STATES WITHIN MARKETS: ELITES, INSTITUTIONS AND THE POLITICS OF PRIVATIZATION-NATIONALIZATION WAVES

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By

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Why do many countries vacillate between periods of greater state ownership in the economy and periods of increased market laissez-faire, between policies of privatization and policies of nationalization? Why do these waves occur in so many countries at once? And what are the processes behind regional or world waves of privatization and nationalization? This research examines the processes of privatization and nationalization as two sides of the same political process which so far have rarely been studied together. Large-scale reform programs reshaping the political economy of entire regions—such as the privatization wave of the 1990s—have occurred and been reversed periodically, although much research hailed the trends as irreversible. I argue that reversals in economic policy are much more frequent and states often shift between privatization and nationalization policies depending on the interaction of two sets of factors. Domestically, the way governments modify the extent of their ownership in the market in turn modifies power relationships within society creating new winners and losers, new winning coalitions in the political process. International factors intervene through forces that integrate a country within regional economic contexts as well as the international financial system, creating ties to international institutions and actors with policy agendas that push states toward privatization or nationalization. I test my theory using an original data set of privatizations and nationalizations since 1950 and find evidence for the presence of these extensive waves.
and their reversals at the nexus of domestic politics and international pressures. Measures of a country’s affinity to the Western order predict greater propensity for privatization when interacted with FDI, WTO membership, IMF loans and the presence of financial crises. I find that the probability of privatization is markedly larger in a country that supports the international liberal order and receives support from that community, for example through IMF funding. Privatizations are also more likely to happen during a financial crisis if the country has high levels of affinity, whereas nationalizations are likely to happen in times of crisis but only in countries that break with the liberal order.
DEDICATION

To my mother
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All remaining errors are my own.
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Chapter 1

Introduction

Large-scale reform programs reshaping the political economy of entire regions have occurred and been reversed periodically, although much research hailed the trends as irreversible. This exploration of waves of privatization and nationalization began with questions about the Post-Communist transition. After over a decade of deep and sustained reform, Eastern Europe is challenging common assumptions about political and economic transition and consolidation. Not only has democracy come under considerable attack from populist challengers on the extreme edges of the political spectrum, but this democratic backsliding has been accompanied by a similar and equally sustained attack on economic liberalization. When Eastern Europe chose to “return to Europe” following the collapse of the former Communist bloc it rejected not just the dictatorships in the region but the command economy that was structuring everyday life. Liberal democracy and market capitalism were being sold as a package deal throughout the region. The policy advice to countries in the process of opening up their markets to the world economy was mostly centered on shrinking as much as possible the role of the state through privatization and adopting substantial reform packages that would take these countries toward the economic development levels achieved by Western Europe which countries in Eastern Europe were eager to emulate.

The optimism of the early 1990s pervaded the analysis of the processes in the region and the hope shared by academics, analysts, politicians and citizens was that
this process of reform would be both unavoidable and irreversible. Supporters believed that the desired levels of economic and political development would be achieved in a relatively short period of time. The promises of the economic transition process were following the wave of economic openness brought on by increased globalization resting on the institutional foundations of the international system with its intertwined international organizations and international financial institutions. What we might term the "Western order" increased the expectation that the political and economic transition process in Eastern Europe would result in democratization and structural reforms that would enshrine market capitalism and economic growth in these countries for decades to come.

This optimism did not bear the fruits expected in the region and the increasing levels of state ownership in the economies of countries that initially were the most successful political and economic reformers in Eastern Europe show the reversible nature of these transitions and why they happened in spite of the costs associated with the shift toward greater state ownership. In exploring this reversal from privatization to greater state ownership I do not argue that the state was ever gone from the market. The phenomenon I am interested in is the change in the levels of state ownership in the economy. The state has a variety of ways to control the economy besides direct ownership, such as regulation, taxes, trade policy etc. Chapter 2 clarifies the issue of state ownership in the economy, ownership versus control, theorizing institutional change and the costs associated with that change. Whenever I discuss "state ownership in the economy" or "the return of the state" I do not imply the state was ever gone or was absent, but rather that the relative size of the state-owned assets in the economy has increased.¹

¹ Conversely when I discuss the "retreat of the state" I also do not mean a disappearance of the state, but a decrease in the share of the state-owned assets.
Throughout the project I refer to “the state” as a unitary actor but I mostly use this as a shorthand to refer to the government of that state in charge of policy. Though “the state” might seem to have agency, what I am examining are the actions of politicians through a general theoretical lens. I do go into specific details about actors, groups, coalitions and interests at several points in my theoretical framework and disaggregate further in my case study—for example in Hungary I distinguish between actions that lead to increased state/government ownership through asset acquisition versus actions that directly benefit individuals and groups around the Orbán government. Yet when making more general theoretical points I will be speaking about “the state” to mean the government, governing elite or the central state apparatus.

In this project I argue that historically the interactions between states and markets constantly ebb and flow. Periods of market dominance and economic openness have historically been followed by states reasserting their power in economic matters. Throughout this project the interactions between states and markets are analyzed through the lens of privatization and nationalization processes. While state-market interactions can take a variety of forms, the processes of privatization and nationalization more formally describe the state’s ownership in the economy. For example, greater state involvement in the economy could also be studied under the banner of the “regulatory state”—a process through which even though the state does not formally own assets and allows the market to function, it still places substantial regulations that make it an important actor in the economy. However, although the state can play a crucial role through such regulations I find the distinction to be that between “player” and “referee”. While “the regulatory state” can be a strong referee, it won’t become a player until it owns assets in the economy and interacts through these assets with private actors. Thus privatization and nationalization change the status of the state in its interaction with other economic actors. For example, the 1990s were a
period of economic openness, increased exchange through globalization and important state divestiture from the economy through privatization. Yet, this period has been followed by states taking over private firms following the 2008 financial crisis and increasing the state’s share in the GDP.\footnote{Since 2005 the list of countries that have nationalized previously private assets also includes Argentina, Bolivia, Brazil, Germany, Greece, Iceland, Ireland, Japan, Kazakhstan, Lithuania, Latvia, New Zealand, Pakistan, Portugal, Sri Lanka, Ukraine, Zimbabwe, etc (Chernykh 2011).}

Focusing on processes of privatization and nationalization, this project shows how the interaction between states and markets has historically followed a wave-like pattern with periods of state dominance of the economy alternating with preeminence of markets and private property. Wave-like patterns have been identified in other processes such as democratization (Gunitsky 2014; Huntington 1993; McFaul 2002) and globalization\footnote{Globalization as a term has been hard to define with various meanings being attributed to the term (Bartelson 2000). I define it as the process of worldwide interaction and integration of people, companies, and governments. I view it as a primarily economic process involving goods and services, capital, and technology with consequences beyond the economic, affecting change in the social and cultural realms.} (Collier and Dollar 2002; James 2009).\footnote{I do not make the claim that democracy and globalization go together, but that these two processes have both been studied under the lens of waves.} Despite the availability of strong historical evidence, the interaction of privatization and state ownership of the economy has not been similarly examined through the wave-pattern lens.

In the case of democratization, Samuel Huntington (1993) identifies the roots of the first long wave of democracy in the French and American Revolutions, and the nineteenth century as the main period of flourishing of the first wave (1828-1926). The ascent of fascism brought this wave to an end with the rise of Mussolini (1922-1942). Following World War II a second short wave of democratization expanded the franchise across Western Europe, parts of Latin America and in former colonies (1943-1962). A second reverse wave (1958-1975) meant that a third of the 32 working
democracies in the world in 1958 became authoritarian by the mid-1970s with substantial setbacks in Latin America and former colonies. Finally, with the end of the Portuguese dictatorship in 1974 a third wave of democracy swept the world. Figure 1.1 describes graphically the waves presented by Huntington linking it to data from Polity. Since the publication of Huntington’s book some have claimed that the third wave continued strong with additional reversals from authoritarianism across former Communist countries through the “color” revolutions (McFaul 2002), while an increasingly large literature shows that hybrid regimes (Diamond 2015; Levitsky and Way 2010) muddy the distinction between democracy and authoritarianism, between a wave of democracy and a reverse wave. This is particularly true when looking at the post 2000 period in Figure 1.1. While democracy is substantially ahead, reversals of democratization have become more common, as I show in the following chapters.

Similar to democratization, globalization has also experienced three waves and their reversal. Collier and Dollar (2002) argue that the first wave started around 1870 with technological advances that allowed for greater exchange of goods, people and capital. Trade, migration and capital mobility are the main flows that allowed separate national economies to integrate and for globalization to take place. However this first wave ended by 1914. Between 1914 and 1945, even though transportation costs continued to fall, barriers resulted in the collapse of trade to its 1870 level (Eichengreen 1998; Rodrik 2011). After 1945 states started cooperating again resulting in increased trade and a second wave of globalization (Collier and Dollar 2002; Helleiner

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5 Huntington’s chronology sometimes overlaps waves of democratization and reverse waves for example between 1922-1926 and 1958-1962 as can be seen in Figure 1.1.

6 While the two measures don’t fully match, the back and forth between democracy and authoritarianism is clear.

7 Some authors date the collapse of the global system of trade even earlier to 1912 (James 2009).
Figure 1.1: Global waves of democracy.

*Data sources:* Huntington (1993); Polity IV (2014).

*Note:* The graph traces the periods Samuel Huntington identifies as waves of democracy (years in light gray) and reverse waves (years in darker gray), as well as the total number of countries that are democracies (blue line) or autocracies (red line) according to Polity IV data.

Starting in 1980 a third wave of globalization has been taking place Collier and Dollar (2002). Many developing countries became “new globalizers," emerging as major actors in the world market for manufactured goods and services.⁹

⁸ According to Collier and Dollar (2002) there doesn’t seem to be a second reverse wave of globalization in the late 1970s.

⁹ In an additional similarity to democratization processes, while the third wave of globalization is still considered to be going on today due to the fact that no dramatic breakdown of the global system of trade has taken place, important challenges have emerged that put into question the supremacy of unfettered trade and migration. National efforts to stop the migration of refugees to Europe as well as some of the restrictions that the Trump administration is putting on trade are part of this larger trend of challenges to the international order, and the chapters on Eastern Europe examine additional challenges emerging from this particular region, as well as Russia and China.
These waves of democratization and globalization complement the waves of privatization and nationalization. However, because the first official instance of something called privatization only occurred in 1977\(^{10}\) in Britain under Margaret Thatcher, the time frame considered is shorter than in the case of the previous two processes.\(^{11}\) As Figure 1.2 shows,\(^{12}\) since 1950 the world has seen a big wave of nationalizations in the 1960s and 1970s, then a global privatization wave in the 1990s and 2000s. Since the early 2000s increased state ownership has been felt through expropriations while privatizations have dramatically limited their reach.

Similarities in the ebb and flow of democratization and globalization can thus be seen in privatization and nationalization waves across the world. The state’s greater ownership in the economy as seen through privatizations and nationalizations follows the same pattern as waves of democratization and globalization. The links between these processes have been noticed before, with some work connecting economic development and democratization,\(^{13}\) globalization and democratization,\(^{14}\) democratization

\(^{10}\) This was the first instance when a head of state officially declared privatization as an objective of their government. Although in the end Thatcher privatized a very small percentage of the economy, it is argued this represents the start of the privatization wave (Megginson and Netter 2001; Young 2001). While an ebb and flow of the level of state ownership in the economy had existed before, the modern version of privatization and state asset divestiture began in the UK.

\(^{11}\) While privatization only started in the 1970s, nationalizations or expropriations have been taking place for much longer. Tomz and Wright (2010) argue that “sovereign theft” has been happening for a long time and have collected data since the 1928. Overall, the earlier episodes of nationalization in the 1930s and the big wave of the 1950s and 1960s map perfectly onto the two reverse democratization waves that Huntington describes.

\(^{12}\) Details on definitions of privatization and nationalizations, data sources and data collection, as well as coding rules are presented in the empirical chapter (Chapter 3).

\(^{13}\) This research agenda spans thousands of articles, but some of the more notable contributions in this debate are: Acemoglu and Robinson (2005); Burkhart and Lewis-Beck (1994); Diamond (1992); Huber, Rueschmeyer and Stephens (1993); Lipset (1959); Przeworski (2000); Robinson (2006).

\(^{14}\) See Freeman and Quinn (2012); Li and Reveny (2003); Milner and Mukherjee (2009); Pratt (2004); Simmons, Dobbin and Garrett (2008).
and economic reform.\footnote{See Haggard and Kaufman (1995); Hellman (1998); Offe and Adler (1991); Przeworski (1991).} However, these processes do not evolve in the same direction at the same time.

Another way to think about these three processes is in terms of the “political trilemma.” According to Rodrik (2011) one cannot simultaneously pursue democracy, national determination and economic globalization.\footnote{In this formulation the choice between privatization and nationalization would fit with Rodrik’s “national determination.” The state choses whether to pursue protectionist economic policies through nationalization and greater ownership in the economy whereas privatization would be the reversal of that policy with the state giving up national control over the economy through greater market freedom.} Markets and governments are complements, not substitutes. In Rodrik’s words “If we push globalization further, we have to give up either the nation state or democratic politics. If we want to maintain and deepen democracy, we have to choose between the nation state and international economic integration. And if we want to keep the national state and self-determination, we have to choose between deepening democracy and deepening
globalization" (Rodrik 2011, p. xviii-xix). For example, one of the main cases in this study, Hungary under Viktor Orbán since 2010 made a clear and loud choice for economic self-determination by enacting several nationalizations and aggressively bringing the state back into prominence in economic matters (Chapter 5). However, it continued to court international investments and remained an important player within the EU (Chapter 6). Throughout this process it was democratization that suffered the most as increasingly authoritarian moves were required to implement the policies the government wanted to pursue.

It is becoming clearer that state-market interactions—like the processes of democratization and globalization—follow wave-like patterns in which some states fluctuate between greater and lesser ownership in the economy.\footnote{While I do argue for the existence of a general wave pattern I do not claim full cyclicity. As I show in Chapter 2, "history doesn't repeat itself but it often rhymes."} This project examines these waves of privatizations and nationalizations. It explains why waves occur across so many countries and the institutional changes that result in these fluctuations between private property and state dominance of the economy.

The focus of this work—beyond demonstrating that waves of privatization and nationalization occur—is to explain why. The authors cited above offer partial answers to why the waves they observe took place, but never make why the center of the study. When trying to explain why there were waves of democratization and reverse waves Huntington (1993) listed a variety of reasons—such as institutions, regime weakness, economic development and economic crises, religious changes, new policies of external actors, snowballing effects. For Collier and Dollar (2002) it is difficult to disentangle the causes of globalization waves. While technological advances that ease trade are the initial impetus, political obstacles can stop globalization even as technology improves.

By contrast this research focuses on answering two main questions:
1. What are the conditions under which a change to either increased private ownership or increased state ownership of the economy occurs?

2. Why do these waves of privatizations and nationalizations occur in so many countries at once? What are the drivers behind regional or world waves of privatization and nationalization?

1.1 Global waves, regional trends and country cases. Case selection and research design

To answer the above questions I use a mixed-methods nested research design approach (Lieberman 2005; Seawright 2016). I have collected and analyzed evidence for my argument at global, regional and country level. There are several reasons for this choice. Using a global perspective helps provide evidence of how my argument applies in a variety of settings across time. To show this I collected data on privatizations and nationalizations since the 1950s across the world and used that data to conduct large-N statistical analyses with a variety of variables and model specifications. While this type of work allows me to draw conclusions on broad trends and show how my story holds across the world and across time, data limitations abound. Although I was able to collect data for the main processes I am interested in, information is not always collected systematically and especially for my independent variables and controls I had to rely on data collected by large institutions such as the World Bank which often have poor data coverage for the earlier time periods and for some parts of the world. This drawback means that I cannot show enough evidence for my argument based on the large-N statistical analysis alone.

While some have identified pitfalls in nested analysis (Rohlfing 2008), in the case of this research these pitfalls are mitigated through evidence from global, regional and country-level analysis.
I therefore supplemented the global analysis of privatization and nationalization waves with regional and country-level analysis. I was able to collect additional quantitative data at the regional level,\footnote{For example, in the case of Eastern Europe I was able to access the large data made available through the European Statistical Service EUROSTAT and in some cases collect additional data on my own as the number of countries and the time period is more limited.} while also collecting qualitative data through several trips to countries in the region conducting elite and expert interviews on the topics of interest. I chose Eastern Europe as the region of interest due to its recent history of vacillation between greater state versus greater private ownership in the economy. The region offers a wide variety of policies adopted, as well as a wide variety of outcomes. While there currently is a regional trend toward populist economic policies of state intervention in the economy, regions are not uniformly moving in that direction and the variations are instructive when trying to disentangle the reasons why we see a reversal of economic liberalization and greater state ownership in the economy. At the regional level I examine both diffusion across a region as well as learning from regional hegemons such as the Soviet Union or the European Union. Latin America could have been an equally instructive region of focus. With the continent’s "left turn" (Beasley-Murray, Cameron and Hershberg 2009; Castañeda 2006) and its reversal, waves of privatization and nationalization, market laissez-faire and state return in the economy (Carnes and Mares 2015) have been a regional feature for the past century. This could make for an interesting addition to the project in the future.

Eastern Europe is also a hard test due to the Communist legacy and the European Union’s impact. Focusing on Latin America or even the former Soviet Union countries in some ways would have been easier. The stringencies of the EU accession process should have made the reversal wave toward nationalization in Eastern Europe impossible. The fact that it happened nonetheless supports my argument that domestic
factors not just international ones matter in these waves. My regional analysis will show that other regions had more prominent waves than Eastern Europe; not just Latin America, but Middle East and North Africa as well as Sub-Saharan Africa.

Within Eastern Europe I collected data from Hungary in particular. Hungary is an instructive case as it was among the first countries to swing back toward increased state ownership of the economy, although in recent years Poland, the Czech Republic and Slovakia have been following in Hungary’s steps. While the chapters focusing on the two sides of my argument-domestic (Chapter 5) and international (Chapter 6)—draw much of their information from field work done in Hungary in 2016 and 2017, I supplement that information with examples from other countries as well as interviews conducted with representatives of international institutions serving the entire region. I hope to add more field interviews in the future from additional country cases. This research design choice allows for comparisons across countries as well as detailed sectoral analysis in at least one country case, thus providing the possibility to test the argument at several levels of aggregation and with different types of data.

1.2 Plan of the project

Historically we can identify several waves of privatization and nationalization. This project explains these waves of privatization and nationalization, why governments sometimes choose to nationalize and become active players in the markets by owning assets or even entire industries, and at other points choose to privatize and decrease their ownership in market processes or replace ownership with other means of control.

Chapter 2 develops a theory of privatization and nationalization waves. At the core of changes in the way states and markets interact we must examine domestic, regional and international sources for these shifts. Domestically, political parties run
on platforms based on domestic demands for changes in property rights which have important redistributive consequences. Once in power these parties enact policies of greater or smaller ownership in the economy in an effort to ensure continued popular support. International factors also play an important role in this story. For a modern economy to function it needs to be integrated into the international financial system which means creating ties to international financial institutions, organizations and actors with specific policy agendas and requirements. Mediated by domestic policies, these international ties create pressures that push states toward specific policy options leading to a new wave of privatizations or in the case of a financial crisis possibly leading to a new wave of nationalizations. Including dimensions such as political struggle over control, self-enrichment and redistributive ownership across groups of supporters, domestic politics is examined thoroughly in Chapter 5.

Chapter 3 tests this argument empirically. Using original data I test the domestic and international hypotheses. Several quantitative methods are used in this process. Logit regressions with privatization and nationalization as the dependent variables are conducted over a variety of model specifications and with several variables that test domestic and international conditions. As an alternative, multinomial probit analyses are also conducted to look at the choice between privatization and nationalization at the same time. Alternative hypotheses, robustness checks and discussions of endogeneity, coevolution of processes and reverse causality are also addressed in this chapter. Part of the chapter also deals with the data collection, sources and limitations. I find that the probability of privatization is markedly larger when the country supports the international order\footnote{A discussion of the measures used is included in Chapter 3.} and it receives high levels of IMF funding. Privatizations are not likely to happen in countries with low affinity levels to the international order regardless of their levels of IMF support. Privatizations are also
more likely to happen during a financial crisis if the country has high levels of affinity, whereas nationalizations are likely to happen in times of crisis but only in countries with low levels of affinity. I find support for the temporal and regional hypotheses.

Once a government privatized or nationalized in the past 10 years, the likelihood it pursues that policy again is substantial. I show the diffusion of both nationalizations and privatizations. Privatizations are more likely to happen if the region has experienced other privatizations, but less likely if it has experienced regional nationalizations. Nationalizations are increasingly likely when a country’s regional neighbors have also experienced nationalizations.

Chapters 4, 5 and 6 examine a privatization wave and its reversal in Eastern Europe. Chapter 4 is a broad Eastern Europe-focused chapter that briefly analyzes the privatization process across the region as well as the recent changes that have swept many countries in the region. The chapter overviews the expectations in the privatization literature and uses qualitative and quantitative data to examine the changes that have taken place across the region. Chapter 5 examines domestic changes that explain the reverse wave of privatization in Eastern Europe. Much of the chapter examines the Hungarian case with in depth studies of the banking, energy and utilities sectors and how domestic factors affected levels of state ownership. Chapter 6 focuses on the extent to which foreign factors have impacted the changes we see in Eastern Europe. In seeking to find out why the international arena did not play the expected role of preventing renationalizations I examine the role of EU conditionality, IMF funding and international investors as possible actors pushing for privatization, versus the influences of alternatives to the liberal order such as China and Russia.

Chapter 7 concludes by drawing broader implications for the project. I analyze the consequences of the changes seen in Hungary and across Eastern Europe. I discuss
possible ways to expand the project in future iterations. The chapter also addresses
remaining questions, future avenues of research as well as other possible implications.
Chapter 2

A Theory of Economic Policy Reversal

Through the questions at the center of this project I examine why many countries vacillate between periods of greater state ownership in the economy and periods of increased market laissez-faire, between policies of privatization and policies of nationalization. What are the conditions under which a change to either increased private control or increased state control of the economy occurs? And why do these waves of privatization and nationalization occur in so many countries at once? What drives their ebb and flow? And what are the processes behind regional and global waves of privatization and nationalization?

The motivation behind this project is to study state-market interactions and how changes in the way governments modify the extent of the state’s ownership in the market, shift power relationships within society creating new winners and losers, as well as new winning coalitions in the political process and how contestations to a specific distribution of benefits from the state’s greater ownership in the economy engenders changes that once again swing the pendulum toward a new dynamic in the state-market relationship. This broad state-market relationship has a myriad of faces throughout the variety of interactions that can occur at the nexus of the state and the market. Taxation, regulation, trade policy or economic policy in general each determine how states and markets interact. Neither one dominate exclusively, but a variety of state-market mixes have and will continue to exist. In this project I make the conscious choice of focusing on one type of relationship between state and market,
namely the processes of privatization and nationalization. This choice is due to the more formal way privatization and nationalization can describe the state’s ownership in the economy. For example, through the process of nationalization the state gains a stake in the economy from the direct ownership of enterprises—sometimes even entire sectors of the economy. As discussed in the introduction and later in this chapter there are different ways for the state to exercise greater dominance over the market, not only through direct ownership but various ways of control—which can range from more formal arrangements through official regulatory processes or informal pressures on private actors.

While these two policies are polar opposites in terms of the relationship they set between the state and the market they share dramatic similarities. Both privatization and nationalization have captured the popular imagination and the intense focus of academics and policy makers alike. The radical break that enacting a large scale privatization or nationalization program represents has always been presented as an almost cathartic moment for a country, a tabula rasa instant where the hope of a new political and economic outcome for the country could be realized either by unleashing the entrepreneurial power of private actors and the market through privatization or by promoting the power of the state in service of the people through nationalizations. Each of these policies promises large scale changes. Chua (1995) traces politicians from across the world making similar and dramatic promises about privatization and nationalization using the same terms and with the same promised outcome.

I define privatization as the transfer of ownership or control of assets from the public to the private sector. The definition of privatization is quite straightforward in the literature—“the deliberate sale by a government of state-owned enterprises (SOEs) or assets to private economic agents” (Megginson and Netter 2001). Almost all the articles and books examined used this—or a very similar version of this—broad defi-
nition. Nuance was only added in quantitative analyses. For example Claessens and Djankov (2002) count as private companies those entities with at least one third privately owned shares. I provide additional detail for operationalization of privatizations in the next chapter.

I define nationalization as the transfer of ownership or control of assets from the private sector to the government. While the definition and the outcome—private property becomes state owned property—are easy to imagine, the phenomenon of nationalization is also quite complex (Chua 1995). Kobrin (1980, 1984) and Tomz and Wright (2010) define expropriations as entailing the following actions: (a) nationalization, defined as action by a government to take ownership of a foreign firm; (b) coerced sale, in which the government threatens or takes actions that induce foreigners to sell part or all of their direct investments to the government or to domestic citizens; (c) intervention or requisition, in which the government takes control of foreign direct investments without proclaiming itself as the rightful owner; or (d) renegotiation, in which the government compels direct investors to accept substantial changes in a contract or a concession. To add to the definitional ambiguity, throughout his work Kobrin uses “expropriation” and “nationalization” interchangeably, only at times equating nationalization to "mass expropriation" (Kobrin 1984, p. 331). This means that under the “nationalizations” heading we would count governments transferring private property to the state, expropriation of foreign investors, as well as changes in legislation and contracts that result in a modification of the property relationship between the state and the private actors.

I define a privatization wave as a move from a predominantly state ownership system to the domination of private ownership occurring in several countries, whereas a nationalization wave means a change from greater private ownership to increased state ownership. While some countries go through more frequent changes between
the policies of privatization and nationalization, as was the case in France when it nationalized in 1982 and then privatized in 1986 (Jacquillat 1988), this project also shows the existence of large-scale, multi-country shifts from privatization to nationalization and back (as seen in Figure 1.2). Waves are of greater magnitude than one country oscillating between public and private ownership. Quantitatively we need to see at least 20 privatizations in a year to start talking about a wave. The crest of a privatization wave would be reached at about 40 privatizations and it would be sustained for at least 5 years. While this number (20-40 privatizations) might not seem large institutional change is not easy. There are always costs associated with enacting privatizations or nationalizations. There are also opportunities in implementing these changes, which is why politicians take the risk of changing ownership rules. Yet at the end of the day privatization and nationalization are major changes that don’t occur every day, which is why a threshold of 20 countries privatizing at world level is not a low bar to clear. In the case of nationalizations, which are even rarer events, I argue a wave starts after at least 10 nationalizations.\footnote{Additional quantitative discussion on the magnitude of waves will be included in Chapter 3.}

In this theory I do not posit that privatization could lead to the absence of the state or that nationalization could result in the complete absence of the market. Neither full privatization nor full nationalization could do away with the state or the market.\footnote{Or in the words of Janos Kornai “History has no produced a single society in which a single property form operates in sterile purity” (Kornai 1992, p. 89).} For John Zysman any analysis must begin from understanding that there are “no markets apart from politics, that markets were in fact political creations, and that political life is entangled with the working of markets and market institutions” (Zysman 1984). Even at the pinnacle of the Soviet Union the state couldn’t completely suppress private enterprise and private transactions continued to take place.
2.1 Ownership versus control

Phrasing my theory in terms of “ownership” rather than “involvement” and “control” has important implications as the state can be both player and referee\(^3\) in its interaction with the market. On the one hand, ownership can be clearcut in some institutional settings, or it can be murky in others. On the other hand, involvement refers to state behavior in the economy regardless of ownership. It is basically the difference between being a “player,” a participant in the market—which implies ownership—and a “referee”, a rule-maker—which implies involvement, governance. According to Vogel (1996), even when we see stronger markets, we might still not be dealing with weaker states. While privatization and deregulation produce powerful images of markets overpowering governments, actually Vogel finds that governments of advanced industrial countries have reorganized their control of private sector behavior and limited their ownership, but not substantially reduced the level of regulation. In most cases of “deregulations,” governments have combined liberalization with reregulation, the reformulation of old rules and the creation of new ones. While ownership seems to be limited or gone, in fact control is still quite important (Vogel 1996). With the rise of the regulatory state (Majone 1996, 1997) new instruments have become available to the states when they want to intervene and return an asset or company under government control.

In the discussion of the variety of ways in which states and markets interact and the distinction between ownership and control Kornai contributes the important notion of diversity in mechanisms of economic coordination, of which the market is just one (Kornai 1992).\(^4\) Bureaucratic and market coordination mechanisms cut

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\(^3\) This dual role has also been theorized as the state being both player and the playing field (Balzer 1996).

\(^4\) He identifies bureaucratic coordination, market coordination, self-governing coordination, ethical coordination and family coordination as the main ways economic activity could be organized.
at the heart of privatization and nationalization. While at first glance privatization could mean greater market coordination whereas nationalization implies bureaucratic coordination, ownership and control matter a lot for nuance. In the case of a system of market coordination even if the state is not a player that owns assets it still controls how the game is played due to its role as a referee. Yet, in the case of bureaucratic coordination the state is the nominal owner, but it is the bureaucracy or a specific influential group within it that controls the assets. It might seem that “the state owns everything in the name of the people” but ownership and control will be divided within a small inner circle (Kornai 1992).

Analyzing the state as both player and referee requires deeper engagement with what variation on being a referee actually means. While assessing how the state engages as a player in the market is relatively easier through good quantitative data on state ownership, assessing how the state acts as the referee of the game means to look into the quality of the state’s ownership in the economy. Chapter 5 examines this quality of state ownership in the economy through the case of Hungary. This way the importance of institutions becomes even more apparent. As the state sets in place the rules of the game, the distance between ownership and policy-making is crucial in explaining better economic outcomes.\(^5\)

The rest of this chapter proceeds by briefly outlining the argument. Second, I examine previous attempts at studying privatization and nationalization together as well as change in property rights more generally. The critical engagement with previous works on this topic serves as a foundation to build my own approach

\(^5\) This issue has been explored by Dan Breznitz (2007) with regards to state policy-making in the field of innovation. He gives examples of various strategies taken by Ireland, Israel and Taiwan where the state’s level of involvement varied by significant degrees but all had surprisingly positive results. Similarly, Luong and Weinthal (2010) show that governance of oil revenues is more important than ownership to offset the consequences of the oil curse.
to privatization-nationalization waves. The remainder of the chapter presents the different components of my argument, hypotheses, expectations and alternative hypotheses. The argument is tested through a large-N statistical analysis in Chapter 3 as well as qualitative analysis at regional and country level in Chapters 4, 5 and 6.

2.2 ARGUMENT IN BRIEF

The relationship between state and market in the late twentieth century and early twenty first century has been seen in the literature as one of increased market power and greater retreat of the state. As seen so far in this project states and markets interact in a myriad of ways and the pendulum can swing from greater state involvement in the economy to some measure of state retreat. Privatizations and nationalizations are ways in which the state can increase its ownership in the economy or diminish it, and these two processes change the levels of state ownership in the economy. I argue that these waves of privatization and nationalization result in the state periodically redistributing property rights across the economy, which in turn plant the seeds for future demands for privatization or nationalization. Property rights in this framework are not only easily mutable, but their change constitutes an important way governments cement new coalitions of support and how future challengers can build their own support base through promises of changing the current distribution of property and power. For example, a regime could gain substantial popular support by nationalizing private property or strategic industries creating new beneficiaries of this policy who will support the regime.6 By extending property rights safeguards the

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6 This was the case in many developing countries where industries owned by foreigners were nationalized in the 1960s to great popular support, but the same industries were later privatized when the state proved incapable to properly manage them with beneficiaries from privatization supporting governments that promised economic liberalization and privatization. The main case study in this work, Hungary, saw great popular support for Viktor
Distributive conflict over property rights always divides not just the people who own assets but society overall. The question is never settled, and there are always new distributive conflicts on the horizon. The waves analogy suggests that when the pendulum swings too far in one direction—for example privatization goes to extremes or nationalization proves inefficient—the resulting movement is a countervailing swing in which new leadership gets elected with the purpose of recalibrating the balance in the pendulum. Thus privatization and nationalization don’t end distributive fights, but create new ones, which will be hashed out over and over in society. This is why this project views the processes of privatization and nationalization not as end points, but as options governments have at their disposal to pursue the ultimate goal of politics—creating enough support to stay in power.

