. Are there reasons to assume that it is more feasible to overcome dependency in bank-based finance than in production? If so, why, and under which conditions?

A second puzzle arises from looking at the two extremes, Hungary and Latvia. Why is it that after the financial crisis, which has exposed the risks associated with a weakly regulated, dominantly foreign owned banking sector that engaged in large-scale carry trade to channel ample liquidity in unproductive (mortgage and housing) markets, policy responses have been so different? The contrasting answers are even more puzzling as Latvia's crisis was much more severe than Hungary's. Why have governments in a country that has faced repeated banking crises not been able or willing to curb the excesses of financialization?

Finally, why have financial nationalists in Budapest been more successful in disciplining dependent finance than financial nationalists in Bucharest? What makes this even more puzzling is that Hungary's financial nationalists confronted transnational finance under more difficult conditions and by taking greater risks than the Romanian counterparts did. The former began to drastically change the regulatory, fiscal and ownership of the financial sector even as they were still formally under the constraints posed by the IMF, had a public debt level twice as high as Romania's, a financial system twice as large as a percentage of GDP and the interest rates charged by the markets for its debt during the reform period (2011-2013) were much higher than Romania's in 2018-2019.

3. Analytical framework

3.1. State-business power and the politics of reembedding dependent finance

In order to address our questions and puzzles, we combine approaches focusing on the strategic interaction of transnational business and political elites with neo-Polanyian approaches that point to the fact that the state and the social coalitions that underpin it can, under certain conditions, bend the priorities of transnational capital to domestic demands for protection from the market.

Overall, by treating business power not as structural, but as a variable contingent on the capacity of some sectors of business to develop relationships of interdependency with the state, the largest theoretical umbrella we fit under is the "business-state power" approach (Brazys and Regan 2017; Regan 2019). This approach brings politics back into comparative political economy by tracing the role of the state in shaping the trajectory of economic development and the ways in which sectors of corporate business exercise power. In this conceptualization, continuity is predicated on bargains between business and state elites that take place in the corridors of "quiet" politics, away from the public arenas of "noisy" electoral politics (Culpepper 2010). It is in these corridors where the most crucial policies for a given growth regime are devised. In contrast, compensatory policies for less powerful economic elites and the electorates are more often negotiated in the electoral arena of noisy politics, and are also more amenable to change, depending on the extent to which the dominant social coalitions change (Bohle and Regan 2019).

The research conducted in this tradition focuses on industrial and enterprise policies in FDI-led growth models, and its main finding is that in these models, the basic bargains between TNCs and state elites tend to stick because TNCs in FDI-led growth models deliver continuous upgrading and export performance. Therefore, even the most nationalist government will not risk rolling back policies that support the very foundations of the national growth. This finding confirms an earlier insight from development theory: initial bargains between TNCs and host governments are unlikely to obsolesce, as TNCs provide host countries with new specific advantages, such as investments, technologies and access to export markets which governments are unlikely to forego (e.g. Kobrin 1987). TNCs can also develop domestic and transnational alliances that reduces their risk of being taken hostage by hostile governments (Moran 1973).

Our hunch is that finance capital is different. While the state and transnational manufacturing firms are in a form of mutual dependence that gives these firms structural power, the same cannot necessarily be said about various aspects of dependent finance and subordinate financialization. If a country is not a global financial center or at least a regional one specializing in some bespoke form of finance (Latvia), but is a "boring" bank-based system (Hungary and Romania), financial innovation is not a central feature of the financial sector and therefore state-finance bargains can obsolesce if finance does not contribute to local development priorities. To better understand the mechanisms of change and lack thereof, in the next section we detail the analytical apparatus that informs the empirical analysis.

3.2. State-finance relations: Possibilities of change and their limits

We build on the original Polanyian insight (Polanyi 2001 [1944]) and neo-Polanyian approaches (Bohle and Greskovits 2012, Ban 2016) to argue that the protection of domestic social actors against market mechanisms can be delivered not only by the usual gamut of mechanisms such as income redistribution, industrial policy or labor market institutions, but also by bending the extent and workings of dependent finance and subordinate financialization to fit the demands of politically salient domestic borrowers (including the state itself). Disciplining finance and politicizing credit allocation is one of the state's oldest functions and three decades of global neoliberalism have not changed that.

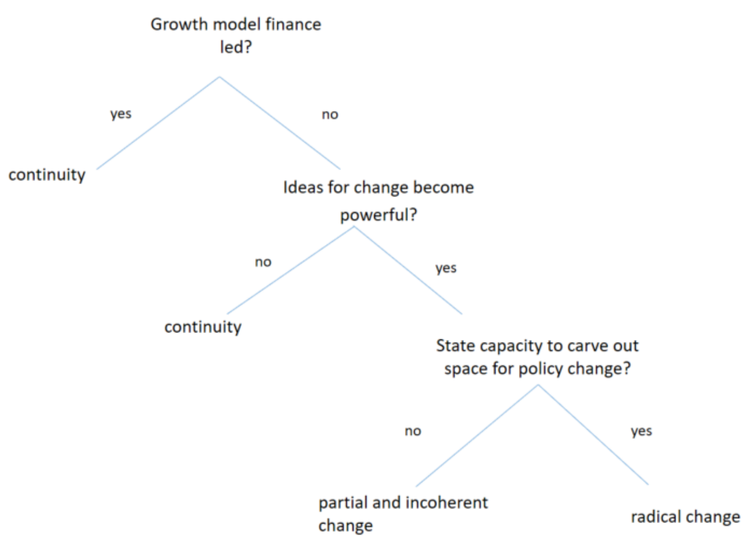
First, to determine whether a government has strong incentives to initiate the disciplining of finance we need to look at the balance between state and private financial power within the local growth model. If the growth model as a whole revolves around finance, such as in "financial entrepôts" (Kapstein 1989; Haggard 1990), the state-finance bargain remains viable and existing patterns of stability and interdependence will dominate. The likely result here is stability and the representative case would be Latvia. However, if the growth model is based less around finance and mostly around global value chains linked to manufacturing and related tradeable non-financial services (such as ICT) states might be more willing to take on financial institutions, even if they are foreign owned. In this case, the initial bargain with (foreign) banks might obsolesce, especially if domestic actors (in our case local banks) can deliver the same advantages to the state, firms and households as transnational financial actors do. We expect this to be the case in the FDI-led manufacturing-based Hungarian political economy and to some extent in Romania's, where convergence with this model has been noticeable. In these countries, foreign owned banks have not contributed much to financing production, while local banks are in principal perfectly able to step in to lend to households and the state. Moreover, the latter have been more amenable to service the political interests of state actors.

Second, since openings in the opportunity structure such as growing bargain obsolescence "do not come with an instruction sheet" (Blyth 2003), the politics of economic ideas that capitalizes on such moments is of critical importance for initiating disciplining actions (Helgadottir 2016). Indeed, since a financial nationalist's nightmare can be a liberal's reverie, obsolescence may not be apparent to all governments, only to those whose policy ideas highlight the vulnerabilities of dependent finance. In this regard, given the ideological landscape in contemporary ECE it is economic nationalists who are most likely to call off the initial bargain from a position of political power (Johnson and Barnes 2015). But emergence of nationalism even under the region's most unbalanced forms of dependence cannot be taken for granted, however. While Hungary is a clean-cut case of politically successful financial nationalism, the case of Romania shows that this ideology remains heavily contested across party lines.