The main goal of this project is to explain why a new wave of privatizations or nationalizations emerges in this periodical succession of ebbs and flows and how domestic and international factors interact to create these shifts. The goal of governments to stay in power presents one side of why these shifts occur: domestic politics is the first part of the argument. The type of government in power—their ideology and economic platform, their view on the liberal order and the way they interact with international institutions—result in specific policies designed to ensure continued popular support. International factors also play a crucial role in the story. For a modern

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7 While I use the general metaphor of privatization and nationalization waves I do not claim all waves are the same. Sometimes we have seen gentle waves such as the first instances of privatization in the UK in the late 1970s. But that gentle wave turned into a tidal wave as the process gained momentum across the globe. In the case of the 2008 financial crisis the need to act quickly created a rip current of swift action toward greater state ownership in the economy.
economy to function it needs to be integrated in the international financial system which means creating ties to international financial institutions, organizations and actors with specific policy agendas and requirements. Privatization has been one such requirement in the past decades which means that sometimes governments have to swing the pendulum toward greater market freedom\(^8\) even when they might not necessarily want it. The crucial part of this work is understanding how domestic and international pressures interact resulting in moving the pendulum and creating a new wave. The interplay of domestic and international pressures in promoting greater state ownership in the economy through nationalization or a retreat of from state ownership through privatization is at the center of this project. I now examine other work analyzing shifts between privatization and nationalization as well as the literature on property rights redistribution before presenting a more detailed version of my argument, mechanisms and hypotheses in the rest of the chapter.

2.3 Studying property rights shifts through privatization and nationalization

To show how my theory of privatization and nationalization waves builds on yet is distinct from previous work I briefly engage with the existing scholarship that has examined these processes. Rather than looking at the immense literature that each one of these processes has generated I look more closely at those works that examine them together, as well as those works that examine the changes in the levels of state ownership in the economy.

\(^8\) Privatization might not always mean greater market freedom as the case of China can attest. While the level of state ownership in this country has been going down, control has continued at high levels.
2.3.1 The theory of privatization-nationalization cycles

The main way to study the state’s ownership in the economy through privatization and nationalization has been through the lens of privatization-nationalization cycles.

The earliest discussions of cyclicity in privatization and nationalization come from the social choice literature. Albert Hirschman was probably the first to ask “whether our societies are in some way predisposed toward oscillations between periods of intense preoccupation with public issues and of almost total concentration on individual improvement and private welfare goals?” (Hirschman 1982, p. 3) Jürgen Backhaus also noticed a turning point for the expansion of the state firm sector in several countries in the 1970s and started theorizing a cyclical movement between states and markets (Backhaus 1989). Jean Jacques Rosa (1988, 1993) developed “a macroeconomic theory of allocation of financial property rights between public and private agents” (1993, p. 326). He was influenced by the French nationalizations and privatizations in the 1980s, and his public choice model is one where the government rationally chooses between different policy instruments. Rosa’s model is the only econometrically tested PNC model to this day. Chua (1995) argued that nationalism is at the base of the privatization-nationalization cycles and substantiates her claims with in-depth case studies in select countries in Latin America and South-East Asia.

9 Although Rosa did not want to explain cyclicity, in a shorter description of his model he wrote: “since all three explanatory variables fluctuate through time, the decision to privatize (or nationalize) can change from time to time” (Rosa 1993, p. 94).

10 He used data on the extent of the public sectors in nine Western European countries from 1963 to 1985, collected by the Centre Européen des Entreprises Publiques which he later updated in a coauthored paper with Pérard (2010), taking into account recent changes in the global financial environment.
Asia. While her research is extensive, by looking exclusively at nationalism in the post-colonial era Chua cannot explain reversals in the waves. Chang et al. (2010) develop a dynamic formal model explaining cycles of ownership in natural resource industries focusing particularly on the cases of Bolivia, Venezuela and Zambia. They explore how external conditions such as the price of commodities and domestic conditions such as the tax regime and government quality affect the choice of private or public regimes in the oil sector. Warshaw (2012) also examines these processes in the oil sector using data from Guriev and Sonin (2011) and Wolf and Pollitt (2008), finding that political institutions determine the role the state plays in specific industries.

While these studies examine the processes of privatization-nationalization on a possible continuum with the state moving from one side to the other there is no consensus as to what causes privatization-nationalization cycles and how we should expect them to evolve. From nationalism in Chua (1995) to fiscal imbalances in Rosa (1993), commodity prices for Chang, Hevia and Loayza (2010), and political constraints for Warshaw (2012) there is really no clear picture as to what could be the

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11 Recently this work has been continued by Kapoor (2015) who focuses on the cases of Argentina, Mexico and the UK.
12 If a state nationalized its economy to give the native population advantages they did not have when they were under the influence of colonial powers or foreign nationals, then how do we account for later privatizations.
13 She also does not explain why the distribution of political and economic power always goes back to what it was during colonial times, only marginally addresses the crucial assumption of her model of why ethnic minorities are always more successful than ethnic majorities in countries with privatization-nationalization cycles, and also does not address whether the same process occurs regardless of regime type.
14 In the end, their account of privatization-nationalization cycles does not address agency, practically removing politics from the process.
15 Although not making a cycles argument some country studies have noticed the back and forth between privatization and nationalization in places such as France (Boix 1997b; Jacquillat 1988; Pint 1990), Mozambique (Pitcher 2002), Tanzania (Bayliss 2008), the Philippines (Brillo 2011), Hungary (Datz and Dancsi 2013), and Argentina and Mexico (Kapoor 2015).
mechanism behind swings from nationalization to privatization and back. Moreover, by claiming a cycle is taking place no attention is given to the possibility that a swing back will not look the same as the last time the state went through this cycle. Examining the interplay between privatization and nationalization as a wave process rather than continuously repeating cycles provides greater flexibility in analyzing the variety of versions for the way the state gets more or less ownership in the economy.

2.3.2 The double movement of political and economic change

Another way to study waves of privatization and nationalization is to examine broader changes in the political arena. Economic changes are directly linked to political changes and specific economic equilibria are a result of political forces—groups, actors, movements—that exert more power than other groups within society at a specific time or on a particular issue, with a change in the strength of those groups resulting in another group coming to power and with it a different set of economic policy preferences.

One of the best ways to understand this process is to use the lens provided by Karl Polanyi (1944). Polanyi argues, contrary to conventional economic wisdom, that markets are neither neutral in their distributionary effects nor natural in their origins. He saw labor as “embedded” in a series of quite “natural” social relationships that made the construction of market institutions and impersonal exchange extremely difficult. The advance of capitalism and the commodification of labor mobilized and demanded protection from the state against the strictures of the market (Polanyi 1944, pp. 56-86, 135-63). Calling this progress the double movement, Polanyi explained that those dislocated by the market use the state to protect themselves, resulting in large-scale institutional change. Similarly, the domestic politics of the privatization-nationalization waves suggests that the choice to adopt privatization or nationalization is a result
of those dislocated by the previous policy using the state to enact a reverse policy change.\textsuperscript{16}

One problem of Polanyi’s double movement thesis as a \textit{theory} of institutional change is the unidirectionality of the process. He concluded that the new institutions that states developed in response to the double movement—which in his day was the establishment of the welfare state within an institutional order that heavily regulated the movement of capital and scope of markets—marked a permanent change in the institutional make-up of capitalism. As Mark Blyth argues, “Polanyi replicated a fallacy he rightly denounced in the liberal economists of his day: the tendency to see market society as the “end of history”” (Blyth 2002, p. 4).\textsuperscript{17} While Polanyi in his lifetime was only able to observe the establishment of the welfare states he studied, some governments sought actions against the new embedded liberal order (Ruggie 1982) during the 1970s and 1980s and resulted in efforts to “disembed liberalism” once again. In this effort, business and its political allies were quite successful, and by the 1990s a new neoliberal institutional order had been established in many advanced capitalist states and—after 1989—in many post-Socialist countries. The reversal of those processes is another wave of the previous more protectionist times brought about by those “left behind” by the process of globalization.

\textsuperscript{16} I prefer not to discuss this phenomenon using in the classical distinction based on factor endowments, which delineates between the preferences of owners of land, capital or labor. While these factor endowments might still matter, they do not fully explain when someone would support a change from greater to lower privatization for example.

\textsuperscript{17} As Blyth suggests, “if disembedding the market led to a double movement where labor demanded protection through an institutional reembedding, then was it not reasonable to expect, in turn, another reaction against those “embedding” institutions by those most affected, namely capitalists? In fact, the political struggle between disembedding and reembedding the market continues today, even though its contours have shifted. The contemporary neoliberal economic order can be seen as merely the latest iteration of Polanyi’s double movement. It is an attempt once again to disembed the market from society, to roll back the institutions of social protection and replace them with a more market-conforming institutional order.” (Blyth 2002, p. 4)
I mirror Karl Polanyi’s approach in that I see institutional change emerging in the same politically fraught way he traced in his account of the embedded liberal order of the mid-20th century, but accepting the possibility of policy reversal, precisely because institutional change is dynamic, contingent and political, a by-product of conflicts among interests seeking distributional gains (North 1993; Weimer 1997).

2.4 History doesn’t repeat itself but it often rhymes. Waves of privatization and nationalization

2.4.1 The domestic dimension

In constructing a new theory of privatization-nationalization waves, the most important aspect is change in the property rights regime—more precisely changes as responses to domestic demands and international pressures for a specific regime.\(^{18}\) Institutional innovation proves volatile in many countries and may be fully reversed in times of crisis or due to changing social or economic conditions as well as political change. Path departures become increasingly likely when economic and political conditions evolve and the institutions’ self-reinforcing mechanism provides sufficient resources for adaptation (Ebbinghaus 2009), all this as long as the cost of said institutional change is considered acceptable by the leaders enacting that change. So far institutional analysis has not fully acknowledged that politics with its fluidity has a much greater importance changing institutions than we anticipate, and with politicians having more freedom in policy-setting than we generally think. There is

\(^{18}\) Political science finds path-dependence to be a particularly attractive perspective considering the importance of institutions in explaining political processes (Pierson 2000) as well as their interaction with economic reforms (Stark 1994). Following Douglass North (1990), we have come to look at institutions as entailing high fixed or start-up costs, requiring learning, coordination and adaptation. Once established, institutions generate powerful forces for maintaining stability.
less persistence in institutions and their outcomes once we move past a superficial analysis.\textsuperscript{19} Whether the public or the private dominate depends on this regime as it enshrines the way asset ownership and distributional bargains are distributed in the national arena. Many of the existing theories of property rights fail to include crucial aspects that can explain the phenomenon of the state-market see-saw of the past century. Some leave out the state completely,\textsuperscript{20} others do include the state but relegate it only to its market regulatory role, leaving out its participatory aspects.\textsuperscript{21} What all theories seem to forget—mostly due to their origin in the discipline of economics—is the importance of politics and of the political bargains that make an economically suboptimal outcome politically optimal, and therefore the preferred course of action.

A better way to conceptualize domestic changes in the state-market interaction and privatization-nationalization waves is to adopt a “distributional theory” (Weimer 1999). For example, Wallis argues that property rights in land in the US are a great instance of how institutions change constantly but continue to be perceived as persistent. In his view, "we cannot understand why property-rights outcomes have remained stable over time unless we understand how the institutions that sustain property rights have changed through time" (Wallis 2014, p. 47).

\textsuperscript{20} This is the case of economic theories of property rights. They argue that institutional changes result from the realization of opportunities for changes in rules that are Pareto improving (North and Thomas 1973). These economic analyses of property rights, even when they do accept a limited role for the government, continue to hold on to a strong assumption of classical economics, that variation in transaction costs was the main explanation for the variety of outcomes diverging from the free market (Demsetz 1967, 2002; Libecap 1989).

\textsuperscript{21} The public choice theory of institutional change introduced government as a strategic actor pursuing goals such as revenue maximization or electoral success through changes in formal rules (North and Thomas 1973). As the driving force in the public choice theory is the government, it predicts that changes in property rights follow from changes in government interests. However, in spite of granting the state a more central role, this approach fails to "unpack" the state and truly see what might induce the government to revise its view on property rights. As Robert Bates argues, if we are to accept Weingast’s (1995) argument that a state powerful enough to create a system of property rights is powerful enough to violate them, "then we must look beyond the institutions themselves when seeking to account for their existence and their impact on economic life" (Bates 2014, p. 61). My work follows Bates’ argument for recentering the debate on the study of politics in the state-market interaction.
which sees institutional change as the by-product of conflicts among interests seeking distributional gains (North 1993). Here the problem of cost associated with diverging from a specific path which North theorized actually turn into opportunities. The government could use institutional change to its advantage by rewarding supporters with benefits during the reform process. 22 Bargaining among interested parties has substantial distributional consequences. The rules reflect asymmetries in bargaining power among the participants. Allowing for the possibility of actors using the coercive powers of government, the conflict may result in formal rules that inflict losses on those with weaker bargaining positions. Institutional change may result from a change in either the interests or the resources of the actors. As Bates argues, previous accounts fail to focus enough attention on the actors who play the central role in the political institutions we collectively call the state (Bates 2014). 23 This project agrees with the assumptions and predictions of the “distributional theory” of property rights and argues that it is the political struggle between domestic actors that explains part of the change across countries and time in privatization-nationalization waves, but look at these waves in the context of international pressures.

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22 Reforms attract money both in the form of loans as well as aid. Especially for a politician that know their time in office is limited, even a less than favorable loan can give them access to money right now that can go to their supporters or sometimes in their own bank account. Girod and Tobin showed how in the case of aid, often times political leaders can “take the money and run” (Girod and Tobin 2016).

23 Bates argues that our current theorizing of state institutions, and how they relate to property rights, having originated in the economic ideas of institutions filling in for market failures, means we are better equipped at explaining the demand for these institutions, and not the supply side (Bates 2014, p. 61). To understand the change in the state’s level of ownership in the economy—thus a change in property rights regimes and privatization-nationalization waves—our theory needs to look both at the supply and the demand side for institutions. As Frye suggests, secure property rights “are not solely granted from above by state actors or seized from below by private actors, but emerge through political struggle between state and private agents.” (Frye 2004, p. 464)
In practice what the domestic dimension of this argument means is that in Eastern Europe for example the coalition of forces that strongly supported the expansion of markets after the collapse of Communism did so by bringing to power politicians that enacted market-friendly policies. The economic policy choices of these governments created winners\textsuperscript{24} and losers\textsuperscript{25} that for a while solidified a winning coalition\textsuperscript{26} that continued support for less state ownership in the market. As the number and power of those supporting the previous pro-market consensus started to change, this created an opening for electing politicians that would come to power on a platform of reversing previous pro-market policies. The more statist stance of the new leadership created a new set of winners\textsuperscript{27} and losers,\textsuperscript{28} which in some countries has already been in power for a while or in other countries is only now emerging as a viable political option.\textsuperscript{29} In the future there might be demands for the pendulum to swing the other way with increasing demands for pro-market policies bringing to power a new leadership and with it a new set of supporters, a new set of winners and losers benefiting from these distributional gains.

\textsuperscript{24} Among these we can count the emerging entrepreneurial class, those who were able to transform Communist era knowledge and networks into marketable skills, foreign investors, etc.

\textsuperscript{25} Those working in under performing sectors or unable to benefit from the opportunities of the privatization process.

\textsuperscript{26} While governing party volatility was extremely high in the period following the collapse of Communism (Powell and Tucker 2014) this argument still holds as all the elites that came to power shared the consensus that market reforms were a positive and necessary step for the countries in the region (Bockman and Eyal 2002; Hooghe 2003), which means that even with leader turnover a similar way of economic thinking was present in power. In Poland, for example, pro market reforms continued even after the center right party that enacted them was removed from power by the former Communist party's successor.

\textsuperscript{27} Those benefiting from additional state support, or directly benefiting from government contracts.

\textsuperscript{28} Foreign investors, those working in foreign owned companies or who own companies that the state considers strategic and which should be under government control. Sometimes the losers are simply those who do not have the right political connections.

\textsuperscript{29} For example, in Hungary Viktor Orbán was just elected for a four term in power whereas in the Czech Republic electoral success of a pro-statist leadership only took place in 2017.
This suggests that the political struggle over economic policies will not end any time soon. Any consensus is only temporary and new waves of privatizations or nationalizations are probably already in the making as soon as one set of policies is implemented and their distributional consequences become apparent. Policy bargaining among interested parties establishes rules that have distributional consequences. The rules reflect temporary asymmetries in bargaining power among the participants. Allowing for the possibility of actors using the coercive powers of government, the conflict may result in formal rules that inflict losses on those with weaker bargaining positions. Institutional change may result from a change in either the interests or the resources of the actors. As Bates argues, previous accounts fail to focus enough attention on the actors who play the central role in the political institutions we collectively call the state (Bates 2014).30

It is the political struggle between domestic actors in interaction with the institutions created in an economic and political context that explains change across countries and time in the level of state ownership in the economy through privatization and nationalization. Although studying the interaction between actors and institutions within this political struggle raises questions of endogeneity, what is more problematic is that previous research assumes exogeneity even when that is simply not the case. As Weimer suggests, for some political scientists and economists “property rights are treated as an exogenous variable, however, the task of political economists is to endogenize property rights in the sense of treating them as the result of strategic interaction between economic and political actors” (Weimer 1997, p. 10-11),31 This

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30 Additionally, the quality of state institutions may depend significantly on the parties to the dispute (Frye 2004, p. 465).

31 Especially in the study of the institutions emerging in former Communist countries, research has been particularly sensitive to the issue of endogeneity (Shvetsova 2003, Frye 2012).
is how this work explains the swings between the state levels of participation in the market.

The hypotheses that emerge from the domestic dimension of my argument—examined more closely in the next sections—focus on the approach to politics and international processes embraced by the country’s leadership. In the statistical chapter I problematize the proper way to operationalize the concepts I am trying to get at and discuss the pros and cons of the main approach taken in the analysis.\textsuperscript{32}

2.4.2 The international dimension

Any discussion of the political leeway that governments have in economic policy needs to examine the international dimension of these processes. While the choices are driven by the political bargain among domestic actors within the political process, as the introduction to this project has shown, other processes of a global nature go hand in hand with the wave-like pattern of privatization and nationalization. Globalization is one such process. Competition in the international arena and the international institutions populating this arena drive counties to adopt specific policies that promote either privatization or nationalization. In many ways the “race to the bottom” in which each country is trying to make itself more attractive for foreign investors pushes governments in specific economic policy directions that end up exacerbating distributional conflicts and thus setting the stage for a future push back (Rudra 2008).

\textsuperscript{32} Originally I focused on the ideology of the party in power but due to data drawbacks I also use a measure of foreign policy orientation based on voting patterns in the US General Assembly as a way to approximate a government’s “buy in” toward the overall liberal order, openness and globalization. This measure of foreign policy orientation is the best way to bring together the domestic arena—votes are a consequence of a country’s domestic political landscape and leadership—and the international pressures—if a country is susceptible to international influence from the most important state in the system—the US and its pro-market approach, then the affinity between the country’s score and the actual economic policy is shown to be high all else being equal. See Chapter 3 for a detailed discussion of this approach.
Privatization and nationalization waves can only be explained as an interaction between the domestic and the international. Much of the literature on international finance argues that the rise to prominence of international financial institutions and other international organizations, the increase in international trade and a general trend toward devolution exacerbated the overall withdrawal of the state from economic matters and led to a decline in the state’s importance (Feigenbaum, Henig and Hamnett 1998; Strange 1988, 1996). It also posits a global understanding of what the appropriate level of state ownership in the economy is, and international organizations end up being the enforcers of that particular view (Appel 2004; Bandelj 2009; Ruggie 1982).  

Some argue that diffusion effects increase this process of state retreat, with proximity to countries that actively embark on these processes increasing the chance for their neighbors to pursue similar policies (Kopstein and Reilly 2000; Pop-Eleches 2007), either to nationalize (Kobrin 1985) or to privatize (Simmons, Dobbin and Garrett 2008). These assumptions do not always hold in light of facts on the ground. Although international organizations have a great impact on the politics and economics of the states that take part in the international system, there are many instances of defiance of the accepted course of action set forth by these institutions (Nooruddin and Rudra 2014) and the domestic demands of one’s constituency ends up being a stronger voice that elites listen to than the demands of the representatives of the European Union or other international organizations. States may choose to reneg on their prior commitments even at tremendous international cost (Well-

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33 In the field of privatization for example, Appel (2004) for example argues that Eastern Europe was under the influence of a particularly deleterious form of the “Washington consensus.”
The state might seem to retreat from the economy but instead prefer alternative ways to control through regulation and oversight, expanding substantially its reach without direct control (Majone 1996, 1997; Vogel 1996).

My research shows that while the predictions in the literature about the effects of international economic interdependence are not entirely wrong regarding constraints on states’ privatization and nationalization policies, governments and politicians do have some flexibility. Swings in domestic politics explain changes in whether the policy pursued will be more closely associated with privatization or nationalization. Thus, taking into account the economic zeitgeist in which a specific policy of privatization or nationalization is adopted can do a lot to explain the choice, but it is not the full story.

While privatization was the preferred option during the heyday of the Washington consensus era and the pressures of globalization created a “golden straitjacket” for governments who saw their policy options shrink (Friedman 2000; Rodrik 2000), this position is now being reconsidered. There is also an inherent bias in looking at the international dimension since there are no real recent international efforts toward nationalization and autarchy. By their very nature, international processes push toward actions that would lead to greater openness, state retrenchment and liberalization. Nationalization is the opposite of those processes which means that the international dimension has two components driving my expectations. International financial institutions and the global system in general promotes openness—thus it will be more market friendly and push toward privatization. On the other hand moments of crisis lead to rallies around the flag, economic nationalism and thus nationaliza-

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34 Plus, that cost might only be temporary. Investors still went to Argentina even after it defaulted on its loans, Hungary still gets substantial support from the markets.

35 The USSR could be described as promoting such a project after World War II.
tion. A severe crisis can make even a strongly liberal government to enact policies of nationalization.

2.4.3 The regional dimension

While my theory posits the interaction of domestic and international factors as the main explanatory elements of privatization and nationalization waves, regions play an important role through the processes of diffusion and learning (Bennett 1999; Kobrin 1985; Kopstein and Reilly 2000). Privatization and nationalization could pick up steam as they are adopted across a region increasing the strength of a wave. One way this could happen is through geographical diffusion: a neighboring state adopts the policy then its neighbors follow suit and those neighbors’ neighbors do the same thus strengthening the wave. Geographical “contagion” is one way these policies could be transmitted. Regional hegemons are another. Countries could be learning from a regional hegemon that privatization or nationalization is the new policy to implement for economic success. The example—and possible success—of the hegemon could inspire other countries in the region to adopt those similar policies, again strengthening the wave.

The impact of a regional hegemon for Eastern Europe in privatization and nationalization goes back to the initial wave of nationalizations following World War II when several of the region’s Communist regimes followed the Soviet example and nationalized all private assets. Similarly, after the collapse of Communism it could be said that the European Union and the US played the role of regional hegemons, whereas currently Vladimir Putin’s Russia might be the example emulated by some Eastern European regimes implementing nationalizations.
2.4.4 Hypotheses

Summarizing this theoretical discussion, my work hypothesizes that countries choose to nationalize or privatize depending on domestic coalitions demanding one or the other of those policies in conjunctions with international economic conditions. The decision as to what assets to privatize or nationalize (industrial assets, land, natural resources, etc.) is informed by the domestic political struggle, and the specific assets the actors in that coalition wish to protect. The process is carried out by state institutions as agents of the winning domestic coalitions (political parties in power and their supporters) created by the political elite of the time.

**Hypothesis 1:** The policy preferences of the domestic coalition in power result in the state implementing privatization or nationalization.

Previously this research examined these preferences as they were aggregated at the level of the political parties’ platforms in those countries. Data drawbacks discussed in Rudra et al (2018) made it a problematic measure. Thus policy preferences of the domestic coalition are conceptualized using a measure of affinity between the country’s leadership and the “Western order.” This measure of foreign policy orientation is based on voting patterns in the US General Assembly as a way to approximate a government’s “buy in” toward the overall liberal order, openness and globalization. This measure of foreign policy orientation is the best way to bring together the domestic arena—votes are a consequence of a country’s domestic political landscape and leadership—and the international pressures—if a country is susceptible to international influence from the most important state in the system—the US and its

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36 In this case coalition does not mean two or more parties coming together to form a "coalition" government, but means to encompass all the actors favoring a specific policy, such as the policies of privatization or nationalization.

37 A similar argument on trade and domestic political support for it has been made by Rogowski (1989) and others.
pro-market approach, then the affinity\textsuperscript{38} between the country’s score and the actual economic policy is shown to be high all else being equal.\textsuperscript{39} Parts of this story resonate with a “winners take all” logic (Hellman 1998) that shows the importance of domestic factors in shaping outcomes even as international pressures towards one of the two policies increase.

I anticipate the following findings:

\textbf{Hypothesis 1A}: Governments with a higher affinity to the Western order will privatize.

\textbf{Hypothesis 1B}: Governments with a lower affinity are more susceptible to nationalize.

Opting for this particular way to measure domestic coalition preferences and their policy outcomes has the advantage of capturing changes in domestic coalitions as shown by Mattes, Leeds and Carroll (2015). It also deals with the problem of populist leadership. As I mentioned throughout the project some of the coalitional changes sometimes push a country toward populist leadership—as it is the case for the main case study of this project, Hungary. Yet, in the absence of quantitative data to measure populist parties in power, the quantitative analysis would miss changes in that dimensions.\textsuperscript{40}

\textsuperscript{38} I use the term affinity for the ideal point estimation measure of Bailey, Strezhnev and Voeten (2017) but it should not be confused with the affinity score of Gartzke (2000). What I examine is the closeness in position between a country’s government and the US-led liberal order.

\textsuperscript{39} Though this is used as a proxy especially for the statistical analysis basing the measure on ideal point estimation done by Voeten et al (2017), the qualitative case studies explore in a more nuanced way the influence of different groups within society as they try to shape policy in the processes of privatization and nationalization and how that is mediated by international economies.

\textsuperscript{40} This is particularly problematic as there are populist parties both on the Left and on the Right of the political spectrum and—as I show in other work—regardless of their left or right leaning, populist parties tend to prefer policies that empower “the people,” which most of times ends up strengthening the state.
However, this affinity does not come in a vacuum. We should expect that a particular affinity of a government will have consequences for the kinds of policies they enact but only once it’s mediated by international factors. This argument refines the first hypothesis to include implications for specific international pressures.

I argue that it is not the domestic or the international dimension exclusively that determine the pursuit of privatization or nationalization but the continuous negotiation of policy-making between domestic audiences and international factors. Therefore another hypothesis focuses on the effect of international financial processes on the probability of pursuing nationalization or privatization. Trade openness and involvement with international financial institutions are expected to predict an increase in privatizations, whereas financial crises create a “rally around the flag” effect which could increase the likelihood of nationalizations.

**Hypothesis 2A**: The greater the country’s involvement in institutions and financial processes that demand openness, the higher the likelihood that privatizations take place.

Participation in international financial processes can take a myriad of forms from trade openness, IMF programs, foreign direct investments, pressures from integration in international or regional organizations, financial crises. Particularly processes such as participation in IMF programs, FDI, membership in certain international organizations and regional organizations such as the EU would have very strong pro-market outcomes as these structures promote policies that facilitate exchange and international cooperation while financial crises can push a country either toward more openness—if it is part of an IMF package—or increased protectionism and state expansion of its economic role if the country decides to weather the crisis on its own.\(^ {41} \)

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\(^ {41} \) The choice of going with the IMF or alone is also mediated by domestic conditions with specific leaders choosing one or the other option.
**Hypothesis 2B:** Financial crises in the context of foreign help increase the probability of privatizations, whereas going through a financial crisis without seeking international support leads to increased nationalizations.

These are broad hypotheses that are analyzed in a variety of ways with different types of data and levels of analysis. Table 2.1 summarizes these expectations interacting domestic affinity and some of the international factors identified here as important.\(^{42}\) When affinity with international processes is high and the country receives support from the IMF then the likelihood of privatization in high. Low affinity and little IMF support more likely results in nationalizations. Financial crises for countries with high affinity leads to increased privatization, whereas for countries with low affinity it results in increased nationalization. Chapter 3 tests these expectations.

<table>
<thead>
<tr>
<th>Affinity</th>
<th>IMF support high</th>
<th>IMF support low</th>
<th>Financial Crisis</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>Privatization</td>
<td></td>
<td>Privatization</td>
</tr>
<tr>
<td>Low</td>
<td></td>
<td>Nationalization</td>
<td>Nationalization</td>
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</tbody>
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A final set of hypotheses deal directly with my concept of privatization and nationalization wave. While I am mainly interested in showing how the interaction between domestic and international factors results in these waves, I also want to show that these waves exist.\(^{43}\) I include in my analysis variables that capture the existence of temporal evolutions and regional waves of privatizations and nationalizations. I expect to see that countries which have privatized or nationalized in the past are more likely

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\(^{42}\) I already identify financial crises as an international factor with diverging consequences depending on domestic circumstances. I picked IMF funding as the other variable here because I also discuss this influence of this institution in the qualitative part of my study so it allows me to present a more complete picture of both quantitative and qualitative results for this variable. In the statistical chapter I also present results for international variables such as WTO membership, trade, exports, and foreign direct investments.

\(^{43}\) I only briefly show descriptive quantitative data and a brief historical account in the introduction to support the existence of these waves.
to do so in the future (Hypothesis 3) and that if the level of nationalizations or privatizations in a country’s region increase the likelihood of that country privatizing or nationalizing (Hypothesis 4).

**Hypothesis 3**: A country that has privatized or nationalized in the past has an increased likelihood of privatizing or nationalizing again.

**Hypothesis 4**: A country in a region that has experienced privatizations or nationalization has an increased likelihood to privatize or nationalize.

2.5 Concluding thoughts on policy reversal and institutional change

The object of this study is to explain waves of privatization and nationalization across the world, regions and countries. Successive waves of privatization and nationalization change substantial parts of the economy. Each change creates new winners and losers, maintaining in power a coalition that in time might be overturned by a new set of actors and interests. I stress the importance of politics and of the political bargains that make an economically suboptimal outcome politically optimal, and therefore the preferred course of action. This argument has several implications for explaining change in the political process. Even though there is institutional stability in this story—the argument implies continued political struggle in a context where different groups in society can voice their preferences with regards to economic policy—change is more prevalent than assumed by the Northern world of high cost institutional change. Path-dependence was an easy framework to see regional processes in Eastern Europe for example—the assumption that once the process of economic liberalization was set in motion the only outcome was full liberalization, yet leaders have a variety of tools at their disposal in the process of economic policy-making. The convergence of a strict set of options—Thomas Friedman’s “golden straitjacket of globalization—
did not reach the pinnacle suggested by the literature because the costs associated with institutional change are not as high as the opportunity afforded by reshuffling economic assets.

Political science is good at explaining the status quo in political processes or upward trends, but change and reversals are a much trickier aspect often relegated to the "exogenous shock" category of explanations. Path-dependence is a particularly attractive perspective for the discipline considering the importance of institutions in explaining political processes (Pierson 2000) as well as their interaction with economic reforms (Stark 1994). Following Douglass North (1990), political science has come to look at institutions as entailing high fixed or start-up costs, requiring learning, coordination and adaptation. Once established, institutions generate powerful forces for maintaining stability and once integrated within the broader institutional arrangements of the political system they create complementarities with other institutions solidifying the status quo (Hall and Soskice 2001). Yet, institutional innovation proves volatile in many countries and may be fully reversed in times of crisis or due to changing social or economic conditions or the political and economic ambitions of individual leaders, whether nationalists or kleptocrats.

Instead of path-dependence, which argues that political change becomes costly with each step taken down the road starting with the first decision made, this alternative view argues that while earlier decisions narrow the choice set, they do not predetermine the next step. The analysis of political institutions accepts the possibility that long-term gradual changes result in important reorientations in time (Pierson 2000) or that functional transformations result in an institution performing other purposes than originally intended (Thelen 2004). Institutional analysis fails to acknowledge that sometimes politics is a much more fluid game, with politicians
having more freedom in policy-setting and that institutional change is not just about costs but also about opportunities.

In this light we can see that historical institutional analysis fails to truly explain change, predicting instead “a world of stability, path-dependence, and persistence" (Blyth 2002, p. 19), in which change within institutions became hard to explain unless it was seen to result from exogenous “punctuations"(Blyth 2006).

Explaining waves of privatization and nationalization is to explain path-departures rather than path-dependence. This research takes elements of the political system usually studied through the lens of path dependence and examines the triggers of change for the processes of nationalization and privatization. Rather than paths the governments embark on, privatization and nationalization are policy options that leaders have at their disposal and can use with the purpose of continued electoral support of their constituencies.

A final comment on the lessons to be drawn from the current state of the literature on institutional change is how much of its conclusions can be applied to a specific regional context. Path-dependence and path-departure, as they have been discussed by the historical institutionalist school (see Thelen) or the agent-driven distributional theory of change (see North and Thomas) all seem to emerge from an in-depth examination of the Western European or American experience. In this context institutions not only have had a long time to develop, but they have also had a long time span to change. Time as a crucial factor in politics is not something to be taken for granted (Pierson 2004) but many of the conclusions reached, especially on institutional path-dependence in Western Europe, travel with difficulty to other places of the world where politics has shown rapid and dramatic shifts from the way the process was conducted a few years ago let alone decades or centuries ago. Examining current institutional change in places like Eastern Europe and Latin America
requires less a focus on deep path-dependence than on the blending of domestic and international factors in a dynamic political process. I now turn to examine statistically this interaction between domestic and international factors as well as regional factors in the emergence of privatization and nationalization waves.
To illustrate the domestic versus international factors affecting the waves of privatization and nationalization I collected all the available data on privatizations and nationalizations across the world since the 1950s. The dependent variable data—while the most complete in existence—still has drawbacks and problems as I discuss below, but at this stage it is the most extensive attempt to bring these two processes together. Data on domestic and international variables—in some cases several versions of the concept I try to get at—complement the privatization-nationalization data to give as much as possible the complete landscape for the causes of privatization-nationalization waves and the interaction of domestic and international factors.

This chapter begins with the data collection process for the dependent variable and shows the privatization-nationalization waves emerging from the raw numbers collected for this project. Next, the chapter discusses the independent variables of interest, the various ways to operationalize the domestic and international factors at play as well as control variables that would allow for the testing of alternative hypotheses. The final section presents the results of the analysis and draws conclusions on the various factors impacting a government’s decision to privatize or the nationalize. The chapter also discusses limitations of the analysis, robustness checks and endogeneity issues. The analysis in this chapter is supplemented by additional robustness checks including an appendix with the analysis of privatization-nationalization waves through multinomial logit.
I find that the probability of privatization is markedly larger when the country has high affinity with the US-led order and it receives high levels of IMF funding. Privatizations are not likely to happen in countries with low affinity levels regardless of their levels of IMF support. Nationalizations are not statistically more likely regardless of affinity. Privatizations are also more likely to happen during a financial crisis if the country has high levels of affinity, whereas nationalizations are likely to happen in times of crisis but only in countries with low levels of affinity to the US-led order. I also find support for the temporal and regional hypotheses. Once a government privatized or nationalized in the past 10 years, the likelihood it pursues that policy again is substantial. While for nationalization past nationalizations predict future nationalizations, in the case of privatization changes to either privatization or nationalization in the past predict future privatizations. I also show the diffusion of both nationalizations and privatizations. Privatizations are more likely to happen if the region has experienced other privatizations, but less likely if it has experienced regional nationalizations. On the other hand, nationalizations are increasingly likely when a country’s regional neighbors have also experienced nationalizations.

3.1 Quantitative data collection strategy

3.1.1 Privatizations

Much of the earlier work focusing on privatization used unsuitable proxy variables such as the state sector as a percentage of the GDP.\footnote{While this could be an alternative measure to use, the data I found so far is limited geographically focusing mostly on Western Europe as it was the case of the work of Rosa (1988).} This project makes use of several data sources including those provided by the World Bank and the Privatization...
Barometer. The data on privatizations spans the following periods: 1988 to 2008 for the World Bank and 1977 to 2013 for the Privatization Barometer.²

The data on privatizations from these two sources do not neatly match to give us a sense of privatizations worldwide. First of all the World Bank data focuses substantially on the developing world whereas the Privatization Barometer includes many privatizations taking place in highly industrialized countries in Western Europe. To account for possible duplicates while keeping the most information, the data from the two sources was merged at the level of privatization event and I eliminated duplicate observations. This resulted in the most complete dataset on privatizations to date—more complete than anything used in the literature at any point until now.

An additional way to approach the data on privatization is to supplement it with information from the World Bank’s Private Participation in Infrastructure Database (PPI) which is still being updated unlike the Privatization Barometer and the Privatization Database. This data provides information on a form of privatization in which “a private entity buys an equity stake in a state-owned enterprise through an asset sale, public offering, or mass privatization program” (World Bank 2016). The Database classifies divestitures in two categories: Full divestitures where the government transfers 100 percent of the equity in the state-owned company to private entities and partial divestitures where the government transfers part of the equity in the state-owned company to private entities. In this last case the private stake may or may not imply private management of the facility.³

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² This covers the period starting with the first wave of privatizations in the United Kingdom under Margaret Thatcher.
³ Divestitures include mostly privatizations of utilities and public services such as electricity (30%), telecommunications (45%), transportation infrastructure (15%), treatment and water plants (7%). Recent work has shown that much of privatizations in the developing world focus on the state selling parts of its traditional service provision tasks to private actors (Post 2014).
Adding the data on full divestitures means that I was able to supplement data on privatizations up to 2015.\textsuperscript{4} Figure 3.1 compiles all available data and presents the newly created variable including all privatizations present in the World Bank Privatization Database, Privatization Barometer and the full divestitures in the Private Participation in Infrastructure Database. The final number of privatizations (thick red line in Figure 3.1) combines all these data sources, eliminates duplicate observations of privatization transactions. Figure 3.2 presents the total value of the privatization transactions converted in 2015 constant US dollars. Figure 3.1 shows the wave of privatizations that started in the mid 1980s, continued through the 1990s and tapered out in the late 2000s. I present both the graph with the proceeds from privatization as well as the number of countries that experienced privatizations each year. Proceeds provide an image of the value of the assets under study and could be used in a separate analysis, Country-year data is preferred as it is the only one that matches existing nationalization data I present shortly.

An additional way to look at privatizations is regional. Figure 3.3 shows the regions with the most sustained periods of privatization. Latin America and Europe were places where extended programs of privatization lasted over a decade.\textsuperscript{5} When we disaggregate by decade the trends become even clearer. Figure 3.4 shows the earlier privatizers in Western Europe and Latin America, with some countries privatizing throughout the decade. Figure 3.5 represents the big wave of the 1990s when countries privatized substantially throughout the decade and across the world.

\textsuperscript{4} I ran the statistical models of this chapter both on the new version of the variable using the most complete set of the data as well as subsets of the variable in the robustness checks with only the World Bank Privatization data or distinguishing between privatizations and divestitures. I did not find significant differences in the results.

\textsuperscript{5} This map depicts the number of years that countries privatized. An additional map with proceeds from privatization could be created, but due to the higher price paid for companies in Western Europe the map would be less informative to the extent of the privatization process in the rest of the world.
Figure 3.1: All privatizations comparing different sources of data (1983-2015).

Figure 3.2: Total values of transactions from privatizations comparing different sources of data (1983-2015).
Figure 3.3: Total number of years with privatizations in each country

Figure 3.4: Total number of years with privatizations in each country in the 1980s

Figure 3.5: Total number of years with privatizations in each country in the 1990s
3.1.2 Nationalizations

The most important element in the discussion of nationalization is the definition of this phenomenon as well as understanding the historical evolution of what nationalization actually looks like. Following Kobrin (1980, 1984), Tomz and Wright (2010) define expropriations as entailing the following actions: (a) nationalization, defined as action by a government to take ownership of a foreign firm; (b) coerced sale, in which the government threatens or takes actions that induce foreigners to sell part or all of their direct investments to the government or to domestic citizens; (c) intervention or requisition, in which the government takes control of foreign direct investments without proclaiming itself as the rightful owner; or (d) renegotiation, in which the government compels direct investors to accept substantial changes in a contract or a concession. To add to the definitional ambiguity, throughout his work Kobrin uses "expropriation" and "nationalization" interchangeably, only at times equating nationalization to "mass expropriation" (Kobrin 1984, p. 331). This means that under the "nationalizations" heading we would count governments transferring private property to the state, expropriation of foreign investors, as well as changes in legislation and contracts that result in a modification of the property relationship between the state and private actors.

This definitional difficulty has resulted in few reliable data sets on nationalizations across the world. So far statistical analysis has mostly focused on the natural resource sector (Guriev et al. 2011, Mahdavi 2014, Warshaw 2012). Because of the strategic importance of the sector, the large amounts involved in the investment as well as the diplomatic effort that often goes into foreign investments in energy projects more effort has been made to trace instances of oil nationalization.

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However, nationalizations occurred across all the sectors of the economy. Thus, efforts by Kobrin (1980, 1984), Minor (1994), Hajzler (2012, 2014) and Tomz and Wright (2010) expanded our vision of the extent of nationalizations across the world. Tomz and Wright (2010) collected all the data from the previous sources for the most extensive data set going back to 1929. Figure 3.6 shows by comparison data from Tomz and Wright (2010), Hajzler (2012) and Li (2009). This figure provides a clearer picture of how the data on nationalizations overlaps and fills in the different time periods. While the oil data seems to be a subset of all the other data sets, the data seems to match best between 1966 and 1989 for Tomz and Wright (2010) and Li (2009).\footnote{The data from Li (2009) ends in 1989 and the two sources of data have a correlation coefficient of 0.965.} Hajzler (2012) collected data for the 1990s and has uncovered more instances of nationalizations than Tomz and Wright (2010).
The problem with the current data on nationalizations is that it does not take into account the effects of the 2008 financial crisis and its aftermath across the world. Most data ends in 2004 (Tomz and Wright, 2010) or 2006 (Hajzler 2012), basically missing a crucial turn of the current privatization-nationalization wave, this time toward nationalizations and increased ownership of states in economic matters.

With the rise of the regulatory state (Majone 1996, 1997) new instruments have become available to the states when they want to intervene and return an asset or company back to the government. Regulations and taxes as well as breaches of contracts have been mentioned by foreign companies as ways in which states have exerted power over foreign investments trespassing on property rights. Three of the four elements of the definition of expropriation used in the literature mentioned earlier describe regulatory action that the state can take against investors. Thus, data on investor-state dispute settlement picks up on recent nationalizations and the rising trend of alternative ways of bringing property under the control of the state (Wellhausen 2016). Although this source of data could add to the current analysis, closer examination showed that this new instrument is temporally problematic because it depends on the existence of a recent international institution. Not all disputes included concern nationalization Pelc (2017) and they primarily concern Western countries. Therefore I decided not to include this piece of data in the main analysis.

The data across the different measures of nationalization support the overall trend of a massive nationalizations wave in the late 1960s and the early 1970s, a lack of

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8 A future version of this project could examine possible measures examining the reach of the “regulatory state.” The number of days required to open a business or procedures required to conduct business, register property, export, etc have been collected by several international bodies, but the data is usually available from the late 2000s onward precluding any conclusions on earlier processes in the 1990s.

9 I did run the models with the additional observations in included and the results did not change.
Figure 3.7: Total number of years with nationalizations in each country

Figure 3.8: Total number of years with nationalizations in each country in the 1960s

nationalizations in the 1990s and a return of state ownership in the 2000s (Figure 3.6). A geographical depiction of the nationalization wave (Figure 3.7) shows the preponderance of this process in Latin America, Africa and parts of the Middle East and Asia. Nationalizations started in the 1960s (Figure 3.8) and expanded substantially in the 1970s (Figure 3.9).
3.1.3 Waves

So far the existing data has been either dichotomous (usually presence of absence of the phenomenon of interest) such as the data for nationalizations or continuous, measuring the value of the economic transactions, usually for privatizations (See Figure 3.10 for a representation of these dichotomous measures together). Due to the lack of data on the value of the assets nationalized the variable that can be constructed to bring privatizations and nationalizations together can only be a categorical variable capturing the presence of one or both policies. Figure 3.10 shows this measure in action. I count the number of countries that have gone through privatization (the area above the X axis) and the number of countries that have gone through nationalization (the area below the X axis). Even with this preliminary visualization the data begins to show the existence of a wave-like pattern with nationalizations dominating until the 1980s peaking in the mid 1970s, while privatizations took off in 1988, peaked in the mid 1990s and have seen a drop in number since 2007.
3.2 Covariates

In order to test the hypotheses of this research project additional data on domestic and international factors have been collected. The main domestic-focused variables look at the institutional context in which these economic policies are proposed and then enacted. Two ways of measuring domestic factors that affect the decision to privatize or nationalize are used in this analysis. First of all I examined the orientation of the main party in power. A large body of literature suggests that leftist parties are more likely to increase the role of the state in the economy, whereas rightist parties do the opposite (Tufte 1980, Boix 1997a, Iversen and Soskice 2006). However, the data from the Database for Political Institutions (Beck et al. 2001) is highly problematic. An important drawback of this measure is that it only starts measuring party ideology in 1975, missing an important part of the early nationalizations. Additionally, Rudra et al (2018) challenge this measure and its ability to represent policy positions.
for political parties in the developing world. They argue that the classical left-right distinction doesn’t fit the political parties of many developing world countries.\(^\text{10}\)

Instead of the initial measure for political party ideology I turned to another measure of state preferences, this time derived from United Nations voting data (Bailey, Strezhnev and Voeten 2017). This measure captures on a single dimension a state’s position toward the US-led liberal order between 1946 and 2012. This measure is better equipped to capture foreign policy shifts, has greater validity than other existing measures, allows for better intertemporal comparisons, is strongly correlated with other measures of liberalism and it is not as sensitive to shifts in US agenda than other existing measures (Bailey, Strezhnev and Voeten 2017). This measure has also been used to test foreign policy shifts after leader turnover (Dreher and Jensen 2013) and changes in policy following shifts in the societal groups the leader is most accountable to (Mattes, Leeds and Carroll 2015). Evidence that this measure better captures changes in the groups that support leaders in power suggests that this is a better measure to capture the hypothesized link between domestic demands for a specific policy—privatization or nationalization—and how the government in power approaches implementing that policy. Considering that throughout the period under study the US-led liberal order has been one that promotes openness and increased state retreat from the market, a link between foreign policies that show support for this order and policies of privatization is very likely. This measure allows me to test this link.

The importance of international factors in influencing privatization and nationalization is tested through a variety of measures. I start with the influence of IMF

\(^{10}\) I originally conducted my analysis with this additional measure for domestic politics and while the nationalization analysis didn’t work out very well because the data misses the most important time for nationalizations, the privatization results support my hypotheses.
lending. IMF money comes with strings attached and compliance to specific market-friendly policies. A country under such a regime would be more likely to reform the state sector and implement privatization (Appel 2004; Stone 2008; Vreeland 2006). I include data on how much money a country is receiving from the IMF in per capita 2015 constant US dollars from the World Development Indicators. It is also important to test whether the country is suffering from a financial crisis. I hypothesize that the constraints associated with a crisis and the possible requirements from international actors in staving off the effects of the crisis could have an important impact on domestic policy choices. Austerity often comes with a drastic reduction of the state sector and privatization of state assets (Blyth 2013), but if the country is not under an international agreement to implement austerity I hypothesize that the government might prefer bailout programs and increased state ownership. The data used comes from Valencia and Laeven (2008) with information on systemic banking, currency, and sovereign debt crises during the period between 1970-2011.

Though not fully incorporated in my hypotheses I also examine other international factors that could impact a country’s decision to privatize or to nationalize. One such factor is foreign direct investments (FDI). Changes in the property rights regime of a country can have immediate impact on FDI. Economic openness often occurs to attract foreign investments while nationalizations would signal a less friendly investment climate (Alfaro et al. 2004; Hajzler 2014; Li 2009; Tomz and Wright 2010). FDI captures the openness of a country to international financial flows. FDI injects into national economies the vagaries of the international market. Downturns and slumps in the international arena are captured in the evolution of the amount invested across the world. The 1970s oil crisis or the 2008 financial crisis are reflected in this variable to show the impact of international influences on domestic economic trends.\footnote{The variable is measured in per capita 2015 constant US dollars.}
Trade openness is another measure to test the influence of international economic pressures on privatization-nationalization policies. If a country has opened its economy to international trade, measured as a percentage of GDP, then we can test whether or not that affects the decision to pursue a policy of privatization. We would expect a country more open to trade to also favor private enterprise and therefore to promote private property protection and by extension privatization. The data for the international variables comes from the World Bank data base.

These domestic and international variables test the main hypotheses of this work. To test the temporal and regional hypotheses I coded additional variables based on privatization and nationalization data I collected for the dependent variables. I address the impact of time in two ways. By adding a lagged dependent variable the analysis accounts for the impact of recent national programs of privatization and nationalization so as not to overestimate the effect of a short lived economic program. Whether a country has a stable private property regime or whether it cycles back and forth between privatization and nationalization is a measure of a country’s past that could impact future attitudes toward reversals of economic policy. If a country frequently goes back and forth between private property and state ownership then the probability of enacting privatizations and nationalizations in the future also increases.

I created the variables “Past privatizations” and “Past nationalization” to measure whether a country had privatized or nationalized in the past 10 years.\footnote{In the full sample about 22 percent of all observations have had past privatizations and 20 percent had past nationalizations. In the more restricted sample of the main regressions, of all observations 40 percent had experienced past privatizations and 25 percent past nationalizations.}

Diffusion effects also matter in the story of privatization and nationalization policies. Some argue that diffusion effects increase this process, with proximity to countries that actively embark on these processes increasing the chance of their neigh-
bors to pursue similar policies (Kopstein and Reilly 2000; Pop-Eleches 2007), either to nationalize (Kobrin 1985) or to privatize (Simmons, Dobbin and Garrett 2008).

Figure 3.11 presents these trends across different regions. I use data from the Varieties of Democracies project for the regional classification.\textsuperscript{13}

Other domestic, international and regional factors need to be accounted for in order to test alternative hypotheses. I include a measure of domestic democratic development. Using the polity2 measure I account for the impact of a transparent form of government such as democracy on the economic openness and stability of the economic policy-making process. This measure is important as it has been found to be linked to privatization and nationalization (Li 2009; Warshaw 2012). Accounting for a possible history with communist rule is important in terms of the legacies countries could be dealing with as they go through transition (Pop-Eleches and Tucker 2017).

\textsuperscript{13} For ease of graphical representation Latin America and the Caribbean were condensed into one group, the same with the various Asia categories (Asia, South Asia and Southeast Asia). In the statistical analysis the original V-Dem coding of the data was not changed.
Considering the large scale privatization process that took place in the 1990s as a consequence of countries in Eastern Europe and the post-Soviet space moving away from state ownership of the economy, examining the effect of whether a state was Communist at some point in its history could add explanatory power to why a country would enact privatizations or nationalizations.

Testing the level of state ownership in the economy can tell us whether a state is already so removed from ownership that privatization is not necessary. I cannot assume that all countries privatize at all times if there is nothing under state ownership and they won’t be able to nationalize any assets if all assets are already owned by the state. The varieties of capitalism literature argues that there are two main types of capitalism and in both the role of the state in the economy is different, ranging from the laissez-faire approach of the liberal market economies to the closer connection between state and market in coordinated market economies (Hall and Soskice 2001). While it has been difficult to expand this theory outside the highly industrialized democracies of Western Europe and North America,\(^{14}\) it is important to note that the level of state ownership of the economy could exhibit threshold effects. Therefore a control variable to account for the preexisting levels of state ownership can help distinguish between different state-market mixes across the world. The Varieties of Democracies project measures whether the state owns or directly controls important sectors of the economy such as capital (including land) in the industrial, agricultural, and service sectors.\(^{15}\) The variable is coded as 0 if virtually all valuable capital belongs to the state or is directly controlled by the state, 1 if most valuable capital either

\(^{14}\) See the various contributions to this debate by Bohle and Greskovits (2012); Hancké (2009); Howell (2003); Nölke and Vliegenthart (2009); Schneider (2009); Soederberg, Menz and Cerny (2005).

\(^{15}\) The measure does not look at the extent of government revenue and expenditure as a share of total output.
belongs to the state or is directly controlled by the state, 2 if many sectors of the economy either belong to the state or are directly controlled by the state, but others remain relatively free of direct state control, 3 if some valuable capital either belongs to the state or is directly controlled by the state, but most remains free of direct state control and finally 4 if there is very little valuable capital belongs to the state or is directly controlled by the state (Coppedge 2015).\footnote{Thinking in terms the varieties of capitalism framework, a liberal market economy such as the US scores an average 3.22 consistently getting at least a 3 since 1950 and since 2004 being at the highest level of the scale. A coordinated market economy such as France between 1959 and 2015 has scored an average of 2.62 showing the greater level of state ownership in the economy. The scores get even lower as we move outside Western Europe. For example, Hungary—a major case study in this book—scores an average of 1.34 for the entire period of the study but that score becomes 2.85 if we only count the post-Communist period which means that the measure accounts for the post-Communist changes to the economy.}

In my discussion of data on nationalizations I mentioned how important nationalizations in the energy sector have been. Considering that this sector is more prone to shift between public and private property (Chang, Hevia and Loayza 2010) I include a control variable for resource rents. This way any distortions caused by a high number of nationalizations in the energy sector don’t affect my results. The political distortions caused by the resource curse have been well documented (Karl 1997, Ross 2001), and the propensity of leaders to nationalize highly lucrative extractive industries is also well known (Guriev and Sonin 2011; Warshaw 2012).\footnote{Data on natural resource rents as a percentage of GDP comes from the World Bank.}

Another domestic economic factor I account for is the level of debt of the country. Rosa (1993); Wellhausen (2015a) find that existing debt could make governments more likely to expropriate as this adds a needed source of revenue to the state coffers.\footnote{Chapter 5 documents how Hungary used expropriation of private pension funds to balance their budget and pay off foreign debt.} Similarly privatizing state owned companies could add money to the budget and remove from state ownership companies that drain the resources.\footnote{This variable is measured as per capita 2015 constant US dollars.} Thus, debt
becomes an important impetus for privatization and nationalization for countries battling it.  

Table 3.1: Descriptive statistics

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3.3 ANALYSIS AND RESULTS

The statistical analysis for this project follows several strategies for modeling. A first set of tests looks at privatizations and nationalizations comparatively examining models that include the main domestic and international factors that emerged from the theory. As discussed in the section on data collection on the DV the variables on privatization and nationalization are coded 1 in years in which countries enacted such policies. An additional robustness check looks at changes between no policy and privatization or nationalization, zeroing in on the moment when the change took place rather than years in which the policy was enacted.

The analysis uses logistic regressions with country clustering and regional fixed effects. To account for temporal effects most of the control variables are lagged and I also include a lagged DV.

The domestic side of the story is tested through variables on affinity to the US-led order, whereas the international dimension is examined through variables on IMF

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20 Table 3.1 shows general descriptive statistics of all variables presented here.
21 An additional robustness check looks at changes between no policy and privatization or nationalization, zeroing in on the moment when the change took place rather than years in which the policy was enacted.
22 The notes for each table of results mentions which variables were not lagged.
Table 3.2: Privatizations

*Note: The dependent variable is coded as 1 in the presence of policies of privatization. The independent variables are lagged except past experiences with privatization and nationalization. Standard errors in parentheses; * sig at 10%; ** sig at 5%; *** sig at 1% using a two-tailed test.*

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</table>
Table 3.3: Nationalizations

Note: The dependent variable is coded as 1 in the presence of policies of nationalization.

The independent variables are lagged except past experiences with privatization and nationalization. Standard errors in parentheses; * sig at 10%; ** sig at 5%; *** sig at 1% using a two-tailed test.

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<td>(0.290)</td>
<td>(0.207)</td>
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<td>-0.350**</td>
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<td>0.214***</td>
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<td>0.214***</td>
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<td>(1.134)</td>
<td>(1.062)</td>
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<td>1.322***</td>
<td>1.350***</td>
<td>1.388***</td>
<td>1.376***</td>
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<td>(0.002)</td>
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<td>Affinity × Trade</td>
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<td>(0.035)</td>
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<td>Affinity × Exports</td>
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<tr>
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<tr>
<td>Affinity × Financial Crisis</td>
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<td></td>
<td>(0.706)</td>
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<td>(0.725)</td>
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<td>(0.672)</td>
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<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
</tr>
</tbody>
</table>

66
funding, the effect of financial crises, FDI, trade, WTO membership, and export levels. I mainly focus on IMF funding and international financial crises but the tables present the results for the rest of the variables.23

Tables 3.2 and 3.3 present the full results of the analysis on privatizations and nationalizations. A few findings jump out right away. Hypotheses 3 and 4 find support across the broad. Past privatizations increase the likelihood of future privatizations in all model specifications even with the lagged dependent variable added to the models (Table 3.2). Similarly, past nationalizations increase the likelihood of future nationalizations (Table 3.3). Diffusion effects are also at work. Privatizations are more likely to happen if the region has experienced other privatizations, but less likely if it has experienced regional nationalizations. On the other hand, nationalizations are increasingly likely when a country’s regional neighbors have also experienced nationalizations.

Figure 3.12: The effect of affinity and International Monetary Fund funding on privatization and nationalization.

Note: The graph plots coefficients in Model 3 Table 3.2 and Model 3 Table 3.3.

To test the interaction expectations I focus on comparing the coefficients of the regressions with IMF funding and financial crises as the main international variables

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23 I was requested to simplify the amount of tables I include in the text, but I can provide additional tables for all the tests I mention throughout the analysis.
Figure 3.13: The effect of affinity and financial crises on privatization and nationalization.

Note: The graph plots coefficients in Model 6 Table 3.2 and Model 6 Table 3.3.

(Figures 3.12 and 3.13). At first glance I find support for increased IMF funding leading to more privatizations and fewer nationalizations, whereas financial crises increase the likelihood of privatization and decrease the likelihood of nationalization. I also plot interaction effects to more clearly see if the expectations from Table 2.1 have been met or not.

Figure 3.14: Privatization and International Monetary Fund funding.

Note: The graph plots the interaction terms in Model 3 Table 3.2.
In Figure 3.14 I find that the probability of privatization is markedly larger when the country has a high affinity with the US-led order and it receives high levels of IMF funding. Privatizations are not likely to happen in countries with low affinity levels (the line in black) regardless of IMF support. Nationalizations are not statistically
more likely regardless of affinity. Increases in IMF funding also do not affect the likelihood of nationalization. This particular expectation was not met.

In the case of financial crises, Figures 3.16 and 3.17 show that privatizations are more likely to happen during a financial crisis if the country has high levels of affinity (gray line), whereas nationalizations are likely to happen in times of crisis but only in countries with low levels of affinity to the US-led order, however, in this case the result is not statistically significant. In Table 3.4 I find that two of my expectations were met by statistically significant results. The other two interactions I expected to find had the correct sign but were not statistically significant.

For other measures of the international dimension, privatizations become more likely in the presence of both affinity and FDI, affinity and trade, affinity and membership in the WTO. Nationalizations are shown not to occur if a country experiences any of these domestic and international forces—which makes sense. If a country has

Figure 3.17: Nationalization and financial crises.

Note: The graph plots the interaction terms in Model 6 Table 3.3.

\footnote{Figure 3.15 shows that countries with low affinity and no IMF funding are more likely to nationalize, but the results are not statistically significant.}

\footnote{The only measure that doesn’t have a statistically significant coefficient on the interaction is affinity and exports.}
affinity for the US-led order and is increasingly enmeshed with the global economic processes, it is less likely it prefers nationalizations. This changes in the context of a financial crisis. Even countries with more affinity to the US-led order contemplate nationalization as a way to safeguard their economies.

Table 3.4: Theoretical expectations

Note: The bolded parts denote expectations that were statistically significant in the quantitative analysis.

<table>
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<th>Affinity</th>
<th>IMF support high</th>
<th>IMF support low</th>
<th>Financial Crisis</th>
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<tbody>
<tr>
<td>High</td>
<td><strong>Privatization</strong></td>
<td></td>
<td><strong>Privatization</strong></td>
</tr>
<tr>
<td>Low</td>
<td>Nationalization</td>
<td>Nationalization</td>
<td></td>
</tr>
</tbody>
</table>

An additional element to my analyses is the fact that throughout the presented regression tables, as well as the same models without the interaction term, I find additional sources of support for my argument. Regional and temporal factors continue to play the role already highlighted. Affinity on the other hand is rarely statistically significant on its own. Similar results are found for the international variables. Although this disproves hypotheses 1A and 1B and only partially provides support for hypothesis 2A, it is good news for the interaction part of my argument. Those hypotheses only looked at domestic factors on their own. And on their own just affinity or just FDI for example do not predict privatization. As I argue, it is the combined circumstances of domestic politics and specific international conditions that create the context that could lead to more privatizations or nationalizations.

A few variables disproved some of the alternative hypotheses. Resource rents did not significantly impact privatization or nationalization. Being a democracy also did not impact choices in economic policy in most of the model specification, whereas Communist legacies mattered only in positively predicting privatizations. Debt was

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26 I didn’t include all the models here but can provide them easily.

27 Some variables are significant in the models without the interaction, but the significance is not consistent.
an important predictor for privatizations across the board, but only sporadically significant for nationalizations.

Some variables had a huge impact on privatizations but none on nationalizations. For example debt positively predicted privatization in all model specifications, but was not significant in all of the nationalization models. Thus a country in debt will prefer to sell off assets as a way to repay debt rather than nationalize. On the other hand, state levels of ownership work contrary to expectations. I find that the more private a country’s property regime is, the likelihood of privatizations increases and the likelihood of nationalization decreases.

The main statistical analysis carefully included variables to take into account different facets of international and domestic factors, a variety of economic and political variables, from state ownership in the economy, resource rents, debt and financial crises to democracy levels and a Communist past. Lagging these variables and including clustering by country were additional ways to make the tests presented here more stringent.

Additional quantitative tests of the theory were conducted using other measures of domestic politics such as political party in power, I conducted multinomial logit analyses, as well as using change as an alternative measure for the DV. The results so far support the previous findings.

3.4 Conclusion

What explains privatization and nationalization waves? This chapter was an in-depth exploration of different ways to quantitatively provide an answer to this question. My theory is confirmed in a few ways. First, the interaction between domestic politics and international factors matters. I find that the probability of privatization is markedly
larger when the country has a high affinity with the US-led order and it receives high levels of IMF funding. Privatizations are not likely to happen in countries with low affinity levels (the line in black) regardless of their levels of IMF support. Nationalizations are not statistically more likely regardless of affinity. Increases in IMF funding also do not affect the likelihood of nationalization. Privatizations are also more likely to happen during a financial crisis if the country has high levels of affinity (gray line), whereas nationalizations are likely to happen in times of crisis but only in countries with low levels of affinity to the US-led order.

Second, waves are real. Past privatizations make future privatizations more likely and past nationalizations make nationalizations more likely. Once a government privatized or nationalized in the past 10 years the likelihood it pursues that policy again is substantial. While for nationalization past nationalizations predict future nationalizations, in the case of privatization changes to either privatization or nationalization in the past predict future privatizations. This means that instead of being path dependent to a specific policy choice—privatization or nationalization—countries have more freedom to choose whichever policy corresponds to their domestic needs and international circumstances. Or, this could also mean that vacillation could be a path all on its own. Countries that have experienced policy shifts in the past continue to experience them in the future. The policy stability in this arena that was experienced by Western European countries throughout much of their recent history—which is the focus of the varieties of capitalism literature—could be a path that no other regions could take once they experienced the pendulum swing from privatization to nationalization and back.

Finally, diffusion matters. While privatization was from the start seen as a process that emerged in Western Europe and then spread across the world I was able to show graphically and statistically that this was the case and that the same was happening
with nationalization. The maps of the world across decades illustrate this diffusion process both for nationalizations and privatizations and my statistical results show the importance of regional trends and learning policy lessons from your neighbors.