Third, our analysis highlights the centrality of institutions supportive of financial nationalism. The convergence between obsolescent bargains and electoral success for financial nationalism provides only an opening in the domestic opportunity structure. These opportunity structures are neither causal mechanisms (Mayer 2003) nor are they unconstrained internationally. Cracking down on transnational finance is a form of financial repression and this can attract the whole gamut of international forms of coercion, from credit downgrades to sovereign debt refinancing problems. Critical in this regard is the policy space the state has, given the leverage that financial institutions have over the state as a debt issuer. Far from being fixed this policy space is as much contingent on state capacity as it reflects structural constraints and opportunities (Evans et al 1992; Kohli 2004; Reinsberg et al 2019). Our contribution is to highlight the capacity to guarantee the existential imperative of refinancing state debt even as the state attempts to deploy actions hostile to finance such as rolling bank dependence on foreign banks and reducing subordinate financialization through tax, regulatory and property changing measures. States with agencies that are capable to increase revenue and collect international financial assistance can minimize the damage done to the prospects of recovery by avoiding procyclical cuts in public spending during bust cycles and weak fiscal states trying to discipline finance may be unable to obtain confidence effects even during boom cycles (Blanchard and Leigh 2013).

Based on these insights we make a twofold argument: (a) only strong fiscal states can pick up a fight with transnational finance and (b) given that few emerging markets can withstand a crisis of confidence in their sovereign debt, only states with central banks that can have the financial back of the state (via debt monetization) can ensure that the disciplining actions do not risk a crisis in the refinancing of the state's coffers (De Grauwe 2018). Figure 1 below visualizes our assumptions about continuity and change in dependent finance and subordinated financialization. The next sections substantiate them empirically.

Figure 1: Continuity and change in dependent finance and subordinated financialization



4. Between obsolescing and viable bargains

In order to address our first puzzle, namely why supposedly economic nationalist governments have disciplined dependent finance but not TNC-finance dependent manufacturing, we draw on the obsolescence bargaining model (OBM, Vernon 1971) and compare the cross-sectoral response to foreign capital in banking and finance in two growth regimes: the FDI-led growth regime in Hungary and Romania and the financial entrepôt economy in Latvia. The OBM is concerned with the changing relationship between TNCs and host country governments. In the original bargain, TNCs have the upper hand, as governments seek access to foreign capital to modernize their economies; while TNCs have many opportunities to invest elsewhere. Once TNCs have invested however, the relative bargaining power shifts to the host government. The sunk costs make TNCs less mobile, and spill-overs to the local economy make host-countries less dependent on TNCs. As a result, governments can impose more stringent conditions on them, "ranging from higher taxes to complete expropriation of [TNC] assets" (Eden et al. 2005: 2).

Originally developed to explain the wave of renationalization of natural resource sectors in the developing world, OBM was considered much less useful for understanding relations between TNCs and host-countries in manufacturing (ibid). This is because transnational investment in production can provide skills and technological upgrading which are difficult to copy by local enterprises. The transnationalization of the supplier industry limits spill-overs to domestic firms, and proximate locations in different host countries can be easily played out against each other (ibid, Kobrin 1987). We argue below that this is true for dependent manufacturing in ECE. In contrast, the OBM holds in the financial sector, under the condition that the financial sector is not central to the growth model. This is because in FDI-led growth models, (foreign) banks have less structural power than TNCs, while sunk costs make them rather immobile. Moreover, given their narrow focus on mortgage and consumer markets, foreign owned banks do not offer sophisticated services unreachable for local banks. It is for these reasons that economic nationalist governments, if they wish to, can tax, tightly regulate or even renationalize foreign banks. The outcome however is different in countries where the growth model is dependent on (foreign) banks.

4.1 The continuing reliance of TNC-finance dependent manufacturing in FDI-led growth regimes

A country's growth regime is decisive for what policies are possible (Baccaro and Pontusson 2016). Both Hungary and Romania are FDI-led growth regimes, i.e. growth regimes that rely on foreign ownership to develop export-led growth. Hungary comes close to an ideal type of FDI-led growth. Around the global financial crisis, foreign affiliates accounted for about 80 percent of the exports (OECD 2010) and that figure has not changed much. Hungary's exports are concentrated in few sectors, with electronics, transport equipment and machinery taking the lead. The Hungarian bargain with TNCs in manufacturing industry originated in the late 1980s and early 1990s, when cash stripped governments sought to privatize fast via FDI and its initial terms favored the TNCs. However, EU accession and the increasing focus of on lean production led to a more balanced relationship between host country and TNCs (Bartlett and Seleny 1998). The terms of this bargain can be labelled a mutual dependency: the Hungarian state offers generous investment subsidies, tax exemptions, infrastructure, and a pool of skilled and comparatively cheap workforce, while TNCs deliver investment, expansion of the local activities, continuous upgrading and increasing export competitiveness (ibid., Hunya 2017, Bohle and Greskovits 2012, Bohle and Regan 2019). Although Romania is, along with Poland, the only ECE country that balances FDI and consumption in its growth model, its reliance for upgrading, exports, jobs and taxes on multinational capital has been significantly increasing since the mid 2000s, with a Hungarian-style bargain with TNCs emerging. Two thirds of exports are carried out by multinational corporations, with most of the investment concentrated in car assembly and parts and an FDI-led ITC sector in spectacular expansion (Ban 2019).

For all their nationalist rhetoric, governments in Hungary and Romania have not dramatically changed the original bargain with the TNCs after the GFC (Hunya 2017, Bohle and Greskovits 2018, Adascalitei and Guga 2018). Manufacturing TNCs are supported by governments and generally delivered on their end of the bargain regarding investment, upgrading and exports. Figures 2a-c show the sectoral composition of exports in Hungary, Romania, and Latvia. They demonstrate the increasing complexity of exports in the former two countries, with a strong convergence between

Romania and the more advanced Hungary during the past 15 years. With domestic private capital concentrated in construction and services, it is clear that Romania and Hungary's convergence with "core" Europe on economic complexity could not have happened without TNCs. Given the structural power of TNCs, rocking the bargain in either Budapest or Bucharest would have been self-defeating. On the contrary, in both countries the state provided manufacturing multinationals with institutional, tax and regulatory advantages as part of the same regional race for attracting capital that shaped East European history since 1989 (Bohle and Greskovits 2012; Adascalitei and Guga 2018). In contrast, Latvia has kept its export orientation in agriculture and traditional industries while the share of service exports is significantly higher than in the two other countries.[1] As the next section shows, this led to a very different outcome.