The main takeaway of this chapter should be statistical proof for the existence of waves of privatization and nationalization and the interplay between domestic pressures and international factors. The rest of the project shows the intricacies of this interplay. I delve deeply into the political and economic processes that reversed the privatization wave in Eastern Europe. The statistical results on the interaction between domestic and international factors need to be supplemented with case studies of the countries in Eastern Europe and their shifts between privatization and nationalization.
Chapter 4

Economic Policy Reversal in Eastern Europe

4.1 Introduction

The guiding questions of this project examine why countries shift between periods of greater state ownership in the economy and periods of increased market laissez-faire, between policies of privatization and policies of nationalization. What are the conditions under which a change to either increased private ownership or increased state ownership of the economy occurs? And why do waves of privatization and nationalization occur in so many countries at once? What are the drivers behind regional or world waves of privatization and nationalization? The previous two chapters proposed a theory that takes into account the domestic demands for property redistribution between state and market, between the private sector and public arena. The theory also underscores international pressures interacting with the domestic sphere as an explanatory variable pushing the government toward privatization or nationalization. Chapter 3 examined these relationships in a large-N quantitative setting with data from the 1950s onward. However, the findings from this statistical work need to be contextualized. As seen in the results of the previous chapter, regional trends and variations matter substantially when we analyze privatization-nationalization waves. The rest of the project examines privatization and nationalization waves both in a regional context (Chapter 4) as well as in specific countries with examples for the domestic part of the argument (Chapter 5) as well as the international (Chapter 6).
Eastern Europe represents one of several possible regions of study. This region is particularly instructive in several ways. I chose Eastern Europe as the region of interest due to its recent history of vacillation between greater state versus market ownership in the economy. The region offers a wide variety of policies adopted, as well as a wide diversity of outcomes. Even in terms of the regional trend toward populist economic policies of state intervention in the economy, the region is not uniformly moving in that direction and the variations are extremely instructive when trying to disentangle the reasons why we see the shift from economic liberalization to greater state ownership in the economy. Several of the crowning examples of successful political and economic transition in Eastern Europe have been experiencing not only shifts in pro-market economic policies but also significant backsliding away from democracy, which allows me to test the link between domestic politics and waves of privatization/nationalization versus waves of democracy/authoritarianism.

The feeling that political and economic liberalism have failed to provide the benefits promised with the fall of communism has become widespread across Eastern Europe. Focusing on Eastern Europe also allows me to engage with the extensive literature of transitology, and political and economic development in post-Communist countries. The developments in the region examined here contradict many of the assumptions in the literature on democratization and economic liberalization. The path from Communism and central planning to democracy and market capitalism has never been inevitable or irreversible.

The analysis of regional and country changes is presented in following three chapters. This chapter is a bridge between the global statistical analysis and in-depth

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1 This study could be expanded to the study of Latin America, another region that has experienced the waves of privatization and nationalization this project examines. Additionally, including the rest of the communist camp, with countries from the former Soviet Union could be another way to expand the geographical reach of this project.
country analysis. First, I address the literature on political and economic transitions in Eastern Europe, showing how my study improves upon the assumptions of that scholarship. The optimism of the era resulted in much higher expectations for the outcomes of the transition. This section examines this literature and engages with those authors that did predict possible failure and I show my own contribution to the study of the region by examining how our expectations about the region change through the lens of privatization-nationalization waves. Second, I discuss in broad strokes the first stage of the waves sweeping over Eastern Europe, focusing on the the 1990s privatization wave. The chapter also includes an overview of the reversals that have taken place in the region and the social, political and economic origins of these shifts. Examining changing public opinion in the region is a building block for Chapter 5 which focuses on the case of Hungary, how the changing public support for privatization brought to power Fidesz, a political party campaigning on a return to a stronger state ownership in economy and reversal of the privatization push in the 1990s. Before moving from the regional level to the country case study I will also analyze the impact of regional hegemons on the decision to privatize or nationalize. In hypothesis 4 I posit the impact of regional levels of privatization and nationalization and in my statistical findings I report a strong impact for regional effects. I will also examine qualitatively the regional dimension by shedding light on the possible regional hegemons shaping privatization and nationalization in Eastern Europe.

2 Across the final two chapters the main case study is Hungary, with examples from other countries. Chapter 6 in particular is region oriented, as the international factors apply more uniformly across the region. In order to fully understand the domestic intricacies of the changes in Eastern Europe Chapter 5 mostly focuses on Hungary to give a detailed account of the full spread of shifts in policies.

3 The political and economic foundations of these shifts are addressed in more detail in the next chapter.
4.2 How did the privatization literature theorize change

Change was the central focus of the privatization process and the literature itself was often summed up under the headline of “transition economics.” (Roland 2000) Even when accepting the dynamic nature of the processes under study, much of this research failed to truly grasp change, particularly due to the way that change was theorized. In much of the early research on this topic, change meant a complete and dramatic break with the past. The literature posited that the collapse of communism represented a tabula rasa moment for all these countries in the region (Elster, Offe and Preuss 1998) and that the goal was building from scratch “states and markets after communism” (Frye 2010) in a process that was akin to a “great natural experiment” (Pickel 1997; Sonin 2013; Stokes 1993) and a “laboratory for economic knowledge” (Bockman and Eyal 2002) that would allow economists and political scientists to test long held theories of market and institution creation in real time. As each country would transition from the previous system it would simultaneously have to choose a whole host of economic and political institutions and social scientists would be able to observe within their own lifetime the progression of that choice, from the crystallization of the ensuing institutions to the impact of said institutions (Bandelj 2004; Checkel 1993; Darden 2009).4 I agree with Gehlbach and Malesky (2014) who argue that some of these scholars used the term “natural experiment” more metaphorically than literally,

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4 For example Nina Bandelj remarked that “[s]ocial scientists rarely come across a natural experiment setting that allows them to examine the conditions under which a market comes into existence de novo” (Bandelj 2004, p. 3). Jeffrey Checkel expressed the excitement over the promise of a relatively controlled environment, writing that “[t]he revolutions in Eastern Europe and the dissolution of the USSR ... present a golden opportunity—a theorist’s dream—to control better for the independent effect of the different variables” (Checkel 1993, p. 297). Additionally, David Weimer extolled the “extraordinary ‘natural experiment’ for comparative study on a grand scale of the political economy of property rights” (Weimer 1997, p. xv). But this view was prevalent from the early days of the transition with Adam Przeworski arguing that this was the greatest experiment in history since the forced Stalinist industrialization of 1929 (Przeworski 1991).
but the use of this framework to examine the changes that were occurring in the region obscures more than illuminates our understanding of the changes taking place.

I argue against this approach for several reasons. First of all, stressing the clean slate these countries had in terms of institution building infused much of the literature on the political and economic transition in the region with a strong teleological propensity (Carothers 2002), which meant that all analysis was guided by the notion that the end point could only be full democratization—in the case of research on the political transition—or successful creation of functioning market capitalism—in the case of research on the economic transition. This strongly held view in the literature basically did not allow room for policy shifts or divergence from the path to capitalism. In line with North it was assumed that the cost of diverging from a chosen path was too high so the only point of true importance was the initial correct selection of a path, the cost of divergence would deter future shifts away from liberalization.

Second, by thinking of the processes in Eastern Europe only in terms of a start from zero denies the presence of important constraints on policy-making originating in the legacies of the different forms of communism in each country (Ekiert and Hanson 2003; Pop-Eleches and Tucker 2017).\(^5\) I argue that the countries in the region not only

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\(5\) Echoing (Bunce 1995), the “points of departure” across these states was one of great variability. For example, the size of the informal sector was an important factor that influenced the success of the reforms and it was not the same across the region. The legacy of the pre-communist period was a factor often forgotten by researchers. The countries of Eastern Europe had had market economies and in some cases democracy before communism which represented both an opportunity (the ability to draw on previous experiences) and a hindrance (sorting through complicated competing property rights prior to the expropriations enacted by Communist regimes). Janos Kornai also had similar expectations where he predicted there will “be a curious dual system in postsocialist society. It is a “mixed” system in which many elements of the socialist and capitalist societies exist side by side and interwoven with each other. If the actual process of development follows the programs announced by the parties and movements taking power, the capitalist element will prevail. There are great chances of this happening, but even if it does, the inheritance of the socialist order will remain for a long time in all dimensions of socioeconomic activity.” (Kornai 1992, p. 579)
started out from different points but adapted policy advice from foreign consultants to their own needs based on the advice of local experts and interests (Bockman and Eyal 2002). Only with an eye on these differences can we explain divergent trajectories across the region.

Finally, much of the work studying the economic changes—of which privatization was only one dimension—could be categorized as promoting one of two recipes: “shock therapy” or “gradualism.” Yet this is a false dichotomy if what we are interested in is institutional change. Therefore, in line with Roland (2002), I argue that the theory of the political economy of transition and institutional change belongs to a more fundamental trend in research in recent years, one seeking “to integrate the political process into the analysis of economic problems” (Roland 2002, p. 30). As Roland sees it, the literature on the political economy of reforms identifies two broad strands: normative and positive. The normative political economy of reforms focuses on the decision-making problem of reformers subject to political constraints. In contrast, the literature on the positive political economy of reforms attempts to analyze the clash of interest groups. The focus is less on deriving policy recommendations than on trying to understand the evolution of the balance of power across countries and across time.

Roland (2002) argued that for the advocates of a “big bang” or “shock theory” approach to transition the most important element was a fast and comprehensive implementation of all major reforms. Speed was of the essence, they argued, because there was a “window of opportunity” (or a “honeymoon period” or a “period of exceptional politics”) created by the establishment of democracy. During this period, they argued, governments should seek to adopt reforms as fast as possible (for example, Balcerowicz 1995; Sachs and Lipton 1990) and attempt to create irreversibility for these reforms (for example, Boycko et al. 1997). On the other side, those who opposed the big bang approach often advocated a gradualist strategy, which emphasized the need for a precise sequencing of reforms (Myant and Drahokoupil 2011). The political economy argument in favor of gradualism was that an appropriate sequencing of reforms would provide successes to build upon, thus creating constituencies for further reforms (for example, Dewatripont and Roland 1992, 1995; Wei 1997). Recent statistical work examining economic outcomes across Eastern Europe and the CIS shows that rapid reformers suffered less damage and recovered more quickly than partial/gradual reformers and non-reformers (Balzer 2016; Havrylyshyn, Meng and Tupy 2016).
and the outcomes of changes in that balance. In the transition context this approach has been much less utilized as a framework of study even though the political aspect of the struggle for policy is what determines a particular road taken (Roland 2002) as this research argues.

If the clash of interest groups and the possibility of policy reversal was at all studied it was from very particular approaches. I categorize them under the different headings of “precedence of legal reforms,” “controlling special economic interests” or “controlling special political interests.” The first school emphasizes the need to focus on legal reforms early on, establish clear property rights and ensure their enforceability (Rapaczynski 1996; Woodruff 2004). The second school focuses on the role of early participants in the economic transition and their efforts to stop further privatization once they achieve a preeminent role in the new order (Hellman 1998; Pyle 2011). Finally, what most Eastern Europe-focused work has feared when dealing with the problem of possible policy reversal has been the capture of the process by political interests (Hellman, Jones and Kaufmann 2003). These interests were sometimes seen to reside within the unreformed bureaucracy of the post socialist states (Brown, Earle and Gehlbach 2009; Kaufmann and Siegelbaum 1997; Shirley 1999; Shleifer 1994) or with the newly elected officials who would not want to relinquish an important policy tool that would secure their election (Boycko, Shleifer and Vishny 1996; Shleifer and Vishny 1994). In these accounts, threats to property rights reside either with the state itself (Frye 2004; Junisbai 2012) or the actions of “predatory agents” of the state (Markus 2015).

7 The logic of partial reform in Hellman does not contemplate full policy reversal but freezing reforms and preventing further progress.

8 The literature notes that by maintaining state owned enterprises that would not be privatized the politicians could ensure that the managers of these companies would keep full employment thus securing the workers’ votes for the politician.
These accounts deal with policy reversal only partially and never explore the possibility that the post-socialist future could see a return of the state in a way that would not mean a full repetition of the communist past, but that democratically-elected governments would “bring the state back in” at the forefront of the economy through new ways of exercising control. The most important work seeking to grasp the possibility of the state’s return to the economy in the early post-communist era is David Stark’s. In his analysis of “recombinant property” in Hungary (Stark 1996) and of “business networks of partisan firms” in that same country (Stark and Vedres 2012), he examined how political actors in the postsocialist context are rebuilding organizations and institutions not on the ruins but with the ruins of communism. His conception of path dependence “does not condemn actors to repetition or retrogression, for it is through adjusting to new uncertainties by improvising on practiced routines that new organizational forms emerge” (Stark 1994, p. 48).

Thus, the literature on the Eastern European experience does partially address one side of my argument—how the domestic political struggle might influence privatization—though these works more readily envision a freeze in the reform process part way rather than a possible reversal. Additionally, the focus of this entire work is exclusively domestic. The international dimension is hardly addressed.\(^9\)

The importance of foreign consultants is well established within the literature (Meaney 1995) and part of these works on the region were actually written by these consultants themselves (see Aslund 2012; Lipton and Sachs 1992; Sachs 1991, 1992). Yet, what the literature on the foreign influences on the policy process in the postsocialist context takes for granted is the unmediated, overwhelming effect that the West had on this process. In Appel’s (2004) account it seems there was no choice.

\(^9\) Whitehead is a notable exception looking at the international dimension of democratization in Latin America and Europe (Whitehead 1996).
and that this neoliberal ideology was the only defining factor exerting an invariable pressure on the policy process.\footnote{Outside Eastern Europe the story is more nuanced. The states of the former Soviet Union seemed to have a wider variety of paths (Darden 2009).} This approach cannot account for the early abandoning of these market friendly policies in Russia (in 1992) or the fact that many countries tailored the policy suggestions to their own situation and not all of them began or completed the reforms at the same time. For example, while in Romania strict retrocession of land to pre-Communist owners was feasible and done on a large scale (Verdery 2004), nothing like this was possible in places as diverse as Hungary and Ukraine (Allina-Pisano 2007).

These limitations in the literature mean that many recent developments in the political and economic landscape of the region cannot be fully explained. While the optimism of the early literature resulted the notion that the end point would most likely be full democratization and market capitalism, this strongly held view was proven incorrect by a few prescient voices\footnote{Przeworski, Stiglitz, Cohen, Gray, Murrell} as well as the some of the region’s recent divergence from the path to capitalism and democratic backsliding (Bermeo 2016; Dresden and Howard 2015; Krastev 2016). Only with an eye on these differences can we explain the divergent trajectories across Eastern Europe—with Hungary reversing many of its privatization policies (Djankov et al. 2015), Romania abrogating 1600 privatizations (Wellhausen 2015b) and Poland following in Hungary’s authoritarian tendencies (Krastev 2016).

The state reassertion in economic matters goes hand in hand with developments in the domestic political arena.\footnote{In a separate research project I show the link between the populist approach to politics and how that is translated into a stronger grip on power and economic matters. With populists coming to power in places such as Hungary, the Czech Republic and Italy, the populist modes of governing come more prominently into view.} Throughout Western and Eastern Europe we have
witnessed electoral victories of far right parties espousing nationalism, populism and extremism (Golder 2016; Ivarsflaten 2005, 2008; Kitschelt and McGann 1997; Mudde 2016). Even though many of these extremist parties come from the right, which would mean they would espouse a much more free-market view of economic policy, the nationalistic element to the platform of these parties has resulted in political programs promising a reassertion of the state in economic matters as protection against the vagaries of the international market (Golder 2016), and a new attempt to “rebuild Leviathan” (Grzymala-Busse 2007). Support for reversal of privatization and state redistribution of former state property now under private control have been seen in public opinion polls both in the World Values Survey and the EBRD Life in Transition surveys (Denisova et al, 2009; 2012). It was only a matter of time before they became important fixtures in the electoral campaigns of parties in the region.\(^{13}\)

A second part of my argument links this domestic evolution to international financial pressures and backlash against liberalization policies. Reform fatigue and the pressures of accession in the European Union have been among the elements of the political backlash in Eastern Europe (Krastev 2016). But the effects of the 2008 financial crisis are important factors in this equation. The political evolution of Greece as well as the nationalization of pension funds in Hungary have been directly linked to the consequences of the financial crisis (Datz and Dancsi 2013).\(^{14}\)

As the 2008 financial crisis put renewed pressures on domestic economic policies of the regionally integrated economies of the EU area, the newest members of the group felt like they were losing out in terms of EU benefits as they had to enact draconian

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\(^{13}\) None of these developments would automatically mean that the country would also see an erosion of democratic institutions. Research on Hungary, Poland and other countries in the region show that a concentration of power in the economic sphere usually follows a similar concentration of power in the political sphere (Bermeo 2016; Dawson and Hanley 2016).

\(^{14}\) This was confirmed by my field interviews, July 2016, Budapest, Hungary.
austerity measures (Blyth 2013; Hobolt and de Vries 2016; Treib 2014) while also contending with the flight of foreign invested capital back to the European capitals it had originated from.\textsuperscript{15} Those who saw themselves as the losers of the financial crisis reacted by supporting leaders promising reversals of European-sanctioned policies that had been acceptable sometimes only months before.

4.3 Exit from communism

The region experienced a variety of exits from communism, from roundtable talks in Poland to violent removal of the dictator in Romania. In economic terms all countries experienced some sort of initial severe economic shock.\textsuperscript{16} There are two possible explanations for the initial economic depression. The first explanation is that the drop is a natural progression from adopting shock therapy as it happened in Poland where following “Washington consensus” policies\textsuperscript{17} prices increased by 179 percent while

\textsuperscript{15} Interviews, Budapest, Hungary July 2016 and January 2017.

\textsuperscript{16} Some economists such as Anders Aslund argue that the output decline did not happen or was not as severe as reported, that is was due to Communist era overreporting of GDP and industrial output rather than a consequence of reforms (Aslund 2002). On the other hand Kornai (1995) argued that the fall in output for which there is no demand is instantaneous, but recovery from new sectors or activities takes time, particularly when it depends on the emergence of new enterprises and new infrastructure.

\textsuperscript{17} The term “Washington consensus” was first used by John Williamson to refer to the typical IMF conditions for financial help for Latin American countries suffering from economic imbalances (Myant and Drahokoupil 2011). These conditions could be summarized in a 10-point package of “prudent macroeconomic policies, outward orientation and free-market capitalism” (Williamson 1993) emphasizing fiscal discipline, liberalization, deregulation and privatization. The economic reforms often required by Western donors and institutions included three major policies. First was the creation of market competition based on “deregulation of prices, free trade, full liberalization of the private sector and the demonopolization of the state sector” (Lipton and Sachs 1992, p. 351). The second was a drive to privatization of state property. A significant part of the industry could be denationalized immediately; small and medium enterprises, particularly in retail trade. The third policy was to handle the disruptive effect of short-term unemployment and poverty for which Western donors could provide support (Lane and Myant 2007).
wages dropped by 56 percent and consumption by 58 percent (Myant and Drahokoupil 2011). Another cause for the depression was the loss of economic ties within the Communist bloc, Soviet subsidies and artificial consumption of much of the industrial output. Hungary for example did not implement shock therapy yet suffered from the shock of losing access to Communist markets (Myant and Drahokoupil 2011).

The exit from Communism resulted in extensive economic reforms required by Western donors. The conditionality of IMF support gave the agency a strong word on how reforms were carried out. The fear of losing Western help and the hope that more funds would be available ensured that outright opposition to the Washington consensus never took off in any of these countries. The debate—if it happened—was usually about how fast the reforms should be implemented—shock therapy vs. gradualism. And the countries in the region—while still pursuing large-scale liberalization—took varied approaches in their transition trajectories (Bohle and Greskovits 2012; Stark and Bruszt 1998). Poland was the trendsetter in the region with its aggressive shock therapy approach and extensive use of international donors to financially support the transition. Czechoslovakia and the Baltic states also followed the Polish path with similar economic downturns in the first years of the transition. Hungary on the other hand could afford to take a more gradualist approach as it had already embarked on reforms before the fall of Communism. Slovenia followed the Hungarian path (Myant and Drahokoupil 2011).

The early period of the transition was a time of intense activity and the entire region was a beehive of political and economic progress. There was almost an informal competition among Central and Eastern European countries in achieving quicker and deeper reforms (Szanyi 2014). Considering that faster progress meant more FDI and

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18 The influence of Poland’s first minister of finance in the Solidarity-led government was a crucial factor in deciding the pace of reforms (Balcerowicz 1995).
access to IMF funding, the competition was intense. Getting positive evaluations on the EBRD privatization scoreboard was a goal for most Eastern European governments which meant there were strong pressures to reduce the extent of public ownership. The extent and proceeds from privatization in Figures 4.1 and 4.2 show the pace of reforms in different countries as well as the bigger pushes for privatization in mid 1990s and early 2000s. In Figure 4.1 Romania seems to take over Hungary in terms of sheer privatizations which is due to a center-right coalition coming to power after the Social-Democratic party had stalled privatization as their support came mostly from those opposed to the rapid transformation of the economy. While Romania did privatize extensively, the proceeds are small as can be seen in Figure 4.2. For all the 1225 Romanian privatizations the value of proceeds is missing for 92.65 % of the observations, whereas of the 1039 privatized Hungarian SOEs we only miss the value.
Figure 4.2: The cumulative size of privatization revenues in some Central and Eastern European countries (1989-2008).

Data sources: World Bank Privatization Database.

Note: The graph traces the post-communist trajectory in a comparative perspective.

of proceeds for 14.82 % of observations. For example Poland, which seems to have more proceeds from privatization (Figure 4.2) only has 8.38 % values on proceeds missing which is 45 observations out of 540 privatizations.

The following section explores in detail the case of Hungary as an example of how privatization took place at the intersection of domestic politics and international pressures as well as the subsequent shift toward greater state ownership in the economy.

4.3.1 The privatization process through the lens of the Hungarian experience

During the first decade of transition Hungary took the lead in privatizations across the region, partly due to the market-friendly policies taken under the so-called “goulash
communism" (Kornai 1996). The country had the advantage of gradual previous economic openness as well as contacts with Western financial institutions. While countries such as Romania used every resource of the country to pay the external debt which meant Romania emerged from Communism weak and fighting to overcome the anarchy of the previous regime, Hungary had long established contacts and an easier way to access foreign investments.\(^{19}\)


The first years of transition were marked by “spontaneous privatization." According to the 1988 Law on Transformation,\(^{20}\) state owned enterprises (SOEs) had to transform their legal status to an incorporated company. This meant that the ownership structure of 2200 SOEs had to be changed. As part of the economic reform process, the last Communist government intended to improve incentive systems by commercializing SOEs and providing effective ownership for them. Soon, state assets were transferred from SOEs to various private businesses, mostly owned by corporate managers. Through this act, SOEs were no longer under the direct control of the Communist Party and the state bureaucracy, but no effective new ownership was introduced (Bartlett 1997).\(^{21}\)

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\(^{19}\) Yet this also meant Hungary had a large level of external debt. Orbán often mentioned this debt in his speeches as a way through which foreign influence is leveraged against Budapest, forgetting the debt also helped the country grow—which happened much faster in Hungary than in any other former Communist country.

\(^{20}\) The full name was Act XIII of the 1988 Transformation of Economic Organizations and Economic Associations. Commonly referred to as the Transformation Act, this piece of legislation has been amended repealed and finally included in the Act LIV of 1992 (Smit and Pechota 1994).

\(^{21}\) In 1989 the estimated value of state-owned productive assets in Hungary was about 2 trillion Forints (USD 24 billion at the time). By July 1994, 47% of these assets had been
a clear ownership structure, Stark argues that in the Hungarian context property transformation "does not necessarily clarify property rights. ... [T]he emerging new property forms in Hungary blur (1) the boundaries of public and private, (2) the organizational boundaries of enterprises, and (3) the boundedness of justificatory principles" (Stark 1996, p. 997). To denote these processes of triple boundary blurring he adopts the term recombinant property as "a form of organizational hedging, or portfolio management, in which actors respond to uncertainty in the organizational environment by diversifying their assets, redefining and recombining resources" (Stark 1996, p. 997).

This practice of asset stripping was stopped only after the new (noncommunist) government under Prime Minister József Antall set up the State Privatization Agency (SPA) (Állami Vagyonügynökség) in 1991 that was also charged with overseeing the process.\textsuperscript{22} Asset stripping was stopped effectively by the establishment of this agency, since SOEs were forced to inform the SPA and get its permission for all transactions above a certain value limit. This regulation also hampered SOEs economic activity, since the agency had only limited personnel capacity (Major, Vezzoni and Szalavetz 1999). Another criticism leveled at the agency was that its employees received performance bonuses for privatizing companies, which meant it created incentives to privatize enterprises at lower prices than normal just to get the enterprises off the state's books (Earle et al. 1993).\textsuperscript{23}

\textsuperscript{22} In February 1992 the government nominated a new minister without portfolio (Tamas Szabó) to be in charge of privatizations. He became the real head of the SPA, directly intervening in many of the individual transactions handled by the agency. This represented an attempt to change the direction of the internal operations of the agency from a technocratic orientation to a political one (Tökés 1996).

\textsuperscript{23} However, governments often privatized for very small sums under deals with the new buyers that jobs would be preserved even after privatization and restructuring.
Soon after these changes, intentional privatization began. The SPA preferred the method of sale to the highest bidder, but simultaneously provided avenues for alternative methods. For example, partial restitution was organized in form of coupons, a kind of security that could be used in the purchase of state assets. Some large manufacturing firms and banks were introduced on the Budapest Stock Exchange, and their shares were sold at discounted rates to interested Hungarian citizens. These transactions had only a marginal effect on the Hungarian privatization experience. The largest impact came when the SPA sold a number of its most lucrative large firms to foreign investors. For example, Tungsram, the internationally known lighting industry firm was sold to General Electric, whereas Chinoin, one of the most successful pharmaceutical companies, was purchased by Sanofi. These deals were precursors to the main stage of the Hungarian privatization process (Schamis 2002; Szanyi 2014).

The bulk of privatization was carried out in the 1994-1998 term of the MSZP socialist government with strong links to incumbent managers. In spite of this socialist return, the privatization process continued smoothly as international actors were closely monitoring the situation. There was consensus among parties and within society concerning the main directions of political and economic transition, including privatization, supporting the international waves of liberalization hypothesis. The opposition criticized some aspects, especially the strong involvement of foreign investors (Stark 1996; Urban 1997) but the process continued.

24 Similarly in Poland a Socialist government continued the Balcerowicz era liberalization reforms and privatization in spite of their leftist leaning.

25 Throughout the region there was a wide variety to the extent that foreign investors were involved. In the case of Russia foreign investors were deliberately kept away from the most important assets being privatized through insider deals. Hungary was at the opposite side of the spectrum with foreign involvement early on. Most countries adopted a gradual approach where foreign investors were mostly sought out several years in for the most important—and often least performant—enterprises.
In terms of the domestic political struggle Urban (1997) finds that the process of change from 1988 to mid-1994 can best be understood in terms of the government's efforts to accommodate managers while pursuing its own electoral advantage. For Urban, "the strategic interaction between political and economic actors, and the credibility of the formal rules that result provides the framework for analyzing the role of politics in shaping the development of economic institutions in Hungary" (Urban 1997, p. 239). Moreover, as politicians gained experience, they came to recognize opportunities for modifying the privatization strategy for electoral advantage (Stark and Bruszt 1998). The result was the addition of many distributive elements to the initial program of competitive sales.\(^{26}\) Thus, privatization evolved according to political considerations from the initial starting conditions under spontaneous privatization (Urban 1997, p. 254). In spite of these political pressures on the privatization process, Hungary performed very well and quickly compared to the rest of the region both in terms of sheer number of enterprises privatized (Figure 4.1) as well as privatization proceeds (Figure 4.2).

On the international dimension Hungary was in an exceptionally favorable position compared to the other countries in the region in terms of access to foreign direct investment because of the economic reforms it implemented during the two previous decades (Kornai 1996), which made it much easier for foreign investors to do business there. However, the country also needed to attract foreign direct investment to

\(^{26}\) This more distributive program appears to be the result of successful lobbying by some academics and professionals, together with the leaders of small trade unions, who were allies of the Hungarian Democratic Forum. They persuaded policymakers that the program would gain widespread support among skilled workers if these provisions were included. Thus, the program appears to be part of an effort by the government to broaden its electoral support. An indication of this is the fact that the program advanced rapidly in the six months before the elections of May 1994. Whereas by the end of October 1993 there were sixty-five companies privatized in the program, by the end of May 1994 the number of companies involved had increased to 169 (Schamis 2002; Urban 1997).
help with Hungary’s external debt, which meant that large amounts of direct foreign investment could be injected in the economy by continuing the process of privatization through competitive sale, even during the period of the introduction of complementary distributive mechanisms (Schamis 2002).27

Table 4.1: Ranking of the leading post-communist states in Foreign Direct Investments, 2007 and 2014 (million euro).


*Note:* Equity, reinvestment of earnings and debt instruments excluding special purpose entities (SPE).

<table>
<thead>
<tr>
<th>Inward FDI</th>
<th>Outward FDI</th>
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<td>Estonia</td>
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<tr>
<td>Czech Rep.</td>
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<tr>
<td>Croatia</td>
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<tr>
<td>Hungary</td>
<td>6475</td>
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<tr>
<td>Slovakia</td>
<td>5405</td>
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</table>

Overall, both in Hungary as well as other Eastern European countries the process of privatization was considered successful. These countries were faring much better than other former Communist countries to the East or in the Balkans. This success made the later shift that much more surprising.

4.4 Reverse wave

Joining the European Union was one of the early and most important goals most of the countries in Eastern Europe focused on—in addition to joining NATO. Accession to these European and transatlantic institutions was collectively seen in the region as the surest way for these countries to achieve democracy and market capitalism (Tucker,

27 See Table 4.1 for an overview of Hungary’s regional standing in terms of FDI. The table shows that even though it was not the top recipient of FDI in the region, Hungary was still very competitive and managed to attract investments even in 2014 when the Orbán government had already started to enact nationalizations and made it clear that some sectors were off limits for foreign investors. (See chapters 5 and 6.)
Pacek and Berinsky 2002; Wagner 2012)—or at least a break from the authoritarianism and collectivism of the Communist era. The EU especially was seen as a stable and prosperous area that Eastern Europe had been barred from when the Iron Curtain was imposed. Both active and passive conditionality (Vachudova 2005) of the accession process allowed the EU to substantially affect the outcome of the transition process in the region, but the inconsistency and lack of precision in the Union’s membership criteria meant this process did not live up to its potential as a transformative force (Grabbe 2015; Pridham 2005).

Throughout the entire process there was substantial consensus among regional elites that EU membership benefits outweigh possible disadvantages (Epstein 2008). That means representatives of the main parties in member states and candidate countries supported the EU in general, and a withdrawal from membership or candidate status was not a realistic or expected option (Hooghe 2003). This consensus about the importance of the EU for the future of the region was shared by both elites and ordinary citizens. In Figure 4.3 we see that the World Values Survey conducted between 1994 and 1998 in Eastern Europe found citizen confidence in the EU to be above 50 percent in all but the Czech Republic and Slovenia where it hovered at 42 and 48 percent respectively. This substantial regional consensus changed dramatically as the strictures of the accession process were felt more acutely.

The early “permissive consensus” (Braun and Tausendpfund 2014) soon changed. In the next wave of the WVS between 1999 and 2004 only Hungary and Slovakia had over 50 percent confidence in the EU, with most countries having dropped at least 10 percentage points in EU confidence (Figure 4.4). The wave of the study conducted after accession captured the optimism of the period when the benefits of

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28 In all the graphs darker shades denote worse opinions on the EU.
Figure 4.3: Changes in confidence in the European Union across Eastern Europe (1994-1998).

Source: World Values Survey and European Values Study.

joining the EU were clear and visible (Guerra 2013), though in some cases such as Slovenia confidence in the EU dropped to about 35 percent.

Figure 4.4: Changes in confidence in the European Union across Eastern Europe (1999-2004).

Source: World Values Survey and European Values Study.
The 2008 financial crisis had a chilling effect on economic development and spurred fears related to the policies imposed by the EU through the accession process that might mean states cannot implement purely national policies but must abide by the European framework. Being part of the EU meant maintaining specific macroeconomic targets that would have alleviated the economic problems of the country if some of those policies were changed.\textsuperscript{29}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{confidence_hungary.png}
\caption{Changes in confidence in the European Union in Hungary.}
\textit{Source}: World Values Survey and European Values Study.
\end{figure}

Another set of questions in that same wave of the study shows how specific fears associated with the EU weakened the institution’s standing in Eastern Europe.\textsuperscript{30} These questions in particular show how Eastern European citizens no longer feel the original benefits of joining the EU—structural funds had become part of everyday life

\textsuperscript{29} The chapter on Hungary delves more deeply into those policies. In Figure 4.5 we can trace this change throughout the entire period and see the steady decline in Hungary.
\textsuperscript{30} Specific economic questions in particular are very telling as economic factors become more prominent for researchers during crisis time (Braun and Tausendpfund 2014). Those economic fears questions were asked for the first time in the 2010-2014 WVS study wave.
rather than the lifeline helping many of the region’s governments sustain their levels of spending.\textsuperscript{31}

In the period of 2010-2014 several fears related to the EU became present concerns for the people in Eastern Europe. Asked if they were afraid of losing their jobs citizens in almost all countries reported high rates of such fears, with Latvia, Slovenia and Hungary among the countries with the highest levels of worry (Figure 4.6).\textsuperscript{32} Asked about fears of losing social security, similar levels of fear were present throughout the region. In both these categories Bulgaria, Poland and Romania do not seem to follow the trend in the rest of the region.

Finally, a fear directly associated with the EU which has also been present throughout the rhetoric in the region is related to contributions to the EU budget. In the first budgetary cycle since their accession Eastern European countries had access to substantial amounts of money set aside specifically for new member states. Countries in Eastern Europe have not all been equally adept at attracting these funds, but they have also benefited enormously from these substantial amounts of money, with countries such as Hungary financing most of the growth in recent years through EU funding. As these countries leave the category of new member states, their financial benefits drop, while they have to continue contributing to the EU budget.\textsuperscript{33} Eastern European citizens seem very worried about the possibility of

\textsuperscript{31}Sometimes to counteract the fact that new member states citizens were not aware of the size of investments the EU was making in a country European officials started putting large signs at sites of important European investment projects in order to raise awareness (Interview with European Bank for Investment official at their office in Budapest, January 2017).

\textsuperscript{32}While these numbers support my argument it is important to note that questions that invite easy blaming and complaints might give misleading results. If these questions asked whether loss of job could be associated with the EU, globalization, government policies etc, and the EU was picked then we might get a less biased view of the actual fears associated with the EU.

\textsuperscript{33}Contributions to the EU budget are points of contention not only in Eastern Europe, Britain’s contribution to the EU budget was a major point of the “leave” campaign for
contributing too much to the EU budget with countries such as Hungary, Latvia and Slovenia having as much as 80 percent of the population worried about this budgetary burden (Figure 4.7). Citizens in Romania and Bulgaria are less worried as they joined later and still have some more time to access substantial EU funding. Overall across Eastern Europe about 70 percent of the people interviewed reported feeling worried about contributing too much to the EU budget.34

While worries such as these are natural, and they can be found throughout Europe, such a dramatic shift in support for the EU does not bode well for the future of the Union, particularly as people start to forget the reasons they originally decided to

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34 The question could have been formulated better as it is hard to tell what is “too much” versus too little, thus leading the surveyed population toward overstating the level of “fear.”
create the organization and the benefits of its existence become less visible in time (Guerra 2013).  

The lack of enthusiasm of EU citizens has also been mirrored by the elites. Elite and social consensus is required for the new states not only to carry out the reforms, but also to maintain the pace of EU integration after accession (Epstein 2008; Korkut 2012). In recent years the number of political parties adopting an anti-EU or euroskeptic stance (Kopecký and Mudde 2002; Szczerbiak and Taggart 2008) has increased and they have become more vocal.

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35 The original mission of the institutions that led to the European Union was the prevent another war in Europe by creating a space of shared economic prosperity initially started by integrating the steel and coal productions of France and Germany in formally established in 1951.
In Western Europe rising public euroskepticism has been articulated mainly by extreme parties, with only modest evidence that mainstream parties have responded by muting their support for integration (Rohrschneider and Whitefield 2016). In Eastern Europe, criticizing the EU to your domestic audience and proclaim to be fighting against the forces of the EU has been increasingly appealing in most countries helping euroskeptic parties become governing parties in places such as Hungary, Poland and the Czech Republic.

In the next section I supplement this broad view of shifting social support for liberalization, privatization and support for the EU across Eastern Europe with detailed data from Hungary.

4.4.1 THE SOCIAL ORIGINS OF NATIONALIZATIONS IN HUNGARY

How do we explain these shifts in Hungary? What social coalitions gave Fidesz the support to carry out extensive economic and political reforms contrary to those followed by previous governments—including a previous Fidesz government also headed by Viktor Orbán? As mentioned in the previous chapters, political parties that come to power on an agenda of shifting away from privatization and liberalization do so in a context of increasing populist appeals and economic disenchantment with global-

\[36\] Extreme parties have become distinctly more euroskeptic, in part because stable extremist parties are more anti-Europe than they were before the crisis, in part because new extremist parties are especially opposed to the EU. In contrast, the position of mainstream parties has only marginally moved toward more restrained support for integration (Rohrschneider and Whitefield 2016). Larger parties are more responsive to the public euroskepticism (Williams and Spoon 2015). This explains why euroskepticism is emerging mostly from small extremist parties, or large parties that are challenging governing parties but need to boost their voter appeal and thus borrow the anti-EU rhetoric of more extreme parties (Meijers 2017). This explains the populist victory in Italy and Austria.

\[37\] The next chapter adds to this story the political and economic circumstances of this story.
ization and economic openness. In Hungary some of the roots for the popular appeal of Orbán’s campaign can be traced back to the privatization process itself.

While the process went quite smoothly and with few major scandals in the way privatization was carried out, at the end of the 1990s there was a feeling that perhaps the people in power at the time did not do the best job in transitioning the country from Communism to market capitalism. Because Hungary had been partially integrated in the Western economic system, its companies and products could—theoretically—live up to the standards required by the international market. This created popular expectations that Hungarian companies could be privatized for high market value. The government repeatedly attempted to sell the most important Hungarian companies at prices much higher than foreign investors were willing to pay (Earle et al. 1993). But in the end the government did not get as much as it thought it could have for the most important companies emerging from Communism. Both government officials and the population had much higher expectations from the process. Even though the process went better than in other places such as the Russian Federation, it still left a large number of people questioning the validity of the process and its outcome. The conclusion many ordinary Hungarians reached was that the government had sold out to foreign capitalists.  

The early days of the transition—though difficult for the larger population—still held the promise of better days ahead. As the 1990s reached an end much of this initial enthusiasm evaporated with only the promise of entering the EU keeping the momentum going. However, deep within the population feelings of anti-market resentment were building up (Epstein 2008).

The best way to trace this shifting allegiance to market processes is through large scale surveys conducted in Hungary. The World Values Survey and the Euro-

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38 Interview, February 2017, Budapest.
Which type of ownership should be increased?

Note: The scale goes from private property (1) to state ownership (3).

Figure 4.8: Population opinions with regards to private versus state ownership in Hungary.

Source: World Values Survey and European Values Study

The European Values Study conducted several rounds of surveys in the country, capturing the changing popular beliefs and opinions about state versus private ownership (Inglehart et al. 2014). With studies conducted in 1989-1993, 1994-1998, 2005-2009 and 2010-2014, using a consistent set of questions we can trace this change in attitudes. For the question “Which type of ownership should be increased?” with 1 being private property and 10 being state ownership, the attitudes of ordinary Hungarians changed dramatically in this period of time. From the earliest study where a majority of the respondents said they prefer private property, the recent trend has been for a demand in higher levels of state ownership. Figure 4.8 shows that while private property was popular in the early 1990s, the 2000s saw an increase in popularity of a much more statist approach to economic matters.

These findings are corroborated by another large-scale study, the EBRD “Life in Transition” study that included a question on private versus state ownership in its
Figure 4.9: Population opinions with regards to private versus state ownership (2010).

Source: Life in Transition 2010 EBRD study.

Text of the question: Now I’d like you to tell me your views on various issues. How would you place your views on this scale? 1 means you agree completely with the statement on the left; 10 means you agree completely with the statement on the right; and if your views fall somewhere in between, you can choose any number in between. (1) Private ownership of business and industry should be increased; (10) Government ownership of business and industry should be increased.

As can be seen in Figure 4.9 Hungarians were substantially in favor of state ownership by 2010 when Viktor Orbán came to power. The most extreme level of state ownership that the respondents could choose was a clear winner out of all the options offered. Few other countries in the region experienced this degree of reversal in opinion. Such a change might be a sign of things to come. Compared to opinions on

39 See Denisova et al. (2009) and Denisova et al. (2012) for an extensive analysis of the 2006 Life in Transition study.
**Figure 4.10: What should be done with privatized companies (2006).**


*Text of the question*: In your opinion, what should be done with most privatized companies? (1) Renationalize and kept in state hands; (2) Renationalize and then reprivatize using more transparent processes; (3) Left in the hands of current owners provided they pay what they are worth; (4) Left in the hands of current owners with no change.

The same question from other Eastern European countries, Bulgaria seems to follow most closely to the path of Hungary. The Czech Republic is the most staunchly pro-liberal of all the region’s countries with Romania close by. While Slovakia and Poland show a much more even distribution of opinions, domestic trends in these countries might skew the center in favor of more statist stance.\(^\text{40}\)

\(^{40}\) In a separate paper I conduct an extensive statistical analysis on who were the groups that changed their opinions the most drastically in Hungary and elsewhere to result in reversal of economic policies. Preliminary findings point to the elderly, men and those working in the state sector as the main supporters to a return of the state in economic matters. On a subsample of the surveys conducted after the financial crisis I also find that those who owned property were also more likely to support the state stepping in as a result of the banking instability during the crisis and most likely the foreign currency loans crisis (more on the impact of the financial crisis in Chapter 5).
Using another question in the Life in Transition survey one can get even closer to popular discontent with the privatization process of the 1990s. A 2006 the survey asked whether privatization should be reversed with different options such as complete renationalization of privatized assets under state control, renationalization and then reprivatization of those assets, or maintain asset control under current ownership.\footnote{Unfortunately this question was only asked in 2006 with no follow up after the financial crisis.}

The most striking thing about Figure 4.10 is that an overwhelming majority in all the countries in the region favors some sort of privatization reversal–paying fair market price is one of the most popular options even though it is not practical.\footnote{It is telling how much people misunderstood the privatization process that most respondents think that such a thing as a “fair market price” existed for an enterprise at the end of Communism. Not only was there no real market to talk about, but often the companies being sold off were under-performing and valuable only in the Communist context. Governments sold entire industrial complexes employing thousands for 1 dollar not because the company was worth 1 dollar but because the investor taking up the company had to find a market use for the products being produced, keep most people employed at least for a period of a few years after taking over the company and it released the government from having to continue to bankroll an unreformed Communist company. With the exception of the very cheap price some Russian businessmen payed for the oil companies that turned them into oligarchs, selling a Communist company for so little money made sense at the time and it didn’t mean that the government was letting the voters down.}

Yet, the option to renationalize under state control is still over 10 percent in all countries and over 30 percent in Bulgaria, Hungary and Slovakia. This is a significant result as both versions of renationalization give the state power over important assets in the economy–either to continue controlling under state ownership or reprivatize as best it can.\footnote{As shown in the next chapter when this second option was implemented in Hungary the winners of the renationalization and reprivatization were not just native Hungarians, but Hungarians closely associated with the Orbán regime.}
4.5 Regional processes and regional hegemons

In my discussion so far I contend that the privatization and nationalization waves experienced by Eastern Europe were region-wide phenomena and both the quantitative results of my statistical chapter as well as the historical overview of this chapter support this claim. An additional explanation for the regional spread of these processes could be not just diffusion but learning. Countries could be learning from a regional hegemon the rules of engagement—which sometimes promote privatization and at other times promote nationalization.

The impact of a regional hegemon for Eastern Europe in privatization and nationalization goes back to the initial wave of nationalizations following World War II when several of the region’s Communist regimes were installed through the direct intervention of Moscow. Following the Communist take over of governments across the region the state shortly became the sole owner of the assets in the economy through country-wide nationalization campaigns (Kornai 1992). Without the Soviet presence looming over the nationalization process and fighting to keep the system running for the next decades several if not all of the countries would have moved away from it much sooner the way Hungarians tried to do in 1956 and the Poles attempted in 1981.

With the collapse of the Soviet Union no true regional hegemon emerged (Bunce 1989). Language barriers and distrust of neighbors are deeply ingrained in a region where territorial disputes resulted in populations not matching neatly with borders. This means that Eastern European countries are less likely to follow the example of a true regional hegemon.\textsuperscript{44} The fact that no country is economically stronger than the rest also did not help in creating a regional hegemon. Thus, for the post-Communist period we do not see a regional hegemon but rather a global one also playing a regional

\textsuperscript{44} For example, if the Poles achieved success it is less likely the other countries in the region would readily take Warsaw’s lead.

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role. The impact of US foreign policy initiatives and US-led financial institutions represented the impetus for the privatization wave of the early 1990's. In the early 2000's that role was played by the EU with many of the reforms being enacted as part of the accession process to the European Union. As discussed earlier in this chapter the influence of these international actors combined with eager local leaders to create the privatization wave.

Whether a regional hegemon played a role in the reverse wave toward nationalization is examined more closely in the next chapter where I look at the waning influence of Western institutions such as the IMF and the EU as well as the resurgent role Russia and China play in the region’s economy. It is possible that the strong control the Kremlin has kept over strategic industries and assets was an inspiration for Hungary’s Orbán who has often expressed admiration for Vladimir Putin. While Russia could be an example that other Eastern European leaders have emulated, the country is no longer the regional hegemon it used to be during Communism. Russia is still a regional hegemon but mostly in the countries that used to be part of the Soviet Union—excluding the Baltics. The Eurasian Economic Union is the kind of project that a regional hegemon would enact, but nothing similar is likely to take place in Eastern Europe (Kirkham 2016).

Regional factors are important in privatization and nationalization waves. I proved this particular hypothesis through the statistical analysis of Chapter 3. In this chapter I examined the possible mechanisms of this hypothesis. By analyzing Eastern Europe’s privatization and nationalization story I show the impact of diffusion from neighbors. An additional factor explored here is the role of regional hegemons. The Soviet leadership mattered in getting state ownership enshrined across the region. US and Western European influence proved crucial for initiating and sustaining the privatization wave of the 1990s. While there doesn’t seem to be a regional hegemon promoting national-
izations right now some regional leaders claim to have followed the Russian example. Chapter 6 examines more closely these alternative models and their impact on the nationalization wave.

4.6 Conclusion

This chapter has been a bridge between the global statistical analysis and in-depth country analysis. I examined the literature on political and economic transitions in Eastern Europe, showing how my study improves upon the assumptions of that scholarship by focusing on the domestic political struggle that might produce the possibility of a reverse wave. The rest of the chapter examined the process of privatization and the social origins of its reversal across Eastern Europe and Hungary in particular. The impact of regional-level hegemons was also included.

Studying the regional dynamics supports the regional hypothesis of this project and the findings of the previous chapter where I looked at diffusion effects at regional level for waves of privatization and nationalization. Eastern Europe allows for the study of such a wave in the context of the changes that occurred in the region following the collapse of Communism.

This chapter also builds on the hypothesis that changing domestic attitudes results in new coalitions of support for a specific policy. By looking at how the privatization process was conducted and the later disenchantment with it by a large segment of the population—tested through responses to large scale surveys—I was able to show that a new wave of support for greater state ownership in the economy has been forming in Eastern Europe.

Next chapter examines in-depth how the reverse wave took place in Hungary with detailed studies of energy, utilities and banking to show the mechanisms that drive
the state’s return in the economy. Within the story of the reverse wave in Hungary I point to political actions that could create the backlash necessary for a new coalition to emerge against the current state-driven economic model, thus leading to a future new wave—this time toward economic liberalization and privatization.
Chapter 5

Domestic Factors

5.1 Introduction

Given that Hungary was one of the most successful early transition economies, its democratic backslide, institutional instability and shift in economic reforms exemplifies the puzzle at the center of this project: privatization can give way to nationalization. This chapter is an in-depth exploration of the domestic factors leading to the dramatic return of greater state ownership in economic matters. The story of the initial decision to privatize as well as the reversal of this process through nationalization will be told focusing on the intersection of domestic politics and international factors (Chapter 6). By focusing on a single case this chapter allows me to show how domestic and international factors interacted. This chapter builds on the sections on privatization and on the social origins of nationalization discussed in the previous chapter by briefly discussing Hungary’s political situation during transition. Next, I analyze the policies enacted under Viktor Orbán in particular the nationalizations that have taken place giving a special emphasis to nationalizations in the energy, utilities and banking sectors.

Across the final two chapters the main case study is Hungary, with examples from other countries. Chapter 6 in particular is region oriented, as the international factors apply more uniformly across the region. In order to fully understand the domestic
intricacies of the changes in Eastern Europe Chapter 5 mostly focuses on Hungary to give the full spread of policies for domestic actors.

Hungary is an illustrative case for the extent and variety of its policies. However, there is an argument to be made that this chapter is selecting an exceptional case. Hungary is the country that has seen the most dramatic changes, making it possible to claim this study is selecting on the dependent variable. As I show in Chapter 3, similar waves have already happened in an extensive way across the world. In Eastern Europe Poland and the Czech Republic are now learning from the Hungarian experience, while Russia has been on a veritable yo-yo trajectory on privatizations and nationalizations and the line between public and private is constantly blurred.\(^1\)

5.2 Political evolution in Hungary or how Fidesz came to power

Hungary’s exit from Communism allowed it to benefit from reforms enacted during the previous regime under the banner of “goulash Communism." This early positive evolution of Hungary in the 1990s does not help to explain the dramatic reversal that occurred in the mid-2000s.

Fidesz\(^2\) and Viktor Orbán have been a staple of Hungarian politics from the first days of post-Communism. Orbán has been a member of Parliament since 1990. In 1998, he formed a successful right-wing coalition with the Hungarian Democratic

\(^1\) While the post-Soviet push for privatization brought about 80 percent of the Russian economy under private control (Blasi, Kroumov and Kruse 1997), the ascent of Putin and the shift from crony capitalism to state capitalism changed the situation (Djankov 2015). By 2015, about 55 percent of the Russian economy was in state hands, with 20 million workers directly employed by the government (Aven 2015), and the Yukos case was the watershed moment that changed the earlier tide of privatization (Djankov 2015). Today some of the numbers on the state’s share in the Russian economy go as high as 70 percent (Szakonyi, 2017) and the informal nature of much of the Russian economy does nothing but bolster the state’s reach (Gaddy and Ickes 2002; Ledeneva 1998, 2006).

\(^2\) An acronym for Fiatal Demokraták Szövetsége or Alliance of Young Democrats.
Forum (MDF) and the Independent Smallholders, Agrarian Workers and Civic Party (FKGP). Together they won the 1998 parliamentary elections with 42 percent of the vote, subsequently making Orbán the second youngest Prime Minister of Hungary at 35, serving between 1998 and 2002. The party enacted a slew of measures that centralized power and gave the prime minister increased responsibilities. Additionally, corruption scandals rocked the political stage and the governing coalition which resulted in the return of the socialists to power in 2002.

Table 5.1: Politics of Hungary. Source: Magyar (2016)

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1945-1989</td>
<td>Hungary is under the Communist regime</td>
</tr>
<tr>
<td>1956</td>
<td>Revolt against the Communist regime</td>
</tr>
<tr>
<td>1956-1988</td>
<td>Kádár regime</td>
</tr>
<tr>
<td>1989</td>
<td>Round-table talks allowing the existence of other political parties</td>
</tr>
<tr>
<td>1990-1994</td>
<td>First democratically elected (center right) government, Prime Minister József Antall (†1993)</td>
</tr>
<tr>
<td>1994-1998</td>
<td>Socialist-liberal coalition government</td>
</tr>
<tr>
<td>1998-2002</td>
<td>First Fidesz government (with coalition partners), Prime Minister Viktor Orbán</td>
</tr>
<tr>
<td>2002-2010</td>
<td>Hungarian Socialist Party (MSZP) government, until 2008 in a coalition with liberals</td>
</tr>
<tr>
<td>2004</td>
<td>Hungary enters the European Union</td>
</tr>
<tr>
<td>2002-2004</td>
<td>Prime Minister Péter Medgyessy (MSZP)</td>
</tr>
<tr>
<td>2004-2009</td>
<td>Prime Minister Ferenc Gyurcsány (MSZP)</td>
</tr>
<tr>
<td>2009-2010</td>
<td>Prime Minister Gordon Bajnai (MSZP)</td>
</tr>
<tr>
<td>2010-</td>
<td>Second Fidesz government (re-elected in 2014, 2018), Prime Minister Viktor Orbán</td>
</tr>
</tbody>
</table>

After eight years in power the socialists were defeated by Fidesz; the party returned to power, this time no longer part of a coalition but holding a comfortable majority allowing it to enact sweeping reforms. Among the most important elements in explaining the successful return of Orbán to the premiership and Fidesz solidifying its place as the most important political party in Hungary with a two thirds parliamentary majority is the lack of challengers on the center-right. A right-wing coalition of three parties governed during the first democratic cycle in 1990-1994, but they all
proved themselves unable to survive in the context of a difficult transition. This first governing period took place during a time that democracy was being consolidated, when there was little governing experience, and policy mistakes resulted in defeat at the voting booth which usually meant the end of a political party. When these parties collapsed Fidesz moved in to fill the space, and transformed itself from a radical youth movement into a catch-all party for conservative voters.

A second reason for the overwhelming 2010 victory was the “arrogance of the Socialists.” The principal beneficiary of the failure of the 1990-1994 rightist coalition was the Hungarian Socialist Party, the main heir to the old Communist guard. The party had shed its dictatorial past, and campaigned in 1994 on its competence to navigate the course of economic and political reform. It won in a landslide, and despite perceived corruption and recurring scandals it won again in 2002 and 2006. But the arrogance of the party leadership, and in particular of Prime Minister Ferenc Gyurcsány, caused the party’s collapse. In a now infamous speech that was supposed to be confidential but was taped and made public, Gyurcsány admitted that the party had lied to win re-election, and that it had accomplished little in its previous four years of governing. The public reaction to these revelations was a political earthquake, with Fidesz and other parties organizing massive protests and calls for resignation. The Socialists never recovered their popularity, and lost the 2010 election by a wide margin.

Third, there was the lack of a viable alternative party. Between the incompetence of the center-right and the arrogance of the Left, Fidesz was the only well-known party left standing. It was skillfully able to capitalize on popular distrust of the socialists and fear of the even more extreme right-wing Jobbik party to win just over two thirds

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3 Interview, February 2017, Budapest.
4 The party won 33% of the votes in 1994, 42% in 2002 and 43.2% in 2002 before dropping to 19.3% in 2010.
of the parliamentary seats, which gave it the voting power to amend the constitution.\textsuperscript{5} The opposition is nonexistent to this day. In 2014 the regime created a host of fake parties with names that sounded real to divide the vote and the resources provided to any candidate running for office by the state, a strategy replicated successfully in 2018 (Washington Post 2018). They made it easy for ethnic Hungarians in neighboring countries to vote—as they were secure Fidesz votes\textsuperscript{6}—but made it almost impossible for Hungarians living in Western Europe to vote.\textsuperscript{7} With an electoral system overwhelmingly favoring the largest party, Fidesz turned 50 percent of votes into 67 percent of seats in Parliament (Washington Post 2018).

5.3 The reverse wave toward nationalizations

Hungary effectively finished the privatization process by the end of the 1990s using mainly the sales method and preferring FDI in the process. In 2009 the Hungarian government declared the process finished. Since then some further assets have been sold, though not at the magnitude of the earlier privatization campaigns. Figure 5.1 documents the entire period under study, showing the wave of privatizations as well as the reverse wave of nationalizations. The line in black traces the amounts of million of USD from privatizations from data gathered by the World Bank. After a peak reached in 1995 the proceeds from privatization dropped in the early 2000s with a small resurgence in 2005-2006 before the end of the available data in 2008. The privatization-nationalization wave is visible even at the country level. In the case of

\textsuperscript{5} Currently the only other viable opposition movement is the youth group \textit{Momentum}, but they are less of a political group and more an issue-centered organization. Their main goal is to oppose the government’s bid for hosting the Olympics due to the high costs associated with it and not necessarily to create an opposition party (Interview, February 2017, Budapest).

\textsuperscript{6} In Hungary’s 2014 election, over 95 percent of votes cast by non-domestic citizens went to Fidesz (Bayer 2017).

\textsuperscript{7} Interview, February 2017, Budapest.
Hungary, both the qualitative and quantitative data collected throughout this research and the corroborating data by Mihalyi (2014) support this point. Figure 5.1 shows the link between privatization, nationalization and a drop in the quality of democracy in Hungary. The black line traces the proceeds from the privatization process, which drop sharply as nationalizations start taking place (light gray boxes). Simultaneously, the quality of democracy drop as of the mid1990s (gray line), with significant democratic backsliding with Fidesz’s return to power. It is also important to note that the complete disruption of privatizations and nationalizations in 2001 coincided with the first Orbán government of 1998-2002. The pattern that emerges shows that as proceeds from privatization decrease in early 2000s, nationalizations start taking place. Similarly, the level of democracy drops significantly as nationalizations become more common. The red line graphs the amount of the assets returned under state control based on publicly available sources of data. There were other nationalizations for which it was impossible to get a figure for the value of the assets. While the red line can give us an idea about the timing and extent of the nationalization process it does not provide definitive numbers to the same extent the World Bank data on privatizations can for the 1990s.

After the country became a member of the European Union in 2004, pressures toward privatizing state assets subsided (Datz and Dancsi 2013). The removal of EU supervision and the weak performance of domestic institutions of checks and balances (political and civil alike) as well as the breakup of the parliamentary opposition increased the leeway for the Hungarian government under Viktor Orbán.8 The stated

8 There is basically no viable opposition in the political system, particularly after the 2014 elections. Also, the benefits exacted by the elite around Orbán are making his stay in power a high stakes game for all the beneficiaries of the so-called "mafia state" (Magyar 2016). These were the conclusions of several of my interviews in Budapest, July 2016 and January 2017.

Note: The graph traces Hungary’s post-communist trajectory. The black line represents the proceeds from privatization in millions of dollars (the Y-axis on the right side of the graph), whereas the red line represents the value of the assets nationalized by the state in millions of dollars. The gray line represents the evolution of the country’s level of democracy (the Y-axis on the left side of the graph). The gray boxes highlight years in which the country enacted nationalizations.

The aim of the new measures was to limit the presence of multinational companies in a series of domestic markets, and increase business opportunities for domestic firms or firms under direct state control (Szanyi 2014).

This shift in policy was made possible through various steps. The first step focused on legal changes that allowed the state to enact expropriations, culminating in the adoption of a new Constitution which had no reference to private property left in its text.\(^9\) Second, the state pursued strategic nationalizations depending on timing and size of expropriation. Figure 5.2 traces the number of nationalizations in different

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\(^9\) This new Basic Law (as it is officially called) took away a lot of discretionary power and property from the municipalities and shifted them to the central government such as schools, in-patient health care facilities, fire brigades, museums and archives (Kornai 2012).
sectors as well as the overall value of the nationalized assets from 2011 to 2016. Examining the data by sectors illustrates the particular areas that were given priority for nationalization by the state at which time.

Following the temporal progression of the nationalizations we can see the systematic way in which the private elements of the economic system were replaced by the government or by acolytes of the government (Magyar 2016). For example, most banking nationalization occurred in 2013 and 2014, whereas most nationalizations in the energy sector took place in 2013, 2014 and 2016. By contrast, 2012 was a year when the state focused on nationalizations in the telecommunications sector. This progression can be explained by the fact that with the initial focus on telecommunications any further nationalizations would get a positive coverage in the state-controlled media.\(^\text{10}\) Once this was accomplished the next step was to remove foreign influence over banks which in turn could provide the subsequent steps of the nationalization process with preferential bank loans to buy out any reluctant owners who did not succumb to political pressure. Overall this has led to the creation of a so-called “post-communist Mafia state” under Viktor Orbán’s guidance and control (Magyar 2016).

Often called “unorthodox economic policy” (Balázs 2016; Kalan and Durlik 2015; Oblath 2016) or “Orbanomics” (Byrne 2015), the general character of the economic policy pursued since 2010 has been rather orthodox in the sense that some of the measures represent conventional right-wing liberal policies such as flat income tax,

\(^{10}\) Magyar (2016) provides decisive information on how Orbán’s inner circle has distributed media power among a select group of oligarchs close to the regime. In Hungary today 80% of the public is getting its information from government controlled media—government subsidized or government-friendly sources. Being favored by the government—some interviewees assured me that there is a black list of media outlets where the government will not buy ads—can make or break a media outlet as the government is the biggest advertiser in the country. For example, the campaign for a referendum on hosting the Olympics represented one of the largest advertisement sources in the country. Similarly, the government’s anti-immigration campaign spent more than the “leave” and “stay” campaigns for Brexit combined (Interview, February 2017, Budapest).
Figure 5.2: Nationalizations in Hungary (2011-2016).

Data sources: originally collected data from news sources and Mihalyi (2014).

Note: The graph traces Hungary’s nationalizations between 2011 and 2016. On the left-hand axis I measure the overall size of the proceeds from nationalization for those observations that this data could be collected (thick line). On the right-hand axis I measure the number of nationalizations disaggregated by sector.

Trying to achieve the smallest possible public deficit and the strict regulation of unemployment benefits within the EU (Oblath 2016). What is unorthodox is the combative rhetoric against service industries (in particular, financial services), accompanied by the introduction of heavy discriminatory levies (sectoral taxes) on these activities (retail chains, telecommunications and the energy sector) (Magyar 2016).

Populist sentiments have characterized the state property management policy of the government after 2010. The repeated anti-globalization attacks targeted mainly the largest multinational companies in various service industries. The reduction of

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11 Special taxes have been placed on the financial services sector as well as telecommunications, but not on manufacturing because it is much easier to move a small manufacturing company away from Hungary whereas a bank is much harder to sell and therefore is less mobile though as I show in the following sections many foreign investors preferred to cut their losses regardless of sunk costs (Interview, February 2017, Budapest).

12 Interview, July 2016, Budapest.
the dependence on the globalized world economy resulted in a strong nationalistic discourse targeted at returning financial institutions to national/state hands, particularly in the wake of the 2008 crisis.\textsuperscript{13} Moreover, in spite of support for private property in the country, the population at large did not see a contradiction between the state protecting their personal private property while expropriating the assets belonging to foreign investors or Hungarian owners who had benefited from the 1990s privatizations.\textsuperscript{14} Table 5.2 lists expropriated assets by country of origin of investors.

Table 5.2: Nationality of the investors whose property was nationalized (2011-2016).

\begin{center}
\begin{tabular}{|l|c|c|}
\hline
Nationality of the nationalized investor company & Total amount paid in nationalization transactions (billion Forints) & Percentage \\
\hline
Russian Federation & 498.3 & 46 \\
Germany & 248 & 23 \\
USA & 196 & 18 \\
France & 72.8 & 7 \\
Austria & 52.1 & 5 \\
Other & 22 & 2 \\
\hline
Total & 1089.2 & 100 \\
\hline
\end{tabular}
\end{center}

The post-2010 nationalization drive by Prime Minister Viktor Orbán was presented to the public as a correction of the allegedly “mistaken” privatization policies of the previous Hungarian governments. Two assertions have been repeatedly made by Orbán: 1. utility companies should never have been privatized at all, because they are natural monopolies; 2. the national interest requires that the share of Hungarian owners should rise and the share of foreign multinationals should go down in strategic sectors like banking and media (Reuters 2014; Stratfor 2014).

\textsuperscript{13} The experience of the crisis was a sign for the Orbán government that it needed to reduce the sources of vulnerability in the economy. Since then the government has mixed a lot of its monetary policy with its fiscal policy and has focused on medium-term goals not really paying attention to long-term goals (Interview, February 2017, Budapest).

\textsuperscript{14} Interview, July 2016, Budapest.
The Orbán government amended the Constitution in October 2010, limiting the jurisdiction of the Constitutional Court a few days before nationalizing the assets of the private pension funds. Since the new law blocked the Court’s ability to hear matters involving budgetary issues, any domestic legal fight against pension reform reversal was effectively preempted (Datzi and Danczi 2013). The government also sought to increase its control over the central bank and the judiciary by adopting regulations that undermined their independence (Bilefsky 2013).\footnote{Eerily similar trends are now taking place in Poland to the alarm of Western observers.}

Table 5.3: Nationalizations in Hungary by sector.