Figure 2a: Sectoral composition of exports in Hungary 1996-2016

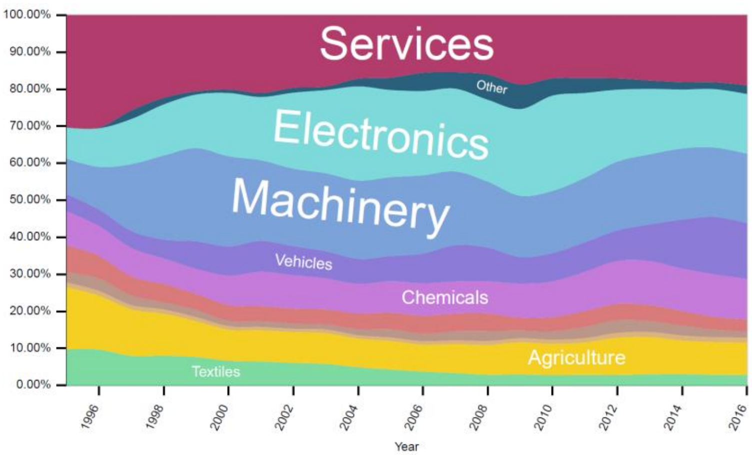
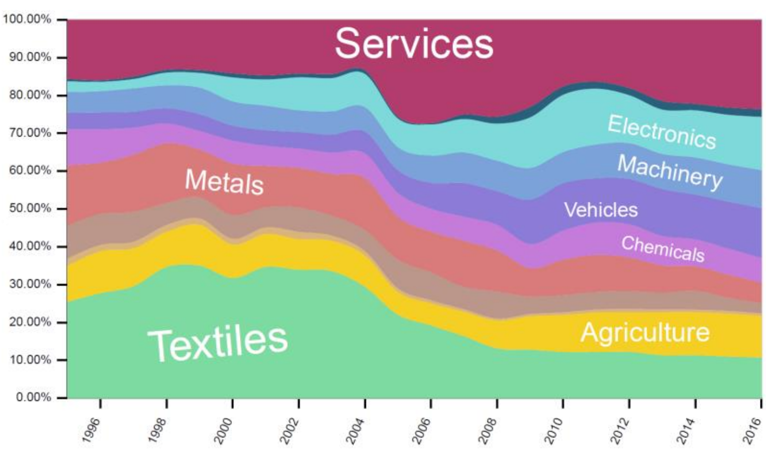
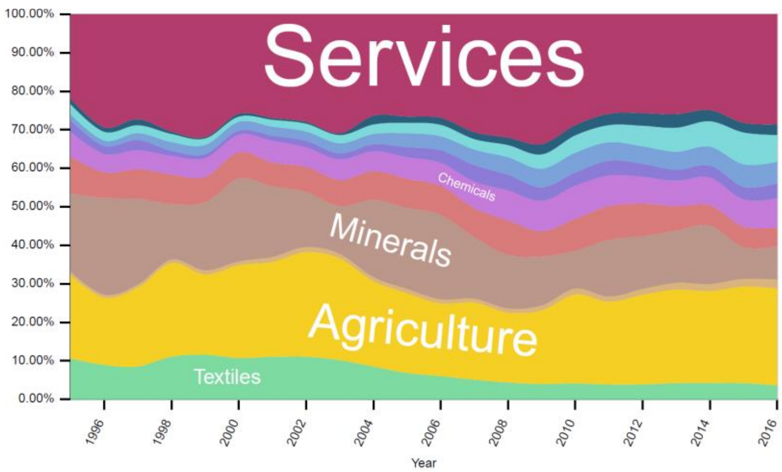


Figure 2b: Sectoral composition of exports in Romania 1996-2016



[1] We follow Greskovits (2005) in using the sectoral composition of exports as a proxy for export complexity. An alternative indicator, also used by the Atlas of economic complexity which looks at diversity and ubiquity (the number of countries that are able to export a product competitively) come to similar conclusions concerning the ranking of the three countries in their export complexity.

Figure 2c: Sectoral composition of exports in Latvia, 1996-2016



Source: Atlas of economic complexity, Center for International Development at Harvard University

4.2 Obsolescent bargaining with foreign-owned banks

In contrast to foreign capital in manufacturing, transnational finance joined together the grievances of a broad constituency of small business owners, mortgage borrowers and large domestic firms for its poor performance in financing the non-financial firms, the exposure to foreign currency loans and the high and volatile interest rates on consumer and housing credit (Barnes and Johnson 2015). The existence of these aggrieved constituencies gave economic nationalist governments in Hungary and Romania an opening to change the initial bargain with the foreign-owned banks.

But why would it be possible for governments in the region to change the bargain with banks, while this was not the case for the bargain with TNCs in manufacturing? Epstein (2014; 2018) argues that foreign banks in Eastern Europe see the region as their "second home markets", and have consequently heavily invested in the region, developed "long time horizons, high toleration for volatility and were pursuing a mass-marketing strategy in host economies (as opposed to just funding corporations from their home markets)." (Epstein 2014: 849).

We build on this argument by elaborating how the second home market business model gave host countries the upper hand in their post-crisis bargain with foreign banks. First, while foreign-owned banks indeed served mass markets, they also set the wrong priorities and heavily mismanaged their business. Exposing Eastern Europe's populations to exceedingly risky credits with an eye on short-term extra-profits, while paying scant attention to non-financial corporations convinced policy makers and large swaths of the population that these banks did not deliver important services to the economy. What is more, there was limited upgrading and innovation in financial services, so that domestic banks could easily move into the same market segments. Given their heavy investments, foreign-owned banks were thus stranded with large sunk-costs and limited structural power, just as the original OBM predicted.

Hungary's financial nationalist Fidesz government was the first to reverse the deal with foreign-owned banks. Against the background of Hungary's public and private debt crisis and the ensuing IMF conditionality, the Orbán government defined the fight for independence from "a world symbolized by banks, multinationals and a bullying IMF" (Oszkó 2012) [2] as a priority of its economic program. The government promised to "magyarize" selected economic sectors, build a successful native entrepreneurial class, and reduce the profit opportunities for foreign-owned banks and other enterprises servicing the domestic market. From 2010 onwards, the government levied heavy special taxes on bank assets (harder to evade than taxes on profits) as well as a financial transaction levy on the banks. In 2009-14, revenues from special sectoral taxes increased from one to almost six percent of the combined revenues of the central budget and Health Insurance Fund (Soós 2017: 264). The lion's share of taxes fell on the financial sector (ibid., Várhegyi 2017). The taxes on banks were designed in such a way that they affected foreign banks more so than Hungarian ones (Várhegyi 2017: 298).

The government also sought to alleviate the burdens for households with foreign currency loans, and to shift some of the costs onto the banks. In 2011, it introduced the possibility to exchange foreign currency loans in forint at a preferential exchange rate for debtors who could repay their debt at one stroke, and introduced an exchange rate protection mechanism, where repayments are calculated at an advantageous fixed exchange rate. In late 2014, finally, the government forced almost all debtors to swap their forex loans into local currency at the then current rate. Banks had also to pay compensation for unfair interest and exchange rates. The political pressure on banks only eased again in 2015. Until then, the sector had made losses every single year since the GFC.[3]

The governments' measures did not only serve to shore up public revenues and ease the pressure on overindebted homeowners. They were also tied to a broader agenda of renationalization. Thus, the government never made a secret of the fact that it wished a much higher domestic ownership in the banking sector, a goal that it indeed achieved. It acquired a number of banks, including the fifth largest commercial lender, MKB. As a consequence, in 2016, the share of banking assets in domestic hands was 60 percent.[4]

A particular concern of the Hungarian government was funding for domestic small and medium enterprises (SME). This is a common source of headache for all ECE countries, and the low incidence of credit among firms in ECE is partly linked to foreign ownership of banks. Not only are they less likely to extend credit to NFC, but firms in the region are also discouraged to apply for loans at these banks (Brown et al. 2011). The credit crunch after the global financial crisis and the banking policies enacted by the Hungarian government led to a further sharp contraction of loans to SMEs. In 2013, the Hungarian National Bank adopted its Funding for Growth Scheme, where the Central Bank offered funds free of charge to commercial banks which granted low-interest loans to SMEs. According the Hungarian Central Bank, the scheme was successful in that it turned around the negative trend in lending to SMEs, contributed to new investment, and reduced regional inequalities in access to credit. At the same time, however, until 2016 corporate lending outside this specific scheme has been in decline (Hungarian Central Bank 2017: pp. 22-23).