*Source: Originally collected data and Mihalyi (2014).*

<table>
<thead>
<tr>
<th>Equity purchase</th>
<th>Total amount paid in nationalization transactions for shares and immovable property (bn Forints)*</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>- energy companies</td>
<td>812</td>
<td>48.0</td>
</tr>
<tr>
<td>- financial institutions</td>
<td>353</td>
<td>20.9</td>
</tr>
<tr>
<td>- other utilities</td>
<td>29</td>
<td>1.7</td>
</tr>
<tr>
<td>- telecommunication, IT, transportation</td>
<td>85</td>
<td>5.0</td>
</tr>
<tr>
<td>- manufacturing</td>
<td>15</td>
<td>0.9</td>
</tr>
<tr>
<td>- miscellaneous</td>
<td>15</td>
<td>0.9</td>
</tr>
<tr>
<td>Real estate (agricultural land, housing, office buildings)</td>
<td>185</td>
<td>10.9</td>
</tr>
<tr>
<td>Tangible assets (e.g. works of arts)</td>
<td>8</td>
<td>0.5</td>
</tr>
<tr>
<td><strong>Total value of equity obtained free of charge after the confiscation of pension fund assets</strong></td>
<td>190</td>
<td>11.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1692</td>
<td>100.0</td>
</tr>
</tbody>
</table>

*All known transactions executed by public authorities, including local governments.*

The following sections delve into the energy, utilities and banking sectors, while the next chapter discusses the international dimension of these nationalizations as well as their economic consequences.
5.3.1 Energy and utilities. The fuel behind the return of the state in the economy

Energy and utilities are a crucial piece of the puzzle of Hungarian nationalization practices. Their centrality for the economic life of the country as well as for the political cycle cannot be overstated. Promises to cut the price of electricity and utilities have become one of the main campaign promises that every party brings up during elections, but it was Fidesz who managed to harness the power of utilities’ price at the ballot box.\textsuperscript{16}

The gas sector in Hungary is vertically integrated and it comprises about 80 companies.\textsuperscript{17} The predecessor to Hungary’s national company MOL was divided into its distribution branch, storage facilities and the oil and exploration side which have remained under MOL’s purview. MOL controlled all the long-term gas contracts for Hungary. After deverticalization/privatization around 1995 the sector became a major place of investment for foreign actors. The distribution network was very well developed and the investors would not have had to do much in addition to maintenance and electricity improvements. This made it an attractive sector to invest both for foreign companies as well as the cash-strapped government. This meant that the distribution system of Hungary’s gas was divided between E.ON, Gaz de France (GDF), ENI and RWE.

The liberalization laws required the unbundling of energy activities to create competition within the sector. By 1998 the energy sector in Hungary was ready to implement this new regulatory framework, give licenses to companies being sold and MOL being partly privatized.\textsuperscript{18} FGSz became the Hungarian Transmission Operator in

\begin{itemize}
\item \textsuperscript{16} Interview, February 2017, Budapest.
\item \textsuperscript{17} Interview, January 2017, Budapest.
\item \textsuperscript{18} The state was still present in the working of the company but it was not through the “golden share” practice where the state keeps one share that it can use to block unwanted
charge of the country’s gas supply. The reason why gas is such an important part of
the story of energy and utilities is that the country is dependent on gas with 25 per-
cent of its energy being based on this fuel. Additionally, 70 percent of households are
connected to the gas network and 65 percent of district heating is also done with gas.
This has made gas prices a highly political issue as each voter is also a gas consumer.19

In 1995 Hungary was consuming 15bcm of gas which dropped to 10bcm around
2005. At this time the country was still producing 20 percent of its total domestic
production, while the rest was bought from Russia through a long term contract for
20 years, which was tied to the price of oil with a “take or pay” clause and which
also defined the delivery route—80 percent of the gas was to be delivered through
Ukraine and the rest through Austria.20 The contract had to be signed regardless
of the negotiating position because Hungarian households were depending on this
gas. This became a single buyer model in which MOL had both the task of domestic
production as well as the international side through the Russian contract. Trading
and distribution were not divided. Local authorities had to buy from MOL and then
distribute to the end users.

In spite of this process occurring during the period of “liberalization”, true decen-
tralization of the sector did not occur until actors in the energy market were allowed
to buy gas from other sources than MOL. As there were two entry points for gas in
Hungary–Ukraine and a smaller terminal in the West coming from Austria—traders
slowly discovered that they could buy some Western gas also from Russia but cheaper
decisions. Instead the government had preferential shares of about 20-30 percent of the
company (Interview, July 2016, Budapest).

19 Interview, February 2017, Budapest.
20 While the 20 year contract had some benefits it went against EU free trade due to the
delivery clause included in the terms of the agreement.
because it had been sold to this other country under a different contract and therefore it was differently priced.\footnote{This was part of Russia's price segmentation strategy where political goodwill was often bought with cheaply negotiated gas (Stern 2005).}

With EU membership there were new requirements for liberalization of the gas market in Hungary, though the process went painfully slow here.\footnote{Interview, February 2017, Budapest.} The sector had very few players, no new sources and no interconnectivity. There might be a desire to diversify but with Russia as the only supplier, diversification was next to impossible. Even if the government wanted to phase out long-term contracts, buyers who had acquired assets during privatization were counting on those long-term contracts to not have to deal with competition at first.

The 2008 crisis brought about immediate change. Because oil prices were very high the crisis brought down consumption very fast.\footnote{The process started in 2005 but the drop became even more significant in 2008.} Cross-subsidies that had been used in the past to make the whole sector viable meant that after each election cycle prices would go back up as a continuation of subsidies was not viable. Another effect of the crisis was that in an effort to avoid the high energy prices people would revert to alternative heating methods such as wood or coal just to get away from gas.

The crisis also affected the overall structure of the industry. Previously the contracts had been on the “take or pay” system which meant that in 2008 Europe was full of Russian gas but nobody really wanted it. This led to a dramatic drop in cost as buyers wanted to recoup at least part of what they had to pay to Moscow for the gas. This basically meant a \textit{de facto} decoupling of gas from oil prices.\footnote{Interview, July 2016, Budapest.} With
cheaper Austrian gas available\textsuperscript{25} the interconnector with Austria reached 100 percent utilization—and sometimes it was congested.

Prior to this situation MOL sold the gas contract to E.ON which was a highly political issue. However, because of the caps to the utilities prices MOL was basically subsidizing part of the population’s consumption. Which meant that the only way to make the deal lucrative for E.ON was to also sell the storage facilities. E.ON in turn bought the MOL assets knowing that the storage facilities would provide most of the income at first but also hoping they would be able to lobby the government to raise the utilities prices.\textsuperscript{26} E.ON at first won with prices increasing and profits going up, but the crisis brought consumption down soon after.

Competition started to increase in this sector as the Austrian Interconnector (HAG) became a source of cheaper gas that was now competing with the gas E.ON was supplying to the country from the long-term Russian contract it had bought from MOL. In this new context MOL became the newcomer to the market and it created a new trading company called MET.\textsuperscript{27} In this context one of the biggest points of contention were the storage capacities to hold the cheap Austrian gas. Using the EU law on third party access to storage capacities the government intervened on grounds of national security of supply and reserved capacity for gas sent through the interconnector. This practice of distributing storage capacity without guidelines but more on political grounds became increasingly used leading to several scandals around it.\textsuperscript{28}

\textsuperscript{25} This was still Russian gas but sold by the Austrians at lower prices after being purchased through their own contract with Moscow.
\textsuperscript{26} This deal was important for the government both because it no longer had to subsidize utilities for the entire Hungarian population, but also because it allowed the country to claim compliance with EU liberalization directive.
\textsuperscript{27} This company was involved in various scandals with regards to the Austrian Interconnector. (Interview, January 2017, Budapest.)
\textsuperscript{28} The biggest accusations were that MET was receiving higher than normal storage capacities and the guidelines in the written government decree were not used.
E.ON had storage and gas trade under their activities from 1996 until 2013 when the government decided that energy was a nationally strategic asset and this resulted in the state buying out E.ON’s assets in September 2013. E.ON had been the largest actor in the energy sector in Hungary by virtue of owning the long-term contract with Russia, big supplies of Russian gas, storage capacity and electricity. Soon after the government decided it was in the national interest to get control of the sector E.ON started getting increasing competition and losing market share. MOL no longer had a long-term contract but managed to get a new government contract as a newcomer to the market. MVN, a big electricity state-owned company which was one of the last remnants from Socialism took over E.ON’s assets storage and gas distribution. Under MVN’s umbrella the energy sector in Hungary was now under direct ministerial influence.29

Until 2010 there was no longer any state ownership in the gas sector. The state was completely absent as an owner from the distribution side,30 the storage side and the few shares it had in MOL were the only way the state was present in the industry. Now the situation had completely reversed with the state owning or controlling most of the sector.

Another way the state started to surreptitiously return to the energy sector was through the scandal around EMFESZ, a Ukrainian-Russian business where Ukrainians were selling gas to Hungary. The Russian state was not happy that its gas was being sold at a profit without their participation—basically they were competing against their own gas on the Hungarian market.31 Even though in Russia Gazprom

29 Interviews, February 2017 and July 2016, Budapest.
30 Local municipalities did own some of their own distribution but it was not under the control of the central government.
31 Additionally, the EU challenged the delivery clause in Russian contract thus liberalizing the market further.
has the monopoly, small sellers are allowed to sell gas. EMFESZ was such a seller. It was able to sell at an 8 percent discount compared to the gas offered through the long-term contract basically undermining E.ON’s business. People started to switch suppliers and E.ON paid the bill. Even though EMFESZ soon lost their discount and the gas they were supplied, this episode allowed for competition to truly appear on the Hungarian energy market.

Throughout this story the main goal of the government was to cut the utilities prices by 10 percent as a fulfillment of campaign promises. This was against EU regulation of price liberalization. Because in Hungary the prices had always been regulated by the state it was not difficult for the government to continue with this tradition. According to experts, the EU regulations can be circumvented if the state casts its price controls in a market friendly way by looking at cost components of the price calculation. \(^{32}\) This pricing scheme to keep utilities under control worked until Fidesz came to power because previous governments didn’t implement extreme price cuts. In the case of the Orbán price cuts the 10 percent drop in price was simply announced and then the analysts from the ministries were forced to come up with reasons for the price to fit with the number announced by the prime minister. \(^{33}\) And this kind of cut to utilities prices occurred three times! While the first cut was justified in some mathematical way, the second cut had no real justification and the third cut’s explanation was “just nonsense.” \(^{34}\)

The main message was of course to the voters who had demanded lower prices. The bad utilities companies owned by multinationals such as GDF or E.ON had to

\(^{32}\) They are putting a liberalized label on what is basically state control. (Interview, July 2016, Budapest.)

\(^{33}\) Interview, February 2017, Budapest.

\(^{34}\) Interview, February 2017, Budapest.
be chased out of the country by making them incur losses and forcing them to sell to
the government.

What is different about these nationalizations from others in the past is that
there is compensation because you are “selling” to the state, the state is not officially
“taking” your asset. Moreover, prior to the moment when the foreign owner sells their
company, the government passes new taxes or new regulations that make it difficult
to stay in business as mentioned earlier in the cases of E.ON and Gaz de France. The
way this story was portrayed to the population also played into the way these foreign
companies were inched out of the sector.

In this context everybody involved in the energy sector is now selling to MVN and
Fogaz—not just E.ON and GDF but ENI as well. With these different components
being sold off the government now owns 100 percent of the sector—storage facilities,
the long-term contracts, and most of the distribution. Every actor in the sector gave
back their license to sell gas to the consumer leaving it to state-owned actors such as
MOL, MVN and FGSZ to conduct business in this sector.\textsuperscript{35} Starting in 2010 Fidesz
made curbing gas prices part of their campaign promises. Even though Orbán made
it clear he wanted the state to take back the gas sector few people in the industry
truly believed it.\textsuperscript{36} The message was that the government would create regulations
that would make it unbearable for foreign investors to stay in the Hungarian market.

In addition to inching out Western investors, a strange dynamic has developed
with regards to Russia in the energy sector. On the one hand Russia suffered under
Orbán by having Surgutneftegaz\textsuperscript{37} investments expropriated by the government.\textsuperscript{38}

\textsuperscript{35} In the meantime a national utilities company, ENKSZ, has been created to manage all
these components as they reach the private consumer.

\textsuperscript{36} Interview, February 2017, Budapest.

\textsuperscript{37} This company is considered among the closest to the Putin regime.

\textsuperscript{38} Table 5.2 shows how Russia was affected by nationalizations.
But on the other hand Moscow has been courted by Orbán through a large scale nuclear energy project. A substantial part of household energy produced by nuclear power comes from the Paks power plant. As this power plant was built under Communism the government reasoned that since “the Russians built it, the Russians can fix it.”\textsuperscript{39} However, the arrangement through which Russia would conduct the repairs and the extension of the power plant was done without an international tender. While this is not in breach with the Euratom treaty it does go against EU competition law.\textsuperscript{40} Moreover, the entire process has been shrouded in mystery. No financial details have been released and no technical specifications of the expansion have been made available to the public. While there doesn’t seem to be any push for an open tender at this stage, there doesn’t seem to be any reason why technical details should be treated as a state secret if the deal was indeed fulfilling international standards.\textsuperscript{41}

The international dimension to the energy sector nationalizations is present not only through the fact that foreign companies were the main targets of government action but also through the involvement of international actors. For example, some of these actions were supported by important allies such as the US who favored the removal of Surgutneftegaz from MOL in 2011—one of the very first to take place—but Washington later expressed concern about the rest of the nationalizations. The policies in this sector were also of great importance for the EU as European institutions were preparing to move into the sector of security of supply regulation following the disruptions to energy supplies during the gas crisis between Russia and Ukraine in 2006 and 2009. This policy is meant to create a continent wide energy solidarity network where households would be the first to be supplied in case of disruptions and only after this would industry be served. The problem is that the policy

\textsuperscript{39} Interview, February 2017, Budapest.
\textsuperscript{40} Interview, February 2017, Budapest.
\textsuperscript{41} Interview, February 2017, Budapest.
is meant to be applied continent-wide. So if there are supply disruptions in Bulgaria, Bulgarian households would get energy through the interconnected supply network before industry in a neighboring country that has not experienced these disruptions.\footnote{Basically this policy means that you must support other countries’ households before your own industry. Vulnerable states like Poland support these measures, but states such as Germany, France and Italy are against.}

For Brussels the problem is not the ownership or the political involvement, but the lack of competition and price regulations\footnote{Interviews, July 2016 and February 2017, Budapest.} According to EU law the network needs to be unbundled and access needs to be granted to the still monopolistic side of the chain. Pipelines and distribution networks can be owned by the state but they need to be accessible to other actors. While this EU philosophy could be put in practice, it is also very naive. If the state has the power to regulate the sector it owns then the temptation is to make sure state monopoly is maintained. And this is what it seems to be happening in Hungary.

5.3.2 Banking on Autarchy

While privatization and nationalization waves would be visible throughout the economy, some sectors can obfuscate the extent to which these processes are taking place in the economy. Banking is one such sector. By nationalizing banks the state’s influence over the rest of the economy becomes less obvious but also stronger. A state might nationalize banks and then use them to distribute credit to various industries under economic pressure. This first act results in the government basically eliminating the need to continue nationalizing other struggling sectors as it will \textit{de facto} control those sectors through access to credit.\footnote{The literature on soft versus hard budget constraints examines how ownership of banks—state versus private—changes the calculations of economic and political actors across the system. For a review see Kornai (1992); Megginson (2005). Cf. China} If we did not pay attention to
the qualitative importance of banks in the process, the quantitative analyses would underestimate the state’s reach into the economy, as nationalized banks will behave in a manner furthering the state’s nationalizing effort. In the case of bank privatization, it might represent a first stage toward a state’s withdrawal from the economic sphere and increased privatization (Bonin, Hasan and Wachtel 2005).

The domestic struggle between proponents of privatization and nationalization is much easier to see in the make up of the banking sector. In this vein Calomiris and Haber argue that “a country does not choose its banking system: rather it gets a banking system that is consistent with the institutions that govern its distribution of political power” (Calomiris and Haber 2014, p. 4). In line with the overarching argument of this project, these authors suggest that “the property-rights system that structures banking is not a passive response to some efficiency criterion but rather the product of political deals that determine which laws are passed and which groups of people have licenses to contract with whom, for what, and on what terms. These deals are guided by the logic of politics, not the logic of the market” (Calomiris and Haber 2014, p. 13). And it is precisely this logic of politics that is guiding a government’s decision to privatize or nationalize as well.46

A focus on banks also illuminates the second part of my argument, the interaction between domestic politics and international financial pressures. As a crucial sector of the economy, governments are reluctant to completely divert their attention away from banks (Clarke, Cull and Shirley 2005), yet the pressure of the increasingly integrated

46 In the case of Hungary one of the first signs of the new relationship the government was planning with regards to the banking sector was the constant conflicts of the prime minister with the governor of the central bank of Hungary. Appointed under the previous government, the governor protested many of the early Orbán policies. This conflict ended with the replacement of the governor in 2013 which basically curtailed the independence of the Hungarian central bank (Magyar 2016).
financial markets forces them to relinquish control which can represent an important dilemma faced by left-leaning governments (Maxfield 1992).

In the case of Hungarian banks from 80 percent foreign ownership in early 2000s (Epstein 2008) the situation changed dramatically after Orbán came to power. Nationalizations were done thought regulatory capture (Yakovlev 2006). As Szanyi (2014) argues, the state began reasserting a greater role in banking by increasing the level of required deposits. Since small banks could not meet the new obligation overnight, the state itself provided them with the necessary capital and connected this transaction to the acquisition of a controlling share of ownership. For example, in 2014 the Hungarian state acquired MKB Bank from its German owners. The German parent bank was unwilling to run the Hungarian daughter bank at loss and sold it to the only serious buyer: the Hungarian state (Mihalyi 2014). Soon after this first move the government announced its intention to bring 50 percent of national bank ownership under Hungarian control (Coppola 2014).

This practice was not new. During Orbán’s first term in power, a similar takeover occurred with Postabank. According to Éva Várhegyi the government reduced Postabank’s capital of 42 billion Forints to one-half-thousands of its value and then provided the bank with 152 billion Forints of capital, with the result that the bank’s equity capital was again increased to 40 billion Forints. In this process capital shareholders lost the value of their investments while the government’s stake increased to 99.7 percent. Similar actions were taken in 2013 when the state acquired 3 billion Forints of Takarékbank (Savings Bank) assets—or one-fifth of its equity capital of 15.5 billion,

47 The early tactic of welcoming foreign banks was in line with the argument that these governments were *borrowing credibility*, where foreign banks with established reputations enhanced the credibility of emerging markets monetary systems by establishing subsidiaries in these countries (Grittersová 2017).
through a capital infusion of only 655 million Forints (Várhegyi 2017). This early strategy was continued once Orbán returned to power. Epstein (2008) argues that for countries such as Hungary or Poland because economic nationalism was always part of the discourse, an increase in the role of the state in the banking sectors was always a given.

In spite of the current anti-foreign ownership of banks discourse the fact that in 2008 at the height of the financial crisis the government did not have to bail out these banks was one of the main elements that helped Hungary extricate itself from the financial crisis sooner than other countries. As can be seen in Figure 5.3 Hungary ranked quite high on the foreign ownership level according to EBRD data compared to a country like Slovenia where the opposite was the case. When the financial crisis hit, Hungary did not have to spend money to recapitalize its banking sector. Slovenia, with its Slovenian-owned banks, had to spend significant amounts of money to recapitalize increased indebtedness. The Hungarian government did not have to worry about this element of the crisis.

As can be seen in Figure 5.3 the government did nationalize most of the banks away from foreign ownership. This is in line with Orbán’s discourse of bringing strategic

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48 Moreover, members of the cooperative owning the bank were basically prevented from participating in the auction as they were considered by law a “third party”, distinct from the Savings bank and the state—in spite of them being members of the cooperative—which meant they had to make a bid to the other shareholders fifty times the bid price per share. With a provision meant to keep out external, nonshare-holding buyers, the government excluded precisely the organization that united the bulk of the savings banks (Várhegyi 2017). Additionally, a governmental decree in late February declared that it was of “national strategic importance” for Magyar Takařek Inc to purchase Takařek Bank. Magyar Takařek Inc. was directed and co-owned by a close associate of the prime minister and the decree prevented the possibility that the sale could be blocked by the Hungarian Competition Authority (Várhegyi 2017).

49 Interview, February 2017, Budapest.

50 During the first post-transition government, Hungary did go through a banking crisis which resulted in the government having to spend up to 9 percent of the GDP to recapitalize the mostly Hungarian-owned banks (Interview, February 2017, Budapest).
Figure 5.3: Foreign ownership of banks in post-Communist countries

sectors under government purview. Part of this decision can also be explained by the
Swiss franc debt crisis rather than the vulnerability of the banks under foreign ownership.\footnote{51} This kind of action—for example telling a bank to convert Swiss denominated
debt into Forints in case of a financial crisis—can only be done if the owner is a citizen
of the country. Foreign owned banks who are usually subsidiaries of larger banking
corporations could not be pressured in this way (Magyar and Vásárhelyi 2017).\footnote{52} This
is why some banks were privatized after being nationalized, but the new owners were
Hungarian not foreign.

The problem of converting the Swiss denominated loans was that it managed to
kill two birds with one stone. On the one hand those who held this kind of loan were
usually middle class wealthier-than-average borrowers\footnote{53} who were the target voters
for Fidesz. Through a though anti-bank stance other voters could also be gained.

\footnote{51} This logic can be compared to the logic in Putin’s Russia, where important companies
are privately owned by Russians who—when needed—will do their “patriotic duty” and put
national policy ahead of profit (Hedlund 2006, 2008).
\footnote{52} Interview, February 2017, Budapest.
\footnote{53} Just qualifying for such a loan require certain economic stability.
Second, the banks were the ones that had to pick up the tab once the government required them to allow foreign currency debtors to pay off their mortgages early, at a fixed exchange rate far below market rates. As an illustration, the majority of holders of loans denominated in Swiss francs had acquired the loans at an average exchange rate of 160 Forints to the franc but by 2011 the exchange rate reached 240 Forints. Act CXXI of 2011 required banks to allow debtors to repay their loans at an exchange rate of 180 Forints to the franc if the debtors were capable of paying back the entire debt (Várhegyi 2017).

Banks were also hit with special fees and taxes that the government was able to pass easily through Parliament using its comfortable majority. This has resulted not only in a great instability of the legal environment but also in a slew of regulations and rules that have increased the regulatory reach of the state. For example, in an attempt to increase budget revenues the government instituted in 2013 a financial transaction fee from all banks. This measure was supposed to bring in substantial revenue, but it drew criticism from the population when the only path the banks could take was to pass on this expense to the consumer. As a countermeasure the government next created another rule in which all citizens can withdraw freely from their banks once a month but other financial transactions would be subject to the financial fee.

This kind of action can only be done when the main levers of control are in strict government hands. The Swiss franc crisis was controlled through nationalizations but it was thanks to Orbán’s control of other key institutions that this could happen.

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54 This nuance shows that when ownership is not possible or not desired regulatory tools will be used to get private businesses under control.

55 Romania is currently going through its own version of the Swiss Franc crisis and the Central Bank governor has come out against governmental action that would intervene in the market in order to bail out borrowers. No such action was taken in Hungary due to the close association between the Central Bank and the government.
That institution is the Central Bank. The importance of central bank independence has been a mainstay of political economy research (Cukierman, Miller and Neyapti 2002). While there is valid criticism for single-minded pursuit of central bank independence in the case of the EU (Berman and McNamara 1999; McNamara 2002) and in the post-Communist space (Epstein 2017; Epstein and Johnson 2010; Johnson 2016), the alternative route taken by Hungary only served to solidify an increasingly authoritarian regime.

In 2013 the former minister of the economy under Orbán became the governor of the Central Bank of Hungary. Previously the government was in constant conflict with governor Simor (Johnson 2016). With the central bank under the control of the political elite it was very easy for the government to enact policies through which large sums of money were being lent out to commercial banks that were now also under state control. This meant that many Hungarians accessed very easy loans through this change in policy. Politically selective lending thus works not only by choosing the winners, but also the losers, meaning that it can also be used to deny the opportunity to obtain credit (Várhegyi 2017).

In addition to this concentration of banking under state-owned banking, the Central Bank itself sent a clear message to the depositors. By taking control of the government-purchased MKB bank, the Central Bank announced that in addition to deposit insurance, they would also provide full guarantee for all the MKB’s deposits, loans and bonds. This meant that money would be more secure in banks under state control than in foreign-owned institutions, regardless of the strength of their capital (Várhegyi 2017).

56 For a critical appraisal of this literature see McNamara (2002).
57 Interview, February 2017, Budapest.
The fight over institutions and particularly over the central bank has brought about many benefits to the government and the Orbán regime. One such benefit is the fact that the Central Bank diverted funds totaling 1% of the GDP to different private foundations which were outside parliamentary checks in spite of using state funding.\footnote{Interview, February 2017, Budapest.} There was also an effort to hide what these foundations were doing, especially since many of them were buying state bonds which goes against European Central Bank policies of conducting monetary policy. Moreover, this kind of funding can have political influence come election time.

One of the main elements of the banking saga has been its purported “transitional” nature. Big questions accompany these swings in ownership. What were the prices for each transaction really reflecting? Did the state reach the goal of economic stabilization it claimed to seek through nationalization and was it now considering moving away from state ownership? The actions taken were presented as a “transit nationalization process,” with the ultimate goal of turning the previously autonomous savings cooperative sector and banks into the hands of the business allies of the government (Várhegyi 2017).\footnote{An interesting case is that of Budapest Bank, an institution privatized and owned by GE Capital for 15 years. In 2015 it was bought from GE for 198 billion Forints and now it is back in line to being sold off. Instead of triggering a departure of GE from Hungary, by paying off the company and offering other tax incentives the government has insured continued investments from the American company.} There is an argument to be made that in the end we are not talking about full blown nationalization. The goal is not for these entities to simply become part of the state. The goal is for them to be “state-adjacent.”\footnote{Interview, February 2017, Budapest.} Close enough to political power to be useful tools for electoral purposes but private enough to not be taken away in case of a change in power. According to the secretary general of the National Association of Entrepreneurs and Employers cited by
Várhegyi, “[w]ith very modest investment, at a value of 650 million Forints, the state has acquired shares inexpensively, which is to say, ownership in the banks. And as soon as the state is in possession, it can take steps to force numerous public institutions, schools, kindergartens, nurseries, hospitals, and municipal governments into their savings cooperative system. These institutions will keep their accounts there, and will transfer salaries to civil servants and public employees from there. In other words, with a small investment, the state was able to acquire huge economic influence and power in the Hungarian countryside” (Várhegyi 2017, p. 303). And this will undoubtedly have a huge electoral impact.

5.4 Conclusion

This chapter has traced the rebirth of Fidesz as the unchallenged political party of Hungarian politics and of Viktor Orbán as a new populist leader espousing strong economic nationalist policies. With this new position the country’s leadership took Hungary from an early–mostly–success story in the region to a country where the state’s ownership of the economy is making the country revert its earlier liberalization and privatization efforts. The state has come to the forefront of many sectors as the main owner of assets and self-proclaimed protector of Hungarian interests. Energy and utilities in particular have been presented as sectors of strategic importance that need to be under state control which have important electoral impact.

In April 2018 Fidesz won another resounding victory giving Orbán his fourth term as prime minister. The wave of nationalizations that has swept the country since 2010 seems to have secured the margin of support needed to stay in power. Chapter 6 examines the international dimension of these changes and discuss the extent to which
international pressures worked—or didn’t work—as I explain the reverse wave toward nationalizations.
Chapter 6

International Factors

6.1 Introduction

The reorientation of Eastern Europe away from the reforms enacted in the 1990s came as a big surprise to many of the international actors that had supported these countries along the way. From international and regional institutions to foreign investors, the changes that took place in Hungary, Poland, the Czech Republic as well as the still fragile reforms in Bulgaria and Romania signaled an unexpected reversal that meant a challenge to the accepted international and European consensus with consequences for how these states would engage in economic matters. Considering that so much effort and resources had been poured in the reform process of Eastern Europe, why didn’t a stronger response help these countries in maintaining the gains from privatization and perhaps not experience the democratic backsliding now visible across the region? Why did the international dimension—so important in promoting the original reforms—shift just as consolidation of those reforms was supposed to take place? How did the reverse wave away from privatization toward greater state ownership in the economy take shape at the international level? The domestic push toward alternatives to liberalization became more popular and propelled to power leaders representing this new coalition is one part of the story examined in the previous chapter. This chapter
focuses on the international dimension that facilitated the reverse wave. The argument here focuses on the deep crisis that continues to affect the original supporters of the economic reforms, and the strong challenge of alternatives to this original model.

In this chapter I argue that the wave of increased state ownership of the economy was not simply a consequence of increased domestic support for this shift, but also a consequence of action and inaction in the international arena. Several factors are at play and I explore them in turn. The reforms championed by the EU weren’t as strong as originally thought because the EU system itself—with its variety of approaches to market capitalism—does not have a strong preference in one direction or another and it wasn’t until some of the reforms in Eastern Europe truly challenged the core of EU values that any action was even contemplated and the coercion mechanisms in place proved to be ineffective.\footnote{The closest the EU came to having to deal with such issues was during accession process for Slovakia who was led by Meciar. However, Meciar lost power in 1998 which allowed the country to proceed with the accession but his strong showing in the 2002 elections put serious doubts on Slovakia’s chance to enter the EU in case of a victory.} Additionally, with the rule breakers part of the EU system any kind of accountability was strongly opposed by the states and their supporters thus making international pressure even less effective.

Secondly, other sources of conditionality such as the IMF or international investors that did not approve of the anti-market nature of the changes taking place were also left without possibility of true response when their only source of real pressure—international loans—was at least partially replaced by other sources of funding that did not have similar stringent requirements or actually actively supported rebellion from the Western order. China and Russia emerged not only as financiers of some of the economic reversals seen across the region, but in some of the more spectacular cases we saw a complete reversal of decades of anti-Russian sentiment with leaders such as Orbán actively embracing Vladimir Putin as a model to be emulated.
In the following paragraphs I discuss the inability of the EU to respond to this internal crisis of confidence and in some cases outright rebellion of member states to its rules and values. Challenges such as domestic deligitimation of the European project within Eastern European countries, political parties in the region abandoning the promotion of European goals, and disillusionment of voters and elites in these countries add up to the EU’s inability to respond to this internal challenge, institutional gridlock and the ability of the rebellious member states to use their position as insiders to prevent the EU from taking action against them. Finally, I examine the role of China and Russia as alternatives to the EU and the “Western order.”

6.2 Reversing liberalization and the slow European response

Joining the European Union was one of the early and most important goals the countries in Eastern Europe focused on in addition to joining NATO. Accession to these European and transatlantic institutions was collectively seen in the region as the surest way for these countries to achieve democracy and market capitalism (Tucker, Pacek and Berinsky 2002; Wagner 2012)–or at least a break from the authoritarianism and collectivism of the Communist era. The EU especially was seen as a stable and prosperous area that Eastern Europe had been excluded from after World War II. The traditional way to gain membership in the European structures had been that once a country achieved a certain level of development it would be invited to access the group of similarly developed countries. In the case of Eastern Europe the accession process itself became a race to fulfill an increasingly long set of conditions necessary for entry. The time between making the commitment to join the EU and accession was

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2 This was the case when the EU was contemplating taking measures against Poland’s government for their measures attacking judicial independence. Hungary preemptively announced it would oppose any vote against Poland.
extremely short considering these countries were building functioning democracies and market economies from scratch. While this accelerated version of the accession process can be seen as detrimental for the consolidation of a democratic order in the region, it did allow the EU to exert sufficient pressure to push for the substantial reforms the region went through. Both the active and the passive conditionality (Vachudova 2005) during the run-up to accession allowed the EU to substantially affect the outcome of the transition process in the region, but the inconsistency and lack of precision in the Union’s membership criteria meant this process did not live up to its potential as a transformative force (Grabbe 2015; Pridham 2005).

In spite of these flaws, throughout the entire process there was a substantial consensus among regional elites that the benefits of EU membership outweigh possible disadvantages. That means representatives of the main parties in member states and candidate countries supported the EU in general, and a withdrawal from membership or candidate status was not a realistic or expected option (Hooghe 2003). This consensus about the importance of the EU for the future of the region was shared by both elites and ordinary citizens. In time this situation changed, as the accession process ended and the financial crisis took hold. The enthusiasm for the EU waned and elites realized that criticism of the EU could win them more votes. In Eastern Europe, criticizing the EU to domestic audience and proclaiming to be fighting against the forces of the EU has been increasingly appealing in most countries, turning euroskeptic parties into important challengers in places such as Hungary, Poland and the Czech Republic.\(^3\)

In light of the changes in Eastern Europe—reversal of liberalization and increasing democratic backsliding—the question emerges that if the original reforms are so important then why didn’t the actors with interest in these reforms to continue—the EU,

\(^3\) The Baltic states are a notable exception on this account.
the IMF, international investors—step in and use their leverage on the countries in the region for the reforms to return to the previously agreed upon status quo? There are several explanations for this apparent lack of persuasive power on the part of international actors. Each of these actors had their own interests and difficulties in the period under study. The EU was dealing with much more pressing matters such as the possible default of Greece, Ireland, Spain and Portugal, as well as a possible collapse of the euro. The IMF was the primary instrument to stave off the deeper repercussions of the crisis. In the context of the financial crisis less attention was given to the ways in which the countries in the region—Hungary in particular—were rewriting the rules of the game when one could say they were trying to stay afloat (Walter 2013). However, international investors were the group most affected by the instability of property rights and government expropriations. Yet, their responses were largely muted. The next section explores each one of these actors in turn. The wave of increased state ownership in the economy was not simply a consequence of increased domestic support for this shift, but also a consequence of action and inaction in the international arena.

6.3 Why did the European Union not properly respond to the Eastern European challenge?

Not only was there a muted European response to the backtracking in economic reforms across several countries in Eastern Europe, but the political changes that have been the most troubling have also taken a long time to elicit a response from the EU. When Hungary changed its constitution giving the governing party power that could extend even after they had been voted out of office or when they illegally replaced a judge on the Supreme Court, European bodies didn’t have a substantial
reply, leaving many—including the Hungarian government—to assume that there will be minimal consequences to misbehaving now that the country was a member of the EU. It took Poland’s party in power to mount a direct assault on the media and judiciary before the European Union started talking about the possibility of withdrawing this country’s voting rights within the union (Bloomberg 2017; EU Observer 2017).

The reason behind this slow response is threefold. First, in many cases these are slow changes rather than a radical sweeping autocratic takeover. The reason why the Polish case drew so much attention was how drastic the change was and how obviously it was damaging democracy in Poland. In the case of Hungary on the other hand— even when it changed the constitution, the consequences of those changes were not as easy to see right away as an assault on democracy. It all seemed like a new party in power—democratically elected—changing the constitution according to the rule of law.

Secondly, the rules and regulations of the EU itself are based on negotiation and slow bureaucratic process. In many cases when a response to changes in Eastern Europe was issued it wasn’t enough to really shame a leader into backing down. Field interviews suggest that the democratic backsliding of the country and increasing populism of the government have resulted in a complete disregard of international consequences. In the words of an interviewee, “by the time the EU issues a statement—not even actual punishment, but simply an official sanction against the government’s actions—it’s been three years since the event took place” by which time everyone has moved on. The slow legal process of the EU was at its clearest in the case of the unlawful removal of a Chief Justice from the Constitutional Court (Budapest Beacon 2014a). By the time the European Court of Human Rights in Strasbourg issued a verdict the political relevance of the issue was gone and the financial compensation

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4 Even though naming and shaming had worked in the past for the EU in implementing unpopular directives (Zeitlin 2008).
5 Interview, January 2017, Budapest.
of 100,000 euros could not make up for the fact that the government continued its unchecked consolidation of power (Budapest Beacon 2016).

Finally, the countries that had been so easy to entice through conditionality during the accession process were now full fledged members that had a seat at the table. Additionally, the early conditionality to enter the EU was not as strongly pursued as the conditionality required to enter the Euro-zone. Juliet Johnson argues that Eastern Europe split into two groups—one that pursued aggressively entry in the Euro-zone and a second group of laggards that did not make adopting the Euro a top priority (Johnson 2008). She argues that “by making it possible for new member states to delay entry, by increasing the difficulty of the entry conditions, and by displaying internal problems undermining the Euro zone’s legitimacy and attraction, EU actors discouraged the laggards from making Euro-zone entry a domestic priority.” Thus conditionality became truly ineffective as the prospect of joining the Euro-zone became unlikely. Now the EU could name and shame a leader, but it still had to work with that country’s leadership. And in many cases that country itself had bargaining power that it could leverage into not being subject of EU censure.

When fighting possible EU criticism Eastern European countries have used two strategies. First they could band together and block any possibility of enacting measures that would lead to actual EU action. For example, Hungary signaled very strongly that it would veto any attempt from the EU in sanctioning Poland for its attacks on the judiciary (Bloomberg 2017; EU Observer 2017). Secondly, these countries are now full European partners and sometimes the leaders that break EU informal—and formal—rules get a pass due to the important role they play within

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6 Interview, July 2016, Budapest.
7 The same way they defend one another, Eastern European countries have also gone against EU trends by advocating for a soft Brexit in hopes of protecting citizens of these countries now working in the UK (Reuters 26 May 2017).
EU institutions. Because the European Parliament includes representatives of each country elected as members of parties, politics within the EU will end up being determined by the national strength of a party that is quite anti-European. For example, since 2004, Fidesz has acquired political power both at home and at the European Parliament. After the 2009 election, Fidesz emerged with a clear majority, winning fourteen of Hungary’s 22 seats to the European Parliament. In the European Parliament Fidesz is a member of the European People’s Party the 2009 election which makes it one of the most successful parties of the group (the fifth largest party in the group). Thus the European People’s Party group is unlikely to vote for any resolutions that would criticize the Hungarian government if they want to keep their majority within the European Parliament.

This policy of criticizing the EU domestically while still benefiting from the advantages it provides can backfire for Hungary and other Eastern European countries. European institutions have been beneficial for the continent but domestic criticism like the one in Hungary is also taking place in other European capitals which will undermine the coherence and solidarity of the European project. When it comes to the EU, the Hungarian government has had a highly ambivalent attitude. Orbán and other leaders like him promote a domestic rhetoric that highlights their country’s “freedom fight” against the shackles of EU regulations. Yet at the same time these leaders remain aware that EU funding sustains their budgets, paying for state infrastructure health and education investments that would otherwise not happen.\(^8\)

One way the EU has been fighting back is by having European leaders such as Emanuel Macron increase support for rebuilding the rule of law within Europe (The New York Times 2018). As a tool to pressure more adherence to the rule of law there

\(^8\) See Magyar (2016) for a discussion of how EU funds are being used to enrich supporters of the Orbán regime.
have been suggestions to use the EU budgetary mechanism as a bargaining chip. Several European commissioners have suggested linking EU payments to assessments of the rule of law. In some of these discussions the possibility to withhold money is linked not to punishment but to the prudent management of EU taxpayer money that would not be disbursed to countries with compromised judiciaries and high levels of corruption (The Economist 2018b, Radio Free Europe 17 April 2018). Whether or not this will happen is now unclear since the budget needs to pass with unanimity which could be blocked by the countries targeted by these measures.

6.4 Other international institutions in Eastern Europe

The IMF was another major international player in Eastern Europe in the 1990s. One that could have taken on a much more important role than the one it ultimately played. Prior to the financial crisis the IMF had lost much of its position as a global lender. While some argue that the IMF was not particularly foresighted in anticipating the crisis and its effects (Conway 2013), it did play a major role during the crisis by supplementing the EU’s ability to shore up underperforming economies such as Greece, Ireland, Portugal, and Cyprus. IMF participation in the Euro-zone rescue played three possible roles. First, it was a source of bridge financing. EU action through the European Stabilization Mechanism was important, but disbursements take a long time to travel through bureaucratic channels. The IMF provided short-term finance until that European mechanism became operational. Second, while there is agreement within the EU that reforms are necessary in debtor countries, EU governments did not want to be seen dictating policy to fellow members and in many instances there is no consensus among member states for the specific conditions to be placed on recipients. The EU thus delegates its condition design and monitoring
role to the IMF (Tirole 2002 and Jeanne, Ostry and Zettelmeyer 2008). In this case, the IMF also served to defuse common-agency problems when existing EU members favor different macroeconomic reforms for the destabilized countries. Third, including IMF financing in this program lessened the exposure of European countries to the rescue efforts. The increased resources of the IMF came from many countries, only a few of which were within the EU. By including the IMF in the European initiative, the US, Japan, China and other IMF member countries were able to provide part of the necessary financing (Conway 2013).  

For example in 2008 the Hungarian economy was at its most vulnerable. Most commentators agreed that after Ireland, Hungary was the next most likely country to enter a deep financial crisis, which is why the IMF came in to help. Usually indicating IMF support would be enough to make additional funding available as investors would be secure in repayment (Eichengreen, Gupta and Mody 2008; Ramakrishnan and Zalduendo 2006). Due to the severity of the crisis the 2 billion Euros requested by the government turned into an IMF loan of 20 billion. Even though the country received such substantial IMF support, once Fidesz came to power it followed a tough line on foreign lenders. Fidesz had won the election on a pledge to ease austerity measures and take a tougher line in talks with international lenders. Viktor Orbán also promised an end to recession by creating jobs and cutting taxes rather than the austerity measures previously imposed by the Socialists. He also promised to form a more patriotic administration to defend ordinary Hungarians’ interests in the face of

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9 Conway (2013) finds that among the former Communist countries the IMF provided substantial help to Armenia (March 2009, 533.6 million SDRs), Bosnia and Herzegovina (July 2009, 1014.6 million SDRs), Georgia (September 2008, 747.1 million SDRs), Hungary (November 2008, 10537.5 million SDRs), Latvia (December 2008, 1521.6 million SDRs), Moldova (January 2010, 184.8 million SDRs), Poland (May 2009, 13690 million SDRs), Romania (May 2009, 11443 million SDRs), Serbia (January 2009, 2619.1 million SDRs), Ukraine (November 2008, 11000 million SDRs). (1 SDR = $ 1.462)

10 Interview, February 2017, Budapest.
pressure from banks, foreign governments and international organizations.\footnote{11} In June 2010, the IMF suspended talks with the government due to a disagreement over its spending plans, fueling fears that Fidesz may allow the deficit to grow in the years ahead. This disagreement left Hungary unable to access funds from an existing 20 billion euros package. Orbán tried in vain to persuade the IMF to accept a higher target budget deficit for 2011, which Hungarian officials claimed would help them implement major structural reforms guaranteeing long-term savings. Because of increasing disagreements between Budapest and the IMF over central bank independence in Hungary, the Orbán regime decided to abandon the IMF deal.\footnote{12} Amid a flood of global liquidity because of the easy-money policies of the U.S. Federal Reserve and other major central banks, Hungary was able to fund itself by borrowing from capital markets (Feher 2013).\footnote{13} This resulted not only in a rejection of further IMF funds, but also in an early repayment of the existing loan\footnote{14} and a request to close the IMF office in Budapest (Reuters 2013).

This power struggle can be seen in other places in the region,\footnote{15} with increasingly rebellious governments refusing to accept external pressures as they did in the 1990s.

\footnote{11} This was particularly important in light of the Swiss franc crisis we discussed earlier in Chapter 5.
\footnote{12} In the words of the Orbán government: “We interpret our agreement with the IMF—our participation in the IMF’s system of cooperation—as a borrowing agreement. The IMF sees it as an economic policy agreement. This is not in our interest ... The Hungarian interest is that if necessary we should make loan agreements with the IMF on a regular basis. It is not in our interest to sign economic policy agreements with the IMF, as that unnecessarily limits the room to manoeuvre of ... the Hungarian government, Hungarian parliament and lawmakers” (Johnson and Barnes 2015).
\footnote{13} See next section on the willingness of foreign investors to lend money to the Hungarian government.
\footnote{14} According to the Hungarian government the last installment of the loan was due in the third quarter of 2014 (Euractiv 2013) and the early repayment saved the country 3.5 billion forints (approximately 14 million US dollars) in interest.
\footnote{15} Ukraine is another example of this strategy.
6.5 International investors and their interests

Finally, an additional set of foreign actors with power over policies that reverse liberalization and privatization are foreign investors. Political economy literature posits that foreign investors will leave a country unfriendly to private property rights protection, and that international arbitration has emerged as a safeguard of international investments (Wellhausen 2015a, b, 2016). In spite of extensive evidence for targeted expropriation especially in Hungary investors don’t seem to have entirely abandoned the idea of investing in the region.\footnote{Foreign investors have proven to be very dogged in their persistence in investing in unfriendly countries such as Russia and China in spite of substantial roadblocks to their presence.} This could be due to several causes. First, leaders have astutely exploited sectoral compartmentalization of expropriations. In the case of Hungary specific sectors were targeted for state control, namely telecommunications, energy, utilities and banking (See Figure 5.2 from Chapter 5 for a chronological representation of sectors affected by state intervention). Investors were still very much sought out for other sectoral investments as long as those investments steered clear from what the government considered part of its strategic interests. For example, an interesting case is that of Budapest Bank, an institution privatized and owned by GE Capital for 15 years. In 2015 it was bought from GE for 198 billion Forints and now it is back in line to be sold off—most likely to native Hungarian investors friendly to the regime.\footnote{Interview, February 2017, Budapest.} Instead of triggering a departure of GE from Hungary, by paying off the company and offering other tax incentives the government has insured continued investments from the American company in a project related to technology.\footnote{In this case the government promoted Magyarization rather than genuine nationalization, opting for nominal control knowing that this could be maintained even if the party was no longer in power. If the state owns the asset then it would be under the control of the new governing party.}
While many of the foreign companies that have been affected by state intervention have cut their losses and left the country, others have gone to international arbitration to fight the state. Table 6.1 gives an overview of international investment disputes Eastern European countries have been part of. The literature on international investment dispute arbitration tells us companies have tools at their disposal to fight expropriation (Wellhausen 2015b), yet Hungary’s actions tell us that new practices are being developed by states, where forcing the investor to exit after some form of payment is worth the international damage as long as the strategic assets are returned under Fidesz control.20

Table 6.1: Investor disputes with countries in Eastern Europe (1990-2016).


<table>
<thead>
<tr>
<th>Country</th>
<th>Disputes Solved</th>
<th>Disputes Pending</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>4</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>21</td>
<td>10</td>
<td>31</td>
</tr>
<tr>
<td>Estonia</td>
<td>3</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Hungary</td>
<td>7</td>
<td>6</td>
<td>13</td>
</tr>
<tr>
<td>Latvia</td>
<td>3</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Lithuania</td>
<td>4</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>Poland</td>
<td>16</td>
<td>1</td>
<td>17</td>
</tr>
<tr>
<td>Romania</td>
<td>8</td>
<td>4</td>
<td>12</td>
</tr>
<tr>
<td>Slovakia</td>
<td>10</td>
<td>2</td>
<td>12</td>
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<tr>
<td>Slovenia</td>
<td>1</td>
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<td>3</td>
</tr>
</tbody>
</table>

The lack of response from the international markets is surprising considering that bond markets should have a disciplining effect on rebellious politicians. If bond-market investors begin to pull their capital, politicians can be left without the funds to support their policies, regardless of domestic support (Johnson and Barnes 2015).

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19 Overall investment disputes in Eastern European countries have accounted for over 15% of total investment disputes according to Wellhausen (2016). These numbers do not include former Communist countries in the Balkans or the former Soviet Union.

20 And as can be seen in Figure 6.1 Hungary’s credit rating took a severe hit after Orbán came to power.
Earlier in the story Hungary seemed vulnerable to such international retaliation. In January 2012 a bond-swap auction was canceled due to insufficient demand to make the swap advantageous for the government. The next day, an auction for 12-month debt went forward, but the government had to offer a yield of almost 10 percent, the highest since April 2009, and still the auction sold only 35 billion forint in new debt rather than the planned 45 billion (Telegraph 2013). Throughout that year, the IMF and various credit-rating agencies warned that Orbánomics was damaging Hungary’s credibility, undermining the confidence of investors, and threatening its ability to borrow on international markets. Hungarian bonds were already rated BB+ (a junk rating) at the time, but the threat was that the credit rating could go lower if Hungary eschewed IMF advice. The threatened punishment from bond markets never fully materialized. Instead, despite explicitly rejecting advice from international financial organizations and in contrast to the negative predictions of credit-rating agencies, the Hungarian government successfully floated an international bond in February 2013. It consisted of $1.25 billion of five-year paper and $2 billion of 10-year, and it
was oversubscribed nearly fourfold (Johnson and Barnes 2015). The yields gave no indication that investors considered the economy to be a bad investment.

Additional examples show even less evidence for bond traders trying to punish Hungary for Orbán’s policies. The government has held dozens of successful bond auctions. While auctions were occasionally canceled or raised less money than planned, predictions that Hungary would simply be unable to attract funds have repeatedly been proven wrong. Furthermore, international support for Hungarian bonds has not waned and instead seems to have risen. In 2010, about 25 percent of Hungarian bonds with a maturity of over a year were owned by foreigners and about 30 percent by insurance companies and pension funds. After private pension assets were nationalized at the end of 2010, foreign holdings jumped to more than 35 percent (and rose to almost 50 percent by mid-2013), while the proportion held by domestic insurance companies and pension funds dropped well below 20 percent (Johnson and Barnes 2015).

Another way to attract foreign participation in the regional economies has been by courting FDI through low taxes. A goal for the Hungarian government has been to make the country more attractive for foreign investments and in November 2016 it announced that the country would lower its corporate tax from a rate of 10 % on profits up to 500 million Forints (about 1.74 million USD) and 19 % above this sum. A new single rate of 9 % would apply to all businesses (Byrne 2016b). This would make Hungary the country with the lowest corporate tax in Europe; lower than places such as Ireland (12.5 percent) or Bulgaria (10 percent). According to Hungarian law this would have put the country in the “tax haven” category alongside countries such as the Cayman Islands, Bermuda and the British Virgin Islands (Karaian 2016).\textsuperscript{21} Therefore the government is now discussing another piece of legislation that would

\textsuperscript{21} According to Hungarian law, any country with corporate taxes lower than 10 percent is considered a “tax haven” or an “offshore.”
change the definition of “tax haven” to ensure that with a corporate tax of 9 percent Hungary itself would not fit in this category.\textsuperscript{22}

Hungary’s experience demonstrates that even countries deeply embedded in the international financial system can successfully pursue economic nationalist policies.\textsuperscript{23} Despite warnings to the contrary, the country taxed foreign businesses, undermined central bank independence, and generally rejected international economic advice. Nevertheless, the government maintained support from international bond markets and kept foreign investment flowing into the local economies.

6.6 Alternatives to the East

The lack of trust in the European project has been felt throughout Europe not just in the newest members, and the Brexit vote is a symptom of the EU fatigue felt throughout the continent. One way certain Eastern European countries have exerted their independence has been through appeals to alternatives other than the EU.\textsuperscript{24} Either for economic reasons—attracting investors—or ideological affinity, Eastern European countries in general—\textsuperscript{25} not just the countries with the biggest shifts—have seen an increase in appeals to “Eastern models.” Yet in spite of this surge in popularity of

\textsuperscript{22} Interview, February 2017, Budapest.

\textsuperscript{23} Moreover, recent research shows how authoritarian leaders that consistently break with international commitments are still welcome in certain parts of the international system, particularly for the purposes of safeguarding their money (Cooley and Heathershaw 2017; Cooley, Heathershaw and Sharman 2018). A classic example was Mahathir in Malaysia in the 1997 Asian Crisis. He instituted capital controls, but there was no massive exiting of FDI.

\textsuperscript{24} This rapprochement has been mutual as Eastern European countries have sought out the money and energy China and Russia could provide, whereas Beijing and Moscow were looking for additional ways to increase their presence within the new EU member states.

\textsuperscript{25} In this section I provide examples not just in Central Europe but also from the Baltics and South-East Europe.
Russia and China, variety still dominates in the approaches taken by these countries both in types of engagement and depth of relationships.

6.6.1 China

In the context of the financial crisis and the economic downturn of investment in Europe, China emerged as a viable alternative flush with cash and eager to invest abroad and more specifically invest in other places than the US.\(^{26}\) China is still a minor investor in Europe in terms of stocks of investment, and the size of Chinese investment is very modest compared to the size of Chinese trade with Europe. But the flows tell a more nuanced story, with investments tripling from 2006 to 2009, tripling again by 2011 to $10 billion and reaching $12 billion in 2012 (Hanemann 2013, Hanemann and Rosen 2012). In terms of FDI the situation has changed dramatically following the financial crisis (Meunier, Burgoon and Jacoby 2014). The number of annual investments with a value of more than $1 million grew from less than 10 a decade ago to 50 in 2007 and almost 100 in 2010 and 2011 (Hanemann and Rosen 2012).

Politically, Chinese FDI has been able to increase rapidly because the 2008 crisis resulted in a dramatic policy change in many European countries. The crisis diminished political resistance to Chinese FDI at the domestic level and made short term calculations prevail over longterm thinking in cash strapped and high unemployment European countries. In the words of Sophie Meunier, “beggars can’t be choosers” (Meunier 2014).\(^{27}\) While the top European destinations for Chinese investments are

\(^{26}\) With the 2008 financial crisis hitting the US economy, China realized that it needed to diversify in a variety of ways. About two thirds of Chinese reserves are held in dollar denominated assets with the country being the largest foreign owner of US government debt. This vulnerability meant China was dependent on the health of the US economy.

\(^{27}\) The crisis brought about fewer buyer for an increasingly large number of assets available for sale. There was a lack of available European capital willing to invest in risky projects
France, the UK, Germany and Sweden, Eastern Europe has raised its profile, with Hungary being the fifth largest destination of Chinese investment in Europe which is surprising for the size of the Hungarian economy compared to the other top contenders. Romania, Poland and the Czech Republic have also been successful at attracting Chinese investments in a variety of sectors and projects such as infrastructure (Meunier 2014).

Another aspect that made Europe very attractive was the unrestricted FDI environment (Meunier 2014). Although there are now European initiatives to change this situation (Godement and Vasselier 2017), according to the OECD FDI Restrictiveness Index, 20 out of the 25 countries least restrictive towards FDI in 2012 were EU members (OECD 2013). Countries which lowered further regulatory obstacles to FDI following the crisis include Austria, Belgium, the Czech Republic, Denmark, Estonia, Finland, Germany, Greece, Hungary, Ireland, Italy, Latvia, the Netherlands, Poland, Slovenia, Spain, Sweden and the United Kingdom.

In addition to easy FDI investment European countries also leveraged their appeal for Chinese investments through citizenship and residency incentives. Directed at individuals, these “golden visas” require a specific sum to be invested in a country for the investor to receive a residency permit giving the individual access to the entire Schengen zone. This has created fierce competition among European countries, with Eastern Europe leading the way. In December 2012, Hungary adopted the “Hungarian investment immigration law” granting residency to those investing at least due to financial institutions hoarding cash to safeguard their own balance sheets (especially French and German banks), depressing the prices further. Demand for European assets plummeted because of low growth prospects in the short term (Meunier 2014). Additionally supply increased with many countries being required to sell state owned assets as part of agreements with bailout agencies such as the IMF and the ECB. Countries such as Greece, Portugal and Spain for example tried to sell off an impressive amount of companies in infrastructure. More assets became available for sale throughout Europe as austerity measures led to bankruptcies.
EUR 250,000 in government bonds. Another way to make Hungary attractive to Chinese investors has been through residency permits for anyone owning real estate in Hungary. This has resulted in a property bubble in Budapest and many Chinese bought properties to get access to the Schengen zone (Financial Times 2015).

Hungary has been actively selling itself as the “gateway to Europe.” The sale of 6,500 Hungarian residence permits to Chinese nationals under this “golden visa” scheme amounted to EUR 1.95 billion over three years (Godement and Vasselier 2017). The Chinese company Huawei has made Hungary its main launchpad in Europe, where it has 2,500 employees. Since 2015 it has had its own “strategic partnership” with the Hungarian government, and is creating a joint IT center with Borsodchem, a major petrochemical firm also under Chinese ownership. Huawei was entrusted with the Hungarian government’s mobile phone network after the acquisition of MVM Net in 2015, and it also manages the national emergency number (Godement and Vasselier 2017). As another sign of goodwill Hungary has even issued bonds in Chinese currency and is financing major infrastructure projects with Chinese money.

Since 2012, China has intensified its influence with countries in Central and Eastern Europe through the “16+1” framework. Annual 16+1 summits have sought cooperation on infrastructure projects between China and participating countries in the region, backed by a new fund. The meetings have prompted speculation in Brussels and other Western European capitals that there is a Chinese effort to “divide

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28 Although not as attractive as the Hungarian offer, other countries have taken advantage of this new trend. In January 2013, Portugal instituted the “Golden Residence Permit” which enables foreigners to acquire residency status in Portugal if they transfer at least EUR 1 million in capital, or create 10 new jobs in Portugal, or purchase property worth at least EUR 500,000. In May 2013, Cyprus started to grant citizenship to foreigners with direct investments in Cyprus of at least EUR 5 million. In September 2013, Spain passed a law granting residency status to non-EU investors in Spanish property of at least EUR 500,000 (Meunier 2014).

29 Interview, July 2016, Budapest.
and rule" Europeans (Hala 2018). This has resulted local complaints about EU processes. In the wake of the “16+1” summits in Budapest and Warsaw, local observers from Romania and Serbia pointed to the inequality of eastern EU member states with regards to their Western European counterparts. Officials point to the much broader scale of past Chinese investment into France, Germany, Italy, and the United Kingdom and the compromises made by these governments in the interest of cultivating the relationship. European Commission inquiries and decisions are sometimes perceived to be under the influence of the EU’s largest economy, Germany, the most influential partner for Eastern European countries. One observer has argued that: “If Germany wants to cooperate with China, it does so bilaterally. If it wants to say no to China, it does this on the European level" thus hurting the prospects of investment for countries in the region (Godement and Vassel 2017).

An increasing debate in Europe has centered on investment screening. Though not directly targeted at China, there is a feeling that Chinese investments have initiated this debate (ECFR 2017a). In October 2017 The European Commission put forth a proposal to the European Council and European Parliament. The plan supported by France, Germany and Italy, if agreed, would encompass all investments that have implications for public order or security and it would allow the European Commission to supervise investments in sectors where it subsidized technologies. It also lists critical technology sectors that are key to the industries of the future and which more often than not have direct military applications. This initiative came after China systematically purchased some of the most important and strategic ports around Europe as well as after Beijing created ever more stringent rules for technology transfer.30

30 Basically, China is now increasingly requiring foreign companies to transfer technology, cede source codes for IT, and generally place servers and data storage inside China (Breznitz and Murphree 2011). This aggressive stance of technology has led to recent accusations by
Even when it purchased large installations and infrastructure, China mainly focused on management takeovers and restructuring rather than greenfield investments.

Overall there are three main problems with the Chinese economic presence in Eastern Europe: not enough investment, but many loans that come with strings attached; a murky division of public and private, and a murky division of economics and politics.

First, China seems to be more interested in lending rather than investing. Eastern Europeans would prefer greenfield investments to loans, and Chinese companies, used to operating in developing economies, dislike EU rules for public tenders (Godement and Vasselier 2017). Chinese loans come with specific strings attached. Not only are the terms for loans less favorable than the ones offered by the EIB but they also require hiring Chinese companies or create links to other deals. For example, China promised Slovenia EUR 1.3 billion in financing for a railway, in exchange for a 99-year lease on the port of Kopfer. This port provides access, through the Brenner Pass, to Austria and Central and Northern Europe. Slovenia declined the deal which made China decide not to acquire any shares in the port, resulting in German and Austrian firms taking on the projects.

Second, while many formally private Chinese companies such as Anbang, Fosun, HNA, and Wanda have come to invest in Europe whether these companies are truly “private" is ambiguous. This group of companies has evidently used political connections to launch substantial investments in what are non-strategic sectors. Since January 2017, these private firms and their chief executives have been ruthlessly brought under control. As Xi Jinping has consolidated power these companies have been brought back in the fold and the distinction between public and private has dis-

the Trump administration of Chinese intellectual property theft from American companies (The Economist 2018a).
appeared where China’s strategic objectives are concerned (Goemant and Vasselier 2017).\textsuperscript{31} A trend similar to what has been happening in Hungary.

Finally, there is another linkage in Chinese participation in Eastern European investment and loan schemes which mixes economics and politics. Eastern European countries have learned not to touch sensitive topics such as Tibet, Taiwan, human rights or the South China sea issues.\textsuperscript{32} The Dalai Lama’s visits to European countries always trigger reactions from China. Nonetheless, these reactions are not equally calibrated: they can involve low level bilateral tensions which ministries of foreign affairs are able to alleviate—this was the case in Denmark and Slovakia after the Dalai Lama’s visits in 2009 and 2016 respectively. On the other hand Estonia received the Dalai Lama in 2011 and relations with China were blocked until 2013 after an informal apology from the Estonian foreign minister. On another occasion, following a private visit by the Dalai Lama to the president of Lithuania, Vilnius faced a number of problems with issuing certificates for the export of Lithuanian agricultural products to China (Goemant and Vasselier 2017).

Some countries have also managed to remedy Chinese reactions to the Dalai Lama’s visits. The Czech Republic stands out in this respect: following the Dalai Lama’s visit in 2009, China and the Czech Republic held no political dialogs until 2014. Throughout this period of tense bilateral relations, the Czech government was

\textsuperscript{31}This difficulty of distinguishing between state and private is also true across all sectors of the Russian economy. While the post-Soviet push for privatization brought about 80 percent of the Russian economy under private control (Blasi, Kroumobov and Kruse 1997), the ascent of Putin and the shift from crony capitalism to state capitalism changed the situation (Djankov 2015). By 2015, about 55 percent of the Russian economy was in state hands, with 20 million workers directly employed by the government (Aven 2015), and the Yukos case was the watershed moment that changed the earlier tide of privatization (Djankov 2015). Today some of the numbers on the state’s share in the Russian economy go as high as 70 percent (Szakonyi, 2017) and the informal nature of much of the Russian economy does nothing but bolster the state’s reach (Gaddy and Ickes 2002; Ledeneva 1998, 2006).

\textsuperscript{32}For example, Viktor Orbán shifted from supporting the Dalai Lama to advocating for the Chinese position on Tibet.
very critical of China and its human rights record. But in 2014 relations resumed after an apology by newly elected government’s foreign minister during a visit to China. Relations then blossomed with Xi Jinping’s visit to Prague in 2016. When the Dalai Lama returned to the Czech Republic the same year, the Czech prime minister and two more senior elected figures penned a letter to the Chinese government claiming the trip was an initiative by “private politicians" rather than a political statement (*Deutsche Welle* 2016).

In some of these instances there seems to be a lack of sophistication in the Chinese approach. While these tactics worked in Africa they are less effective in Eastern Europe. While some leaders have fully embraced the Eastern way, in the case of China it seems to be mostly strategic and a means to create an alternative to the West. That Western and Eastern Europe are competing for the same goal of attracting Chinese investment might be the more worrisome aspect of the Chinese presence in Europe. As seen before, Eastern European states complain about the way stronger Western European states have the ability to get ahead using their economic clout in bilateral negotiations and strong economic and political position in Europe. In this case the competition for Chinese investment rather than Chinese strategy could end up dividing the continent.

6.6.2 Russia

While most of Eastern Europe has welcomed Chinese money with open arms, the same cannot be said about Russia. The historic ties between the region and Russia create a variety of reactions to Russian engagement in the region and differing degrees of cooperation with Moscow. For many East European states, the “return to Europe" after 1989 meant not only re-aligning with Western structures, but also building up independent, adversarial and often difficult relationships with Russia. For countries
like Poland and the Czech Republic, the post-1989 period was marked by strong delimitation from post-Soviet Russia (Koran 2016). This was not exactly the case for Bulgaria, as observed by Katsikas (2011), where Russia had a positive image in the public opinion due to the economic benefits and status the country held in the Soviet era. Moreover, the expansion of NATO in the region was done in most cases with the express wish to have Western backing in case of Russian aggression.

These early fears of direct Russian meddling were replaced in the late 2000s by fear of energy dependence. Up until the shale revolution in the US and the 2008 financial crisis, energy and energy disruptions through Ukraine were the main way to distinguish between the attitudes of Eastern European countries toward Russia. Countries such as the Baltic states, Slovakia, the Czech Republic and Bulgaria are among the most energy dependent states in the region, with over 80 percent of the natural gas coming from Russia. This dependence has resulted in a variety of approaches. Some countries such as Romania and the Baltics became increasingly more interested in European energy independence and constantly looking out for Russian pressures on their countries. Other places such as Bulgaria and Hungary became much more accommodating to Russia and even worked toward building Russian energy projects that would pass through their territory.