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[2] Oszkó, Peter. 2012. "Guest Post: Orbán's Hazy Memory of Debts, Cuts and Economic Policy." Financial Times. January 23, 2012. http://blogs.ft.com/beyond-brics/2012/01/23/guest-post-orbans-hazy-economic-memory/.

[3] http://www.eiu.com/industry/article/96507393/hungary-banking-sector-risk/2018-03-01

[4] https://financialobserver.eu/ce/hungary-is-unexpectedly-back-on-investors-agenda/

While Hungarian economic nationalists successfully challenged the initial bargain with foreign owned banks, Romania's economic nationalists were much less determined during their "honeymoon" period in office (2007). This was despite the fact that the sector did little to reduce its vulnerabilities, and foreign owned banks continued the misallocation of funds towards consumer and mortgage lending instead of supporting the productive sector. Indeed, what drew a lot of discontent from quarters as different as SMEs and politicians was that banks' lending to non-financial firms shrunk for the entire 2008-2018 period and particularly once recovery kicked in after 2012 (BNR 2018: 69, figure 3.3), while lending to households during recovery was one of the strongest in the region. Since the GFC, foreign debt between the subsidiaries of multinational firms and the "mother" firm doubled, reaching 26.8 billion euro in 2017. In contrast, domestic corporate borrowing from the Romanian financial sector was 24 billion euro in 2017. Similarly, pension funds locked their lending portfolios in government bonds (65 percent) and only a small share of them going in the real economy via equity (20 percent) (BNR 2018: 96). In contrast, growing domestic commercial banks like Banca Transilvania did much better than the subsidiaries of transnational banks with regard to granting loans to SMEs and consumers. [5]

Against this background, the Romanian policy regime favorable to finance finally began to deteriorate in late 2017. However, unlike in Hungary, change was not a "big bang" of anti-bank measures. Instead, the government took timid attempts that rolled back the space for the market in order to protect borrowers. Specifically, it started in 2017 with capping real interest rates and penalties in some loan contracts[6] and closed a large tax loophole for banks that made NPL sales tax fully tax exempt. measures were but the opening salvos of the all-out surprise assault that came in December 2018. Then, with a two year lag the government passed an emergency order (whose preparation had been entirely secret) whose foundations were imported from Budapest: it taxed bank assets if the bank used interest rates higher than the local LIBOR. The measure was meant to capture more revenue from the banks' large profits (highest returns on assets in Europe in 2017-2018) [7] at a time of fiscal stress and protect critical electorates and firms affected by increasing interest rates. Other than the tax on bank assets, these steps were not as sweeping as the Hungarian measures, but they do differ from what happened in Latvia.

4.3 Why Latvia is different

In contrast to Hungary and Romania, the state-finance bargain did not obsolesce in Latvia. More precisely, this country remained as wedded to the original bargain with its most powerful banks as the economic nationalists in Hungary and Romania with the manufacturing TNCs. The bargain however differed. Latvia mostly serves as an entrepôt economy (Haggard 1990), offering offshore financial services and commercial activities for its Russian neighbour. Finance plays a major role in this. The country's financial sector exhibits two segments: next to the foreign – mostly Scandinavian – owned banks that dominate the local credit markets, domestically owned banks are mostly dependent on non-resident deposits and specialize in financial services to non-residents. The latter segment assigns Latvia an important role in global illicit wealth chains[8], as it serves as an entry point for semi and illegal money flows stemming from the wealth accumulated during the post-Soviet privatization and the commodity

[5] Author interview with banking supervisor, January 2019.
[6] Legea nr. 436/2017
[7] Statement by BNR's Florin Georgescu, February 2019
[8] We borrow the term global wealth chains from Seabrooke and Wigan 2014; 2017.

boom of the 2000s. This specific specialization of the domestic owned banking sector also explains why the initial bargain with Swedish banks never became obsolescent: domestic banks were simply not interested in developing the more conventional banking segments that foreign banks serviced, and the state had no incentives to foster lending to non-financial corporations, as these play only a minor role for the Latvian growth model (figure 3a).

The foundations for the central role of banking in Latvia were laid in the immediate post-independence period. Latvia's economic institutions have been built around a "stability culture" of sound monetary and fiscal policies, which reflect the fusion of neoliberalism and nation building (Feldmann 2006, Bohle and Greskovits 2012). A most influential neoliberal nation builder was Einars Repse, Chairman of the Bank of Latvia from 1991 – 2001; Prime Minister between 2002-2004, and Minister of Defense from 2004-2005. In a recent piece on Latvia's banking sector, Aslund (2017: 10) writes about him: "Prime ministers and finance ministers were replaced almost every year, while Repše stayed put. His economic ideas were clear and firm. He was a monetarist, who believed in a conservative monetary policy leading to stable prices, and he believed in an open economy. His ideal was Switzerland, *and he desired that Latvia would develop into an international banking paradise characterized by the rule of law and monetary stability*." (italics added). This brief quotation captures the essence of Latvia's growth model: its institutional hallmark is the Central Bank, its commitment to monetarism, and the fusion of Central Bank interests with those of its commercial banks. The singular concern with stable money and balanced budgets also contributed to wiping out the country's manufacturing sector (Greskovits and Bohle 2012).

During the 2000s, the country underwent a spectacular finance-led growth spurt, which was nurtured from two sides. On the one hand, the commodity boom of the 2000s created vast fortunes for post-Soviet oligarchs, leading them to seek locations to launder and store their cash (Sommers 2009). On the other hand, as in other ECE countries, Latvia's EU entry made its underdeveloped domestic oriented banking sector an attractive destination for FDI. Figures 3 shows the inflow of FDI in the FIRE (finance, insurance and real estate) and the manufacturing sector between 2001-2014/17 in Latvia and Hungary. These figures show that before the crisis, the FIRE sector attracted significantly more FDI than manufacturing in both countries, but this development was much more pronounced in Latvia than in Hungary. The figures also show that this trend continued in Latvia even after the crisis in contrast to Hungary, where FDI in manufacturing took the driving seat again.

Figure 3a: FDI inflow as a percentage of GDP, Latvia (2001-2014)

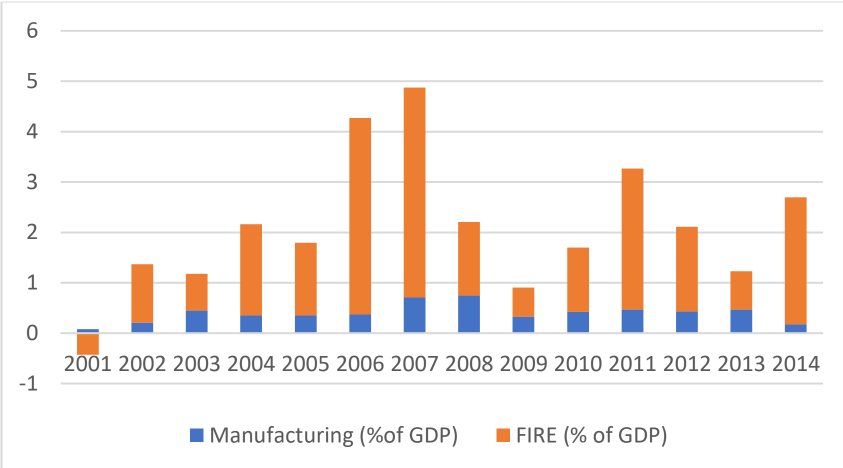
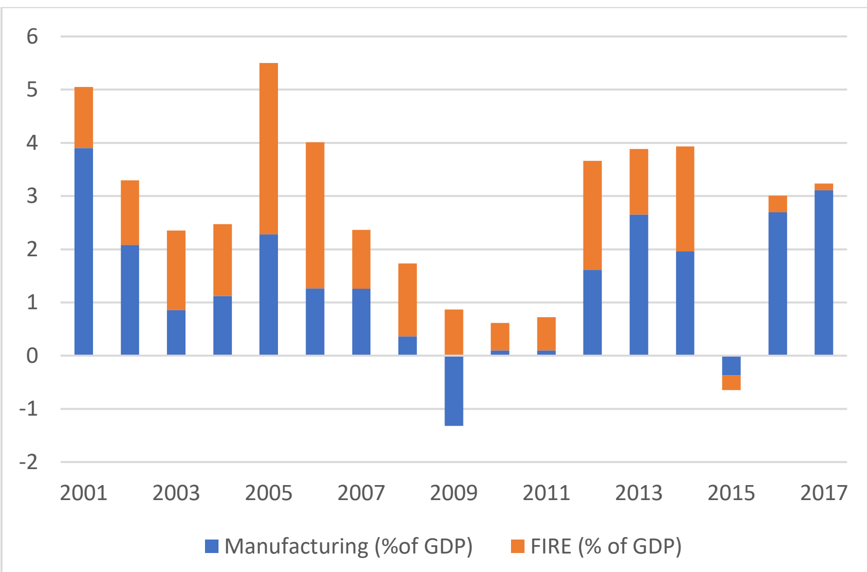


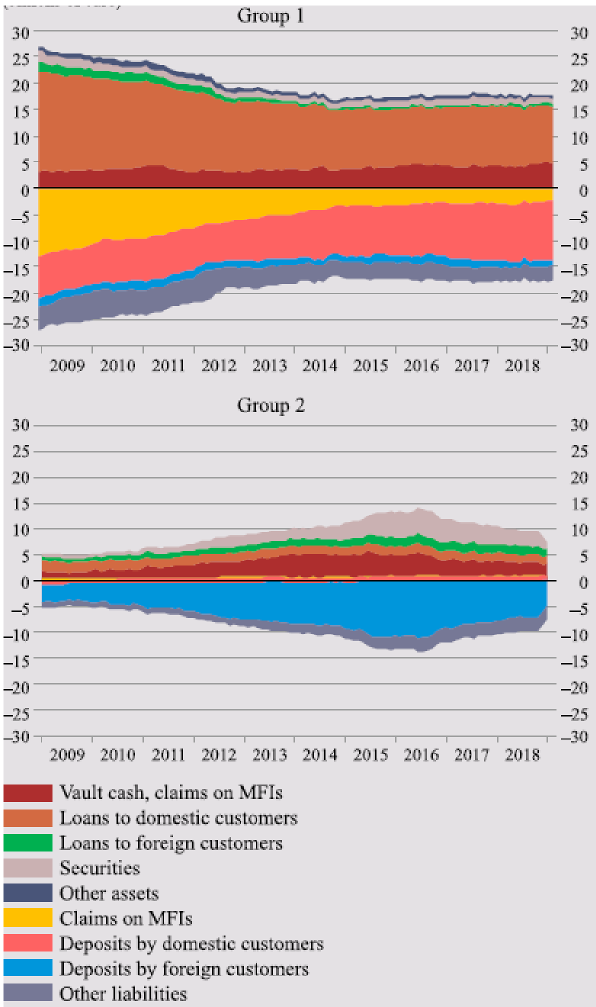
Figure 3b: FDI inflow as a percentage of GDP, Hungary



Source: Own calculations based on WIIW database. http://wiiw.ac.at/fdi-database.html.

The financialized nature of Latvia's growth made it particular vulnerable to the GFC, and in 2000, it experienced among the steepest recession in the world. The depth of the Latvian crisis notwithstanding, bank-based financialization remained a major tenet of Latvia's post-crisis growth model. The action however now shifted entirely to the second leg of Latvia's financial system, non-residential loans and their downside, money laundering. Figure 4 shows the contrasting fate of Latvia's two banking segments.

Figure 4: Structure of credit institution's balance sheet (billion of Euros)



Source: Bank of Latvia Financial Stability Report 2018: 17

The share of the non-resident deposits however does not provide the full picture of the stellar rise of Latvia's non-residential banking sector after the GFC. As argued by Bershidsky (2018) "[t]he Latvian banks that specialized in servicing non-residents were always a group apart from those that worked with locals and didn't focus on attracting deposits. Rather, through a strong network of correspondent relationships with Western banks, they served as a pipeline for post-Soviet money to safer havens, a pipeline as capacious as the ones that have pumped Russian gas to Europe. In 2013, when the IMF reviewed the system, it found that a quarter of the non-resident banks' assets were parked with foreign banks with which they had correspondent relationships. Switzerland, in other words, was not so much a model as a destination". All in all, according to a recent Bloomberg report (Meyers et al. 2018), in 2015, "about 1 percent of all U.S. dollars moving around the world… were going through Latvia…. That's 30 times more than might be expected in an economy the size of the Baltic nation's."

To put it differently: after the GFC, Latvian banks have, once again, become a central location in global illicit wealth chains mostly originating from the Post-Soviet region (for details see e.g. Aslund

2017, Eglitis and Speciale 2018, OCCRP, 2014, 2017, Jemberga 2018). What is more, money laundering was not confinced to Latvia's domestic owned banks. As was recently revealed, Swedbank, the owner of Latvia's largest commercial has also been deeply involved in dirty money operations (Milne 2019, The Economist 2019). Most of the Scandinavian banks' laundering activities seem to be focussed on their Estonian subsidiaries. However, already in 2016, the Latvian Financial Watchdog fined Swedbank for series deficiencies of its money laundering and terrorism financing systems (LSM.LV 2016).

As before the crisis, commercial banks and the Central Bank moved in tandem to secure the central place of finance. Against this "united front", the political sphere appeared weak. Although there had been quite some international pressure on the country to strengthen its anti-money laundering measures, things only changed when the US, in the aftermath of Russia's aggression in Ukraine, started to be tougher on money laundering (e.g. Jemberga 2018). The situation came to a heed in February 2018, when two prima facie unrelated events broke out at the same time. The first was the US Treasury's Financial Crime Enforcement Network's (FinCEN) initiative to ban Latvia's then second largest bank ABLV from having a correspondence account in the US (see for this and the following: Jemberga 2018, 2019; Meyer et al. 2018). The reason for this harsh move were money laundering concerns in a large number of cases and a failure to comply with the North Korea sanctions. The bank was also accused of bribery. US authorities informed the Latvian diplomats and regulators only an hour before they issued the note. That ABLV has not been a clean sheet had been clear for a long time. It had been central party to most major Latvian money laundering scandals, and had already been under investigation for circumventing the North Korea sanctions. However, Latvia's Financial and Capital Market Commission (FKTK) decided in 2016 that it had no strong enough evidence to punish the bank.

At around the same time when ABLV was targeted by the US treasury, Latvia's eight largest commercial bank, Norvik, filed an international complaint before a World Bank arbitration body against a senior Latvian official for corruption (Piovano 2018, see also Eglitis and Speciale 2018). Allegedly, this Latvian official had demanded a 100,000 Euro bribe a month for protecting the bank against new regulatory measures. The Latvian official this way accused was no other than Ilmārs Rimšēvičs, the governor of Latvia's Central Bank. Other banks soon pushed similar charges. The Central Bank governor has consistently denied any charges of bribery and corruption. The Latvian government however barred him from performing his duties, which also includes his role at the European Central Bank. This decision was overturned by the European Court of Justice in early 2019 (Khan 2019).

Thus, 10 years after the 2008 crisis, Latvia faces another major banking crisis which once again risks spilling over into the rest of the economy. This time around, it however looks as if the structural power of Latvian finance has taken some hit. In sum, at the end of 2018, much of the infrastructure that allowed Latvian banks to engage in money laundering, offshoring, and foreign resident banking is being winded down. Latvia is still under review by Moneyval, the financial watchdog of the Council of Europe. In case of insufficient progress, Latvia risks being blacklisted by the Financial Action Task Force (FATF), which might create serious problems for any international financial transaction (UAwire 2019. Under huge (mostly international) pressure, the government amended the Law on the Prevention of Money Laundering and Terrorism Financing. It prohibits banks' dealings with shell companies, which were often part of money laundering systems. The number of banks dealing with non-residential banking decreased from 16 to 12, and the share of non-residential deposits to around

30 % (see figure 4, Meyers et al. 2018). The authorities plan to decrease this share to 5 percent (FKTV annual report 2017: 7). The banks strongest domestic ally, the Latvian Central Bank – or at least its governor - has suffered an enormous reputational loss. Latvia has also become cut off from almost all correspondent banks in USD (Anders 2017: 27-28). Apart from possible negative implications for the real economy, this partly endangers the very business model of Latvian banks, which, as we have seen above (Bershidsky 2018) consisted of transferring the money of their non-resident clients to a network of correspondent Western banks.

In short, growth regime type is decisive for the obsolescence or resilience of state-finance bargains. Yet, as the Romanian case shows, the growth regime itself is not a sufficient condition for governments pushing back decisively on transnational finance(ialization). As the next section shows, governments need the right lenses to read obsolescence or viability into a social bargain; and states must be capable of implementing these ideas.

5. Opportunities and constraints for financial nationalism after the GFC

5.1 Ideas for change: The importance of being economically nationalist

Counterfactuals and within case comparisons suggest that ideological change was a precondition of attempts to roll back dependent finance and subordinate financialization in both Romania and Hungary. Clearly, as the literature on Hungarian financial nationalism shows, while Fidesz' political opposition was and remains critical of financial nationalism, from the mid 2000s onwards Fidez developed an articulated, bold and relatively technical ideology that saw the financial sector as the servant of domestic policy priorities and the interests of the social coalition providing political support to Fidesz (Johnson and Barnes 2015; Sebők 2017; Bohle and Greskovits 2019). There is no literature on the resurgence of Romanian financial nationalism but for the purposes of this paper it suffices to point out that while financial nationalism ruled in Budapest, in Bucharest there was a bipartisan consensus during this period. Moreover, within case variation in the case of Romania is instructive. Not only were all the post crisis Romanian center-right and technocratic governments in Bucharest between 2008 and 2016 committed to the continuity of Romania's policy status quo, but the PSD government of the 2012-2014 was as well,[9] albeit with minor calibrations.

This ideological continuity in Bucharest meant that transnational financial firms benefited from continuing state support. Contrary to what happened in Hungary, the central bank delivered protection for banks against the regulatory initiatives pushed by consumer organizations deploring high cash handling fees and risk commissions (Kudrna and Gabor 2012). The government and the central bank also rejected judicial attempts made by consumer organizations in 2010 to lend *erga omnes* value to court rulings finding abusive clauses in loans. Rather than a higher tax burden, as in Hungary, in Romania banks got tax exemptions for selling their non-performing loans. The result was the region's largest NPL trading and a major increase in asset quality during recovery, with the NPL rate slashed from 21 percent in 2014 to 6 percent in 2018 (BNR: 2018, 78-79). When, the financial nationalists removed this tax loophole in 2017, their profits suddenly shot up.[10]

It took a change in government in late 2016 from a technocratic centrist government to an alliance of the Social Democrats and a centrist liberal party (ALDE) for financial nationalism to begin assert itself in Romania. Importantly, however, within case variation shows that financial nationalism was not on the initial agenda of PSD-ALDE campaigning on wage-led and profit-led growth measures, with

[9] Author correspondence with cabinet economic expert, January 2019.
[10] Author interview with ANAF official, October 2018.

unspecified trade-offs. Unlike in Hungary, where economic nationalism was theorized in the books and articles of Fidesz technocrats during the 2000s (Sebők 2017), beyond the few select flirtations with heterodox economics of a handful of experts, there had been no such ideological blueprints in the ranks of the PSD-ALDE (Ban 2016).

Following this political shift, the policy regime favorable to finance began to deteriorate in late 2017 following the increasing assertiveness of Euroskepticism and nationalism inside the ruling coalition, a development based on contingencies that are beyond the scope of this paper. The fundamentals of the financial nationalism rising in PSD resembled Fidesz in some respects, although it came in less shrill, decisive, consistent and articulated versions. As we saw above, in line with this "softer" rhetoric, the government took more timid and gradual steps to increase the weight of political priorities in credit allocation.

In short, in both Romania and Hungary transnational finance triggered a substantial list of grievances in government, domestic business and society and the rising political force of financial nationalism brought with it harsh attempts to discipline it. However, as the next section shows, the final outcome was decided less by the optimism of the will and more by the pessimism of institutional capacity.

5.2 The institutional backstops of financial nationalism

Generally, the state subordinates its policies to the ultimate imperative of being able to refinance its debt. Given this assumption, we hypothesized that states can "do" financial nationalism to the extent that they have the institutional capacity to reduce its vulnerability on the market for sovereign bonds. Critically, weak fiscal states are not in the position to be successful at financial nationalism. The problem is that getting tax collection agencies that are able to improve tax compliance are difficult to come by (Kiser and Karceski 2017) and so are agencies specialized in attracting EU structural funds, a form of capital inflow that reduces pressure on the current account, a critical factor for the exchange rate.

The contrast between the two countries is sharp. The Hungarian government had designed and implemented a blueprint for how to refinance its debt even as its financial sector repression drew criticism from institutions whose word is generally seen as having a high signaling value in the sovereign bond markets: the IMF and the European Commission. In addition to increased consumption taxes, sectoral taxes and trimmed welfare state Fidesz worked to consolidate the institutional legacy of a relatively able fiscal state. The centralization of revenue collection, the introduction of online cash registers leading to improved VAT collection and higher salaries for taxpersons helped. The effect was a consistent growth in the share of tax revenue in GDP, which in turn helped ease the tax burden on a key element of the social coalition of financial nationalism (the petty bourgeoisie). Most importantly, however, the measures led to a drastic fall in the value of the gross government debt in GDP (figure 5) while pro-export measures coupled with low wage growth cranked our external surpluses. To top it off, under Fidesz Hungary became a top performer in attracting EU structural funds, with these flows exceeding FDI by the mid to late 2010s (Bohle 2017).

In contrast, the Romanian financial nationalists encircled finance while neglecting the fiscal state. They did little to boost the capacity of the revenue authority and adopted a flurry of tax and social security cuts for corporations (including a planned tax amnesty) simultaneously with large increases in public sector wages and pensions. Moreover, a month before they announced the bank levy, the cabinet inexplicably terminated an essential World Bank program designed to provide the revenue authority with an effective e-tax software system essential for better collection. The result was a decline in the share of tax revenue in GDP from already low levels and the prospect of further deterioration (IMF 2018: 7). An IMF staff paper calculated that if Romania would have upgraded its revenue agency capabilities it would rake in a whooping 2.5 percent of GDP more in the public budget. Yet as a result of the weak state, the pace with which Romania cut its foreign debt was much more modest despite the higher growth rate (figure 6a and b) and, to top it off, strong wage growth combined with lower than expected investment to generate external deficits, a red flag in the sovereign debt markets already irked by the bank levy.

Figure 5: Tax revenue as a percentage of GDP

Figure 6a: Gross public debt to GDP ratio in Hungary

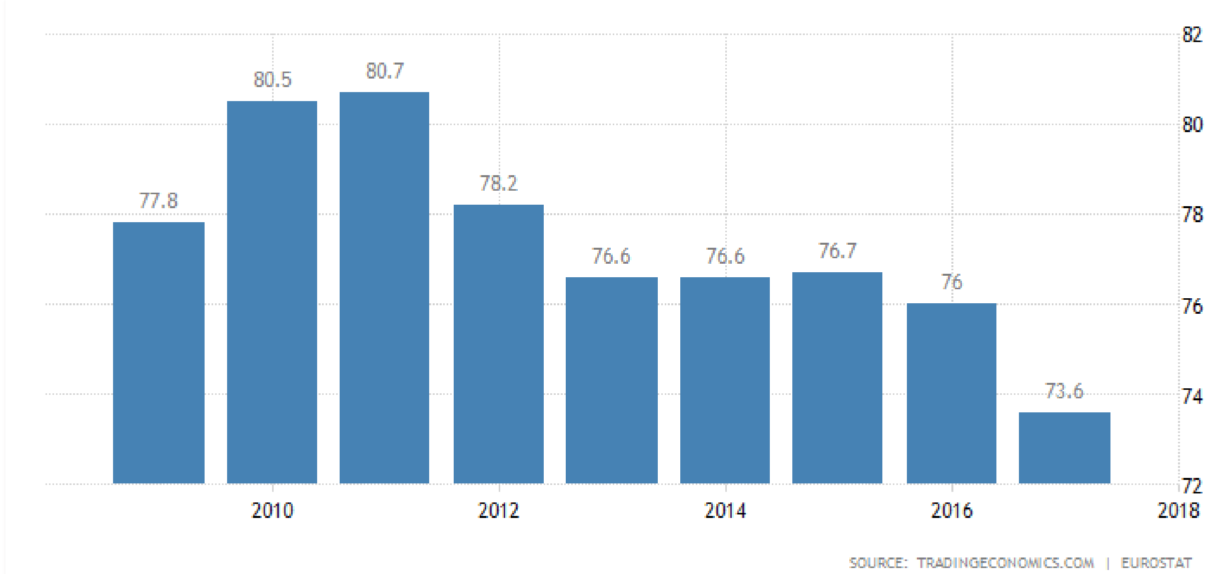
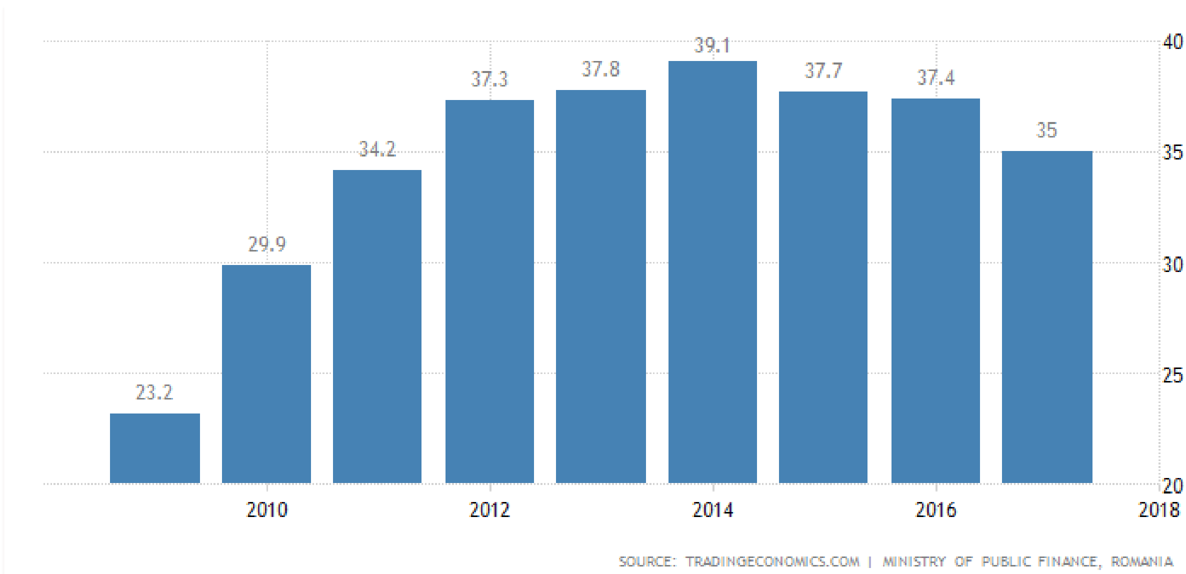


Figure 6b: Gross public debt to GDP ratio (Romania)



As witnessed by the Baltics or Ireland during the crisis, fiscal rectitude does not always protect against a bond market panic (Matthijs and Blyth 2015; Jones and Kelemen 2016; Schelkle 2017). Indeed, in a financial system where sudden stops are not black swan events, nothing can replace a supportive central bank. Once frowned upon by economists as an inflationary risk and source of distortion in the market, direct debt monetization received new respectability among some in the elite of mainstream economists given the low inflation environment after 2008 (De Grauwe 2018; Della Posta 2018). One need not be a financial nationalist to emphasize this, as seen in the UK and the US, where the central banks rolled out debt monetization programs (an operation that turns the central bank into a lender of last resort to the government) (De Grauwer 2018; Gabor and Ban 2016). However, since embracing debt monetization has generally been controversial among postcommunist central bankers (Johnson

2016), financial nationalists have no choice but force the central bank to backstop its sovereign debt fortunes. In practice, this entails breaking the walls of central bank independence and appointing management sympathetic to a less conservative definition of the lender of last resort function for such a change to take place.

The comparison between Romanian and Hungarian financial nationalism highlights the significance of a supportive central bank, because only the latter battled finance with a strong fiscal state *and* a supportive central bank. One can improve revenue but this takes time while protective central bank interventions can be deployed overnight. The required subordination of the central bank to the cabinet's debt refinancing and its associated financial repression policies is precisely what happened in Hungary (Sebok 2018). Timing was of essence: the Fidesz-appointed board members already formed a majority in the board within a year from the elections and the Fidesz governor took the post two years later. Soon after the former Fidesz minister and economic architect György Matolcsy became central bank governor in April 2013, the MNB cut a whole range of financialization instruments (e.g. the two-week repo) and was instrumental in targeted nationalizations and reprivatizations of commercial banks with the stated aim to lowering foreign ownership to 50 percent of the financial sector (including by taking shares in the resulting entities). Most importantly, however, the MNB rolled out a multiannual public debt monetization program called the "Self-Financing Scheme" that changed the composition and maturity of government debt while delivering unlimited interventions to support government debt in case of bond market tensions (Matolcsy and Palotai 2018: 25).

In contrast, there was no plan in Bucharest to take over a central bank renowned for its conservatism and institutional continuity (BNR has the longest serving governor in the world). The Romanian ruling parties showed that they had neither the full-scale authoritarian ideological practices, nor the organizational infrastructure and capacity to coral opposition and civil society that Fidesz has had. But even if the Romanian government had a plan, it would have been harder to execute politically. Ultimately, Romania has more checks and balances than Hungary: it is a semi-presidential system where the President can and occasionally exercises veto power. The President came from the opposition and was keen to exercise his prerogatives.

Moreover, while Fidesz's election win in 2010 was not effectively contested by the judiciary branch, the institutionally independent anti-corruption prosecutor (non-existent in Hungary) kept many in the PSD-ALDE leadership in courts, busy defending themselves *and* orchestrating a costly onslaught on the judicial system. All this curtailed the political and legal room for maneuvering against the BNR, the country's strongest institution.

Finally, the Romanian financial nationalists did not have a "shovel ready" alternative elite ready for a central bank takeover. One year after the 2010 elections the Hungarian economic nationalists already appointed board members who were sympathetic of the plan to discipline the banks and reduce dependency in 2011 (Sebok 2018). Two years later, Fidesz took over the governorship and folded the supervision authority within the central bank. In contrast, although the Romanian central bank (BNR) had two members with heterodox views who once served as PSD ministers (Ban 2016), their loyalties were not primarily with the PSD but to BNR. Unlike the Fidesz appointees in the MNB, they never openly clashed with the governor and the orthodox board members. Two attempts to nationalize the Pillar II pension funds and regulate the shadow banking sector as if it were the banking sector were shut down by vocal BNR opposition and with their support. Moreover, they closed the ranks with the old guard in the case of the 2018 tax on assets and criticized the repression of the transnational financial institutions in general. Most importantly, the PSD-ALDE did not have the counterpart of the Matolcsy-Balotai ilk: ruling party loyalists well versed in central banking.

Given this balance of forces, finance operated with the various bits of its institutional infrastructure intact: independent central bank, independent supervisory authority and the financial lobby organizations. The central bank's chief economist literally spoke for banks and pension funds in several venues. Most importantly, when bond market concerns mounted (the spread on Romanian bonds reached nearly 5 percent in 2019) the central following the tax on assets, the BNR added its voice to that of transnational banks anticipating unsustainable increases in the bond yields. When the spread did indeed go up in January 2019 reaching the highest levels in the EU, and one debt issuance session went without buyers, the BNR hanged the government dry, forcing the Ministry of Finance to dip into the buffer and start negotiations with the BNR, the supervisory authorities and the bank lobbies. Claiming that the tax on assets damages the monetary policy channel, the central bank rallied the financial institutions on which the government relies for sovereign debt refinancing and dug in, engaging in a game of chicken. This coalition was soon joined by credit rating agencies threatening with downgrades while negotiating with the government to withhold the downgrade if the law would be changed to accommodate finance.

Given these multiple vulnerabilities, it took less than six weeks for the government to blink. They acquiesced to taking the tax on assets to be debated in a macroprudential policy body where the private sector and central bank experts watered down the tax enough to make it palatable to the banks and allow the government to save face. As testimony to the importance of central bank independence and power, the revised asset tax order posted by the Ministry of Finance bore the signature of a board member of the BNR.

6. Conclusions

This paper asked three related questions: Why has the Great Financial Crisis and its exposure of the vulnerabilities of dependent finance led to very different policy responses in dependent finance economies, with some countries attempting drastic curbs on finance (Hungary and Romania) while others defending it (Latvia)? Why have economically nationalist governments (Hungary, Romania) tried to discipline dependent finance but not dependent manufacturing? Why was financial nationalism successful in some settings (Hungary) but not in others (Romania)? By answering these questions, we made several contributions to the comparative political economy literature on dependent finance in general and apply insights of the "business-state power" to finance.

First, we bring to the fore the insights of the obsolete bargaining model, whose classical form was originally developed to explain the wave of renationalization of natural resource sectors in the developing world in the 1970s. Later research showed that the OBM was much less useful for understanding relations between TNCs and host-countries in manufacturing, an insight also confirmed by our paper. However, we also showed that for two of our cases, OBM applies. This is counterintuitive – finance is usually considered the most mobile and a most sophisticated form of capital. Transnational finance should therefore always have the upper hand in bargains with host countries. We attribute the fact that bargains in finance can obsolesce to a to a fundamental transformation of bank –based financed. As Jordà et al (2014: 2) write: "To a large extent the core business model of banks in advanced economies today resembles that of real estate funds: banks are borrowing (short) from the public and capital markets to invest (long) into assets". This is exactly the business model that banks from advanced capitalist countries have also exported in the East European periphery. While this had been a blessing before the crisis, as non-existing mortgage market were developed in these countries, the excesses in mortgage lending have convinced policy makers and populations at large that something might be wrong in this business model. Policy makers could disband with the services of foreign-owned banks, if they wished so.

As our case studies show, the willingness to (at least partially) dispand with the services of foreign owned banks is dependent on how important bank-based finance is for the growth model, how much domestic banks are able and willing to provide similar services as foreign owned banks, and how strong the ideological anti-finance stance of the respective government is. Further, willingness is not enough, as states need to have the institutional capacity to do so. Thus, policy makers in Hungary were both willing and able to take on the foreign owned banks, and they could do so because the major source of finance for their growth model stemmed from FDI in manufacturing, rather than banks. While this latter holds true for Romania as well, this country lacked the capacity to implement major changes in the bargains with banks. Finally, in Latvia, banks as a sector enjoyed structural power, as the sector is crucial to the country's growth model. Domestic owned banks were not interested in taking services provided by foreign owned banks, as they had their own lucrative market niche.

A second and related contribution is to the "second home market model" in the comparative analysis of peripheral banking. Where this model stressed the strengths of having transnational banks with long time horizons, attention to households and resilience to volatility, we found that model was rendered vulnerable to financial nationalists by the combination between sunk costs, low upgrading capacity and, critically, poor performance at financing domestic non-financial firms. When economic nationalism came into office (Hungary post 2010 and Romania post 2016), making these vulnerabilities part of an economic paradigm, dependent banking experienced state-led attempts at drastic transformation.

Third, while we highlight the importance of economic nationalism as a necessary factor in financial repression, we also advance the literature on the limits of these economic ideas when bargains between state and finance obsolesce and the obsolescence is called out by nationalists. By synthesizing insights from development studies and economics we stress the importance of state capacity as a form of leverage exercised by the state over the financial market. Where the extant literature focuses on industrial policy institutions, we bring to the fore the centrality of central banks and revenue authorities. Specifically, the comparison between Hungary and Romania shows that in the short term, financial nationalists cannot do battle on finance without having a central bank committed to defend the state in the sovereign bond markets via debt monetization. Central banks can act as lenders of last resort to the government if their ruling doctrine allows thus but if it does not, the dispensation with central bank independence becomes an existential imperative for financial nationalists. Finally, since debt monetization is an emergency measure, in the medium term, financially nationalist governments need capable revenue agencies and institutions able to rake in tax and non-tax revenue to reduce debt roll over risks.

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