As energy worries subsided and the broader financial crisis took hold, other concerns emerged such as the situation in Ukraine and Crimea, as well as the specter of increased Russian influence on elections. Eastern European–and Western European–countries have been feeling an increasing polarization of domestic discourse due to extensive online activities linked to Russia (Pomerantsev 2015). In addition to online polarization, often in support of fringe political parties,33 there have also been

33 Particularly in Western Europe this support has been widely documented by the Washington Post 2017, The Atlantic 2017 and ECFR 2016.
attempts at winning hearts and minds. For example, in Slovakia, Moscow appears to have pursued a two-pronged approach. On the one hand, it was seeking to build bridges with the former prime minister, Robert Fico, who has connections with Russia (he was present in Moscow at a United Russia bloc rally in 2011 on the night Putin announced his plan to reassume the presidency). Additionally, since the 2016 general election Fico has also allied again with the more overtly Russia-friendly right-wing Slovak National Party (ECFR 2017c). At the same time, Moscow is seeking to build closer alliances with the far-right in Slovakia, exploiting panic about migrants and refugees, and seeking to build media alliances which allow Russian news easier and wider access into the country’s information sphere.34

Where institutions are weaker, Russia may even seek state capture, such as in Bulgaria where the Kremlin is seeking to establish powerful networks of allies and clients inside the country, while using Bulgaria’s position inside NATO and the EU (Reuters 11 November 2016). It is thus striking how far political, cultural, and economic interests are often aligned. For example, Russian oil company Lukoil and its various local subsidiaries are both the largest corporation in Bulgaria and the largest taxpayer in the country (Conley 2016). Especially telling is the way that Bulgarian outlets generate and distribute pro-Russian stories not because of pressure or promises from Moscow, but because there is a ready local market for them (ECFR 2017b).

Where institutions are of only moderate strength, Russia can hope to acquire a degree of influence, at least through specific individuals and minority parties. These connections can help Russia potentially exert leverage in the future. While the Czech government remains a steadfast supporter of NATO and the sanctions regime, President Milos Zeman’s outspoken criticisms of NATO and the EU are repeated in Moscow’s propaganda campaigns throughout Central Europe (ECFR 2017b).

34 Foreign Policy 2017, GLOBSEC (2016).
In countries where institutional safeguards are weak, Moscow will target the state, not in the expectation of being able to capture it, but to seek to influence it on specific issues—such as sanctions—and to work on nudging it into a more favorable position. Viktor Orbán, for example, is no ally of Moscow in the grand scheme of things, but the Russians are deeply appreciative of his disruptive role within the EU and seek to encourage that.\footnote{It is noteworthy, after all, how far Hungary’s laws on NGOs echo Russia’s ‘foreign agent’ laws, as well as the broader echoes in claims by government figures such as Minister of Foreign Affairs and Trade Péter Szijjártó that Washington has sought to destabilize the Orbán regime (Budapest Beacon 2017). Not to mention the similarities in the way Orbán has dealt with the Central European University. Every step of the journey was similar to the attacks on the European University in St. Petersburg (Redden 2017).} Russian active measures in Hungary push an anti-American and, especially, anti-EU narrative that works with the government’s discourse, as well as a social conservatism that chimes with Orbán’s own position.\footnote{This narrative is even more surprising when applied to historical events that should make Hungary less friendly toward Russian which Orbán twisted to be anti-EU. On the occasions marking the 60th and 61st anniversary of the Hungarian 1956 revolution and the subsequent invasion and occupation of Budapest by Soviet troops, Orbán used the events to draw parallels between Hungary’s struggle against Moscow and his own struggle against the European Union. In his official speech he stated that “Our responsibility is to prevent Brussels from Sovietizing” (Bayer 2016; Byrne 2016a).}

Those countries characterized by intractable hostility, notably Estonia and Poland, are clearly not likely to be won over. As a result, Moscow seeks to demonize them, to exploit them as a negative example to others, whether by presenting them as unthinkingly paranoid Russophobes or, where possible, by targeting them as convenient warnings. The covert and overt onslaught on Estonia, from the 2007 cyber attacks, through the 2014 kidnapping of security officer Eston Kohver, to the continued threats embodied in Russian military exercises, all demonstrate the way that Tallinn is targeted not simply because of its location, nor simply because of Putin’s own dislike, but also as a warning. Likewise, in Poland one of Moscow’s key aims is to stir up extreme nationalist elements—even if these are also anti-Russian—in order
to widen divisions with Washington and Brussels and make the country appear unreliable and extreme in the eyes of its allies (Lucas and Pomerantsev 2016).

One additional element of the international dimension is the alignment with other autocratic states in the international regime. Orbán’s admiration for Putin and his policies has been widely documented and his desire to emulate the so-called “Eastern models” has been present in significant political speeches (Magyar 2016), in addition to two state visits to Budapest in 2015 (The Economist 2015) and 2017 (Feher and Gulyas 2017). While Orbán’s government does think that the EU sanctions toward Russia hinder more than help, the main goal is to maintain the relationship going on the energy front as discussed in Chapter 5.

Many comparisons may be drawn between the personalist regimes in Moscow and Budapest: both are socially conservative, place emphasis on patriotism and religion, reduce the separation of powers and the security of private property rights, both have used nationalizations to favor cronies. Some have even called Orbán’s regime “Putin-lite” because the kind of illiberal policies seen under Putin have not been fully enacted (Szelényi 2017). However, this might be more a categorization of similar trends rather than true affinity. A strange trend emerges where criticizing the liberal order creates solidarity among leaders with fewer democratic inclinations than expected. For example, after Donald Trump’s victory Orbán made a speech in which he argued that now every country can consider itself as coming first, and that its interests come first. The same way the US is promoting “America first" so should Budapest promote “Hungary first." If other EU countries also pursue this anti-EU rhetorical approach, the weakening of the European project would result in those same countries losing the EU funds that have been keeping those regimes in power.

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37 Tusnad speech
38 Interview, July 2016, Budapest, Bechev (2017).
6.7 Epilogue on the Hungarian case study

Before concluding the chapter it is important to examine the consequences of the reverse wave in Hungary. How soon a new coalition emerges demanding a new shift in policy—this time toward economic liberalization and privatization—depends on how the previous shift was implemented, how many winners emerged, and whether those winners are now well off enough to continue supporting the current policy orientation. I am examining the economic consequences of the reverse wave toward greater state ownership in the economy through the lens of several economic indicators.

6.7.1 The economic consequences of nationalizations

In spite of the economic troubles that were declared to be the reason behind the initial return of the state in economic matters such as the Swiss franc crisis and the utilities controversy, the Orbán government seems to have been able to consistently show economic growth, low unemployment and low inflation. In spite of this apparent success, beneath this surface the economic foundation on which the regime has built its future is much shakier than it is touted by the Fidesz camp. One of the recent trends has been for the government to cherry pick the number it likes best and use that one in the media. Also they revise official growth projections at odd times during the year instead of the traditional practice of letting the Central Bank make revisions (Interview, February 2017, Budapest). I examine in turn growth, unemployment and inflation.
6.7.2 Growth

The Orbán government has consistently claimed that the country achieves substantial economic growth, however when one compares the numbers from 2010 when Orbán took power to 2015 the situation changes. Moreover, growth was also better in the privatization era. The aggregate economic growth is higher in the Baltics, Romania, Poland and Slovakia.\footnote{The question isn’t whether this future shift occurs. My theory posits that if shifts occurred in the past they will take place in the future and Chapter 3 showed this statistically. It just means that how soon this shift occurs depends on how the previous shift was implemented.} For example, in Figure 6.2\footnote{Interview, February 2017, Budapest.} we can see how since 2010 Hungary has lagged behind other Eastern European countries. According to EUROSTAT data from 2010 to 2014 Hungary performed below countries such as the Baltic states, Romania, Poland and Slovakia, and only in 2014 it narrowly outperformed Latvia\footnote{I also have data comparing Hungary to the EU average which can be provided. For space I only discuss the situation comparing Eastern Europe.}.
and Slovakia.\textsuperscript{42} In certain sectors such as services there is sustained and even rapid growth but in most sectors the growth is barely average.\textsuperscript{43} Moreover, economic growth so far can be explained by the infusion of EU structural funds after the accession of Hungary to the organization. This not only resulted in an increase in GDP but it also represented the most important source of investment in sectors such as infrastructure and construction.\textsuperscript{44} In Figure 6.3 we can see the important role played by EU transfers in Hungary. From 1 percent of GDP in 2008, in 2014 Hungary received over 5 percent of its GDP from EU funds, placing it well ahead of other Eastern European countries. What is problematic about the reliance on EU funding is that without it the actual economic growth would be zero.\textsuperscript{45} Moreover, after 2020 Hungary will no longer be entitled to many lines of funding from the EU as the country moves out of the recently integrated member states category.

It is becoming clear in Hungary that without these governmental spending projects there are few other companies that could help boost economic growth. Some examples of large scale investments often mentioned in my interviews are Audi and Mercedes, but not many others.\textsuperscript{46} Some of the most important investments have been by companies that do not actually produce anything in Hungary or regard it as an important market but are coming in for the tax benefits. GE Capital invested in a major innovation center that it uses for its accounts support. Blackrock also has a major office in Budapest. AVIS has its largest office outside the US in Hungary and uses it to manage the entire European fleet. Audi and Mercedes also have a large presence on

\textsuperscript{42} EUROSTAT, Financial Statistics Database, consulted in March 2017.
\textsuperscript{43} Interview, February 2017, Budapest.
\textsuperscript{44} In 2013 the EU provided 6.3 \% of the country’s gross national income. Additionally, over 95 \% of all public investments in Hungary are co-financed by the EU (European Commission, Hungary).
\textsuperscript{45} Interview, February 2017, Budapest.
\textsuperscript{46} Interviews, January-February 2017, Budapest.
Figure 6.3: Net European Union transfers in Eastern Europe (% of GNI).


the Hungarian market, but it is not to sell here but as customer support.\(^{47}\) These companies do create some jobs, but the tax incentives they receive mean they add little revenue to the budget.

Another goal often touted by the government is lowering the budget deficit. This is an important achievement. In the period between 2001 and 2007 the country ran budget deficits amounting to 9-10 percent of the GDP. Now the deficit is measured at 1.6 percent by EUROSTAT.\(^{48}\) Figure 6.4 confirms this story. While in the late 1990s and early 2000s Hungary saw deficits amounting to almost 10 percent of the GDP it currently outperforms many Central European countries.\(^{49}\)

However, if we look at what is behind this number we see two problematic policies that have proven to be short term fixes for this budgetary issue. The first fix was

\(^{47}\) Interview, January 2017, Budapest.

\(^{48}\) EUROSTAT, Financial Statistics Database, consulted in March 2018.

\(^{49}\) Except the Czech Republic.
nationalizing the private pension funds Hungarian citizens had been contributing to since 1998. The second solution was budgeting via taxation. In the words of some interviewees, when the government “needs income” it creates a new tax.50

The initial step in tackling the budget deficit issue by the Orbán government was to target the private pension funds that had been established as an alternative to contributions to the state-run social security program which would entitle all employees to a pension from the state. The establishment of a private pension sector is a broader reform promoted by the World Bank in the 1990s as a response to the demographic crisis that would imperil most state-run systems where there would not be enough young people to fund the increasingly large old age population (World Bank, 1994).

Using the lower than projected performance of the private pension funds as an excuse, the government nationalized these institutions.51 At the end of 2010 the

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50 Interview, February 2017, Budapest.

51 An OECD chief economist pointed out that the lower performance of the private pension funds should not have triggered their eradication. Instead, their operation should have been improved by increasing competition within the industry, allowing the funds to invest in
deposits in these pension funds totaled about 14 billion US dollars or 11.2 percent of the Hungarian GDP at the end of that year. Half of the pension funds’ assets were invested in government bonds and treasury bills (Datz and Dancsi 2013). By bringing these funds into the public sector the sovereign debt ratio could be immediately reduced and according to EUROSTAT the deficit was lowered to 2.3 percent of the GDP in 2012. Additionally, this measure also resulted in the state redirecting monthly private pension contributions to its coffers. In a statement from the Ministry of the National Economy, the pension fund nationalization had as a key objective to “improve the budget balance that has been gradually deteriorated year after year since the implementation of the multi-pillar system, [...] and to cut explicit public debt relative to GDP in order to minimize the country’s exposure to external shocks” (Ministry of the National Economy 2011, p. 6).

While a major goal in this entire process was to put Hungary back within the EU targets for budget deficits, the end result was not the one hoped for. The EU did not accept the nationalization of private pension funds as a long term and sustainable corrective measure to keep budgetary figures under control. This kept Hungary under the Excessive Deficit Procedure until 2012. Moreover, in February 2012, the

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53 The EU policy sets targets for budget deficits which must not exceed 3 percent of GDP and the public debt must remain under 60 percent of GDP. If an EU member state reports larger deficits than allowed, the European Commission starts an Excessive Deficit Procedure. This procedure usually entails stronger EU surveillance in the form of suggested corrective macro-financial steps. Member states can face financial sanctions, and their EU subsidies can be suspended until they demonstrate enough efforts to meet the required deficit figures. Hungary has been under the Excessive Deficit Procedure since its EU accession in 2004 for missing the mandated deficit targets every year (Datz and Dancsi 2013).

European Commission proposed to withhold a third of Hungary’s regional fund aid (approximately 495 million Euros) from 2013, if substantial steps were not taken to reduce its budget deficit (The Guardian, February 22, 2012). It was this action that finally prompted Hungary to revise its budget and implement more conventional austerity measures which led to the Commission unblocking the frozen funds in May 2012.55

In terms of the tax situation Chapter 5 addressed banking taxes and fees. Similar stories come from the government’s attempt to decrease the value added tax (VAT) as well as the internet services tax. This last initiative was met with the largest street protests of Orbán’s time in office (The New York Times 2014, The Economist 2014). The final result is more regulation, and the general problem with the economic policy under Viktor Orbán has been that the prime minister gets an idea for improving the government’s position and then swiftly implements it without any consideration of side effects and possible negative interactions between the new regulation and preexisting institutions. As the unintended consequences become apparent new regulations are then created to counteract these side effects. Two clear examples illustrate this process in action. Chapter 6 discussed the changes in corporate income tax, but personal income tax was also deeply affected.

Personal income tax is one of the main areas where unintended consequences were very visible because of the direct way it hurt different segments of the population. Before the Orbán government, Hungary had a progressive tax system with different tax rates depending on income with subsidies for the poorest Hungarians. Widely discussed in many libertarian circles but implemented in places such as Eastern Europe, a flat tax was seen by governments in the region as a possible cure for the ram-


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pant tax evasion plaguing these countries (Appel 2018; Baturo and Gray 2009; Boas and Gans-Morse 2009; Myant and Drahokoupil 2011). It was argued that while the tax level became 16 percent for the entire population governments would not lose revenue—even with the lower amount collected from the richest members in the high tax brackets—but would gain from more middle income segments of the population declaring their income and paying taxes on it.

In 2012 the government implemented a major tax overhaul introducing the flat tax. This disproportionately affected poor people. While the rich saw their taxes getting lower, the poor were now paying more taxes due to the fact that the flat tax was eliminating important subsidies that had benefited them in the past. Because they promised during the campaign that implementing the tax reform would not make anyone worse off, the government had to create additional interventions in the economy to fix this situation.

As there is no way to directly regulate the wages in a market economy, the government once again used a host of regulatory measures to fix the situation it had created. First, public sector employees saw their net salaries increase. Secondly, the government also implemented measures meant to increase the minimum wage. While the net minimum wage would remain the same the gross wage was changed so that the tax reform would have no effect on the citizens. However, because unlike the public sector measures this piece of legislation did affect private sector companies the state used different ways to exact compliance from these private actors. Companies that did not increase salaries would not be entitled to any public support or participate in public tenders. They also used positive incentives so that companies which did

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56 The gross salary remained the same but the net salary was adjusted so that taking into account the new tax levels people would get the same income as they did before the reform was implemented.

57 Interview, February 2017, Budapest.
increase their wages would be entitled to support from the government to cover for the difference in salaries. In an effort to simplify the tax system, lack of planning and expert thinking resulted in additional burdens on the state and a myriad of new regulations meant to counteract the side effects of the initial regulation.59

In spite of the government’s attempts to bolster its budget since 2010 and to improve economic performance, severe budgetary shortages have plagued education and health care, especially since the government centralized these services away from local authorities. For example, Hungary has the EU’s lowest level of public funding for health care, at only 5 percent of the GDP whereas the EU average is 7.5 percent. In Figure 6.5 we can see Hungary trailing other Central European countries such as Slovakia and Czech Republic in health spending, with Poland as the only country in the region doing slightly worse than Hungary.

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58 This was another way in which the state basically had to take money out of its pockets to fix a measure that was supposed to bring them more revenues.
59 Interview, January 2017, Budapest.
Figure 6.6: Education spending in Hungary and Central Europe (% of GDP).

Figure 6.7: Education by level of government in Hungary.
Similarly, funding has decreased in education following the centralization of this service under the leadership in Budapest. Prior to 2012 local governments ran their school districts, but now it is the central government who makes decisions on education, including funding and human resources.\textsuperscript{60} In Figure 6.6 we can see that Hungary seems to be doing well compared to the overall region, however the severe drop after 2010 shows the dramatic effect of Fidesz policies on education spending. Once we look specifically at education spending by level of government (Figure 6.7) we see that while central government spending has increased slightly after 2010, local government spending has dropped below 1 percent of GDP which means that the overall spending on education has dropped. In the entire second term of Orbán the overall spending on education has not returned to the levels prior to 2010.\textsuperscript{61}

6.7.3 UNEMPLOYMENT

Another economic indicator that the government relies on to prove its good economic record is the unemployment rate. The unemployment rate looks very impressive compared to the Euro zone and it also holds up to a comparison with the other Central European countries with the Czech Republic being the only country outperforming Hungary (see Figure 6.8).

However these results look less impressive once the processes at the basis of this indicator are examined. A first reason for the improvement of the rate of unemployment rests with the overall recovery process following the financial crisis. After the shock of 2008 and 2009 things were bound to improve as long as the economy started

\textsuperscript{60} Several interviewees in Budapest related cases where teachers that are critical of the government fear losing their jobs. Often the choice between two candidates is made in favor of the one with more political connections rather than the best qualifications.

\textsuperscript{61} EUROSTAT, Financial Statistics Database, consulted in March 2017.
recovering. While unemployment was still above 10 percent in 2010 and 2011 it started recovering soon after.

Yet, this recovery rested on another problematic factor other than economic performance. Since 2010 the state has dramatically increased the levels of public employment. Another program emerged after the restructuring of the public works scheme. Employing over 200,000 Hungarian citizens the public works scheme targets those receiving unemployment support (The Budapest Beacon 2014b). Now, you were no longer entitled to this support—thus saving the state the money it had to pay for those unemployed—but instead you could receive support if you worked for the state—usually local authorities. This was not a public sector job as the remuneration was far below the minimum wage required by the law. It was the government’s way to no longer have to pay for unemployment while taking hundreds of thousand of people off the unemployed list, which meant a drop in the official rate of unemployment. Balint Magyar documents numerous instances where people on this kind of state help ended
up working in the private households of local officials or had to perform agricultural labor for local government at harvest time (Magyar 2016).

This situation is problematic not only because it creates incentives for government officials to use these people as staff and even threaten them with withholding payment unless specific work was performed, but it also resulted in additional dubious moral practices. In some municipalities the entire maintenance staff was fired and then rehired under this program at much lower wages for the same work and with no job security or benefits.\textsuperscript{62} Moreover, in addition to the insecurity of these positions, there is no training or useful work experience that the employee could take to a new job and it frequently prevents people from finding a new position because they spend their time working these menial tasks instead of looking for a better job. If the people in this system would be added to the numbers of unemployed Hungarians, the unemployment rate would actually be around 8 percent.\textsuperscript{63}

A third reason behind Hungary's improved unemployment rate is outward migration. It is estimated that in the past 5 years approximately half a million Hungarians have migrated to Germany, Austria or the UK due to lack of economic prospects in Hungary (\textit{Hungarian Spectrum} 2015). With these people migrating another big part of the population no longer counts as unemployed further improving government statistics.

\subsection*{6.7.4 Inflation}

Inflation is another indicator that the government often uses to demonstrate its economic success. In the past few years Hungary has managed to keep its inflation in check, in some cases even going below 0 as was the case in parts of 2014, 2015 and

\textsuperscript{62} Interview, February 2017, Budapest.

\textsuperscript{63} Interview, February 2017, Budapest.
Figure 6.9: Monthly inflation rate in Eastern Europe (annual rate of change).  

2016.\(^{64}\) Hungary has been a good performer in comparison to the rest of Eastern Europe (Figure 6.9).

The reasons behind this low level of inflation are threefold. First, as was discussed in the section on energy and utilities, the government still regulates prices in that sector which is one of the usual sources of inflation. A second factor is connected to the global price of oil. For years those prices had been at record low levels which has kept the prices of other products from increasing (this has not changed much even with the price of oil increasing). Finally, inflation has also been low because there has been no real economic growth. If growth were truly to the levels mentioned by the government and not a consequence of EU funds, then there would be higher demand for goods and services and a slight increase in inflation.

In spite of these three reasons why Hungary should have lower numbers on this indicator it still doesn’t lead the region when it comes to fighting inflation. As can be seen in Figure 6.9 while most of the countries in Eastern Europe have converged in terms of fighting inflation—especially after 2004 when they were trying to abide by EU accession requirements—at the beginning of 2017 only the Baltic countries had higher inflation than Hungary; everybody else was performing better.

\(^{64}\) EUROSTAT, Financial Statistics Database, consulted in March 2017.
6.8 Conclusion

In the story so far the international dimension has played a counterintuitive role from the one predicted by the literature claiming that we are living a period of global diffusion of markets and democracy (Simmons, Dobbin and Garrett 2008). The early influence of the consensus that market reforms and privatization under the guidance of the EU and the IMF were good for the countries in the region has been replaced by skepticism fueled by local politicians picking up on the anti-European preferences of their constituents. Delving deeply into the shifting coalitions that made the reverse wave possible allowed me to show the domestic dimension of privatization-nationalization waves emerge at the domestic level before they aggregate up to regional and global level. This chapter has examined the changes in the region from the perspective of international shifts in priorities and alternatives to the West and so far a few preliminary conclusions emerge.

This chapter has added an international dimension to the reverse wave away from liberalization in Eastern Europe. I argued that the reforms championed by the EU weren't sufficiently institutionalized making them easier to reverse. It wasn't until some of the reforms in Eastern Europe truly challenged the core of EU values that any action was even contemplated and the coercion mechanisms in place proved to be ineffective.\(^65\) Additionally, with the rule breakers part of the EU system any kind of accountability was strongly opposed by the states and their supporters thus making international pressure even less effective. Not only were the international pressures not strong enough to play the determinant role they had in the 1990s when the consensus was to reach market economy status and be integrated in the West, but

\(^{65}\) The EU was created on the basis of shared values which means that no coercion mechanism was considered to be needed.
alternative illiberal models from Russia and China are emerging as sources of funding and examples in implementing state capitalism.

These qualitative accounts support my statistical findings in several ways. The decreasing affinity of Eastern European countries with the US-led liberal order means they become less likely to embrace policies such as privatization. Even if affinity stayed high the fact that IMF loans were returned earlier in Hungary means that the interaction effect between the international and domestic factors will predict a lack of further progress on privatization. The financial crisis interacted with a low affinity for Western liberal values which led to the predicted increased likelihood of nationalizations.

My regional hypothesis was also confirmed by the fact that the lessons of Hungary are now being examined, learned and applied by other countries in the region with diffusion effects gaining ground. Finally, the nationalizations of the post-2010 era in Hungary were foreshadowed by the earlier nationalization of banking institutions by Orbán during his first term in office, thus also providing qualitative evidence for my temporal hypothesis–if you nationalized in the past, you do so again in the future.

Examining the consequences of the nationalization campaign in Hungary provided additional insight into economic problems that have already been picked up by emerging domestic coalitions that could push for a new leadership in the country. If my argument is right, this domestic development combined with the support of the international community could move the country toward increased economic liberalization and privatization.
7.1 Overview of the project and the findings

This project has studied post-1989 changes in Eastern Europe in the context of broader waves of privatization and nationalization. The questions at the center of this project examined why countries vacillate between periods of greater state ownership of the economy and periods of private ownership, between policies of privatization and policies of nationalization. What are the conditions under which a change to either increased private ownership or increased state ownership of the economy would occur? Why do these waves of privatization and nationalization occur in so many countries at once? What are the drivers behind regional or world waves of privatization and nationalization? Large-scale reform programs reshaping the political economy of entire regions—such as the privatization wave of the 1990s—have occurred and been reversed periodically. The explanation for these periodical policy changes rests at the intersection of domestic politics and the international economic pressures these countries experience. Domestically, the way governments modify the extent of their ownership in turn modifies power relationships within society creating new winners and losers, new winning coalitions in the political process. The new coalitions might one day change the level of state ownership in the economy which could once again result in a new wave toward a new dynamic in the state-market relationship. International factors intervene through forces that integrate a country within regional economic
contexts as well as the international financial system, creating ties to international institutions and actors with policy agendas that push states toward privatization or nationalization. The interaction of these domestic factors and international pressures creates the context that could lead to privatizations and nationalizations.

In Chapter 2 I argued that domestically, political parties and leaders run for office on platforms based on domestic demands for changes in property rights which have important redistributive consequences. Once in power these parties enact policies of greater or smaller state ownership in the economy that ensure continued popular support. If these economic policies fail to provide enough benefits to people in the support group, another leader could win coalitional support and change the level of state ownership in the economy. International factors intervene in this story through forces that integrate a country within the international financial system which means creating ties to international financial institutions, organizations and actors with specific policy agendas and requirements. Or in case of financial crisis international pressures could push a state toward protectionism or increased reliance on the international community or international financial institutions. The interaction of these two sets of factors is expected to impact the likelihood of a new wave of privatization or nationalization.

In Chapter 3 I examined this argument empirically. Using originally collected data I tested the domestic and international hypotheses. Several quantitative methods were used in this process. Logit regressions with privatization and nationalization as the dependent variables were conducted over a variety of model specifications and with several variables that test domestic and international conditions. I found that the probability of privatization is markedly larger when the country supports the international order and at the same time receives support from the international community—in this case in the form of high levels of IMF funding. Privatizations are not likely to happen in countries with low affinity levels to the international
order regardless of their levels of IMF support. Privatizations are also more likely to happen during a financial crisis if the country has high levels of affinity, whereas nationalizations are likely to happen in times of crisis but only in countries with low levels of affinity.

I also find support for the temporal and regional hypotheses. Once a government privatized or nationalized in the previous 10 years, the likelihood it pursues that policy again is substantial. Additionally, I showed the regional diffusion of both nationalizations and privatizations. Privatizations are more likely to happen if the region has experienced other privatizations, but less likely if it has experienced regional nationalizations. Nationalizations are increasingly likely when a country’s regional neighbors have also experienced nationalizations.

Chapters 4, 5 and 6 examined the privatization wave and its reversal at the center of this project’s puzzle: the wave in Eastern Europe. Chapter 4 analyzed the privatization process across the region as well as the recent changes that have swept many countries in the region. Chapter 5 studied domestic changes that explain the recent wave of nationalization in Eastern Europe, and Hungary in particular. In-depth studies of the banking, energy and utilities sectors showed how domestic political considerations affected levels of state ownership. Chapter 6 focused on the foreign factors that have or have not impacted the changes we see in Eastern Europe at the intersection of domestic politics and international pressures. In seeking to find out why actors in the international arena did not play a similar role to the one they fulfilled in the 1990s and early 2000s I examined the role of EU conditionality, the IMF and international investors as possible actors pushing for privatization, versus the influences of alternatives to the liberal order from China and Russia.

These qualitative accounts support my previous statistical findings in several ways. The decreasing affinity of Eastern European countries with the US-led liberal order
means they become less likely to embrace policies such as privatization. Even if affinity stayed high the fact that IMF loans were returned earlier in Hungary means that the interaction effect between the international and domestic factors will predict a lack of further progress on privatization. The presence of the financial crisis interacted with a low affinity for Western liberal values which led to the predicted increased likelihood of nationalizations.

My regional hypothesis was also confirmed by the fact that the lessons of Hungary are now being examined, and applied by other countries in the region, with diffusion effects gaining ground. Finally, the nationalizations of the post-2010 era in Hungary were foreshadowed by the earlier nationalization of banking institutions by Orbán during his first term in office. This provides qualitative evidence for my temporal hypothesis—if you nationalized in the past, you continue to do so again in the future.

Thus pursuing privatization or nationalization are in fact policy options for governments which can be changed and modified. The varieties of capitalism literature has already suggested that a diversity of state-market interactions can result in successful states and sustained growth. Does this mean that perhaps the concern over the reversal of privatization and increased nationalization and regime control over the economy in Hungary is premature?

7.2 Is the Hungarian experience generalizable?

The overview of the economic consequences of the reverse wave in the Hungarian case was not encouraging. But does nationalization always lead to sub-par economic and political outcomes? It depends on the end goal, which in many cases may be power not economic performance. The evidence in this project offers reasons for optimism for both democrats and budding autocrats.
While the previous chapters did not give many reasons for optimism in terms of sustainability of the economic system, politically the regime seems to be doing fine. In April 2018 Orbán was elected for a fourth term as prime minister with Fidesz maintaining a comfortable majority after having rewritten the constitution to ensure future victories and having created a group of wealthy supporters and content core voters who will back Fidesz for the foreseeable future. Thus, nationalization can do wonders to build up a semi-authoritarian regime and Hungary has offered a blueprint that Poland and other countries in the region seem to happy to follow. There is a case to be made that nationalizations allow some regimes to build a new form of authoritarianism on the back of the liberal order and democratic institutions. The interaction between domestic affinity with the liberal order and the difficulties of the financial crisis resulted in a re-assertive state we now see in the Hungarian economy.

Although the EU has disappointed, an Eastern alternative has not really emerged. Some countries in the region are touting a turn to the East, but it seems this is more a pragmatic decision to attract no-strings attached Chinese funding and deeply discounted Russian energy rather than a full embrace of these countries at the expense of Europe. Even the most staunchly anti-European regimes such as Hungary prefer the position of inside critic of the EU to a Brexit-like solution. While critiquing the EU is easy—particularly to domestic audiences, leaving it is not in the cards as of yet. This might change in the future. As the EU becomes more critical of democratic backsliding—as it did toward changes in the judicial system of Poland for example—the possibility of true repercussions such as suspension of voting rights or even more importantly penalties in the next EU budget negotiations could result in this anti-EU stance turning into a much more aggressive critique of the European project. Or these EU pressures could turn even the more rebellious of the Eastern European populist regimes into more amenable partners that could turn back toward privatization.
The choice of nationalization over privatization is not the end of the story. As this project has shown, waves take place periodically. A return to privatization could be in the future of each country that is now pursuing nationalization. The big question however is whether this is done at the expense of healthy institutions. Committed democrats can take advantage of the additional policy options offered by nationalization. Less than democratic politicians will see this as an opportunity for increased political power. In addition to the economic changes in Hungary for example an assault on democratic institutions has hollowed out most of the checks and balances on the political sphere. In Dani Rodrik’s “political trilemma” Hungary has chosen nationalization and global integration at the expense of democracy—and Viktor Orbán seems fine with that choice. Yet, democratic backsliding is not as easily reversible as reprivatizing banks and liberalizing utilities prices. A wave back to greater privatization might be easier to achieve than a shift away from increasing authoritarianism.

7.3 Contributions of the project

I make several contributions through this work. The project brings together two interrelated topics that have rarely been studied together and never quantitatively. Privatization and nationalization are important processes that have constituted the topic of countless articles and books. I bring together data on both processes in a more generalized theory of privatization-nationalization waves. Exploring the wave pattern of these processes is another contribution of this work. Wave-like patterns have been analyzed before in the study of democratization and globalization, but considering the link between these processes posited by Dani Rodrik’s “political trilemma,” we also need to examine privatizations and nationalizations using the same wave metaphor.
I contribute a more generalized understanding of what explains waves of privatization and nationalization. I showed the importance of regional and temporal patterns, as well as the interactive effect of domestic views of the liberal world order and international pressures coming from institutions, trade, exports and financial crises. The analysis and its results contribute to our understanding of what drives privatization and nationalization waves.

This project problematizes transitions and reforms. I engage with a large literature that in many ways still has difficulty explaining change, both political and institutional. While I don’t claim perpetual instability and constant institutional shift, in some parts of the world running on a constant platform of change is the way to get into office. Institutional weakness results in promises of new reforms and privatization and nationalization represent possible reform options.

Engaging with change allowed me to tackle head on the transition paradigm emerging from my region of interest. Eastern Europe was a laboratory of social science research and many of the early assumptions and conclusions of the authors studying that region in the 1990s went unexamined as the transition process entered its second decade. In this project I contribute a new understanding of why promising reforms succeeded in some part of the former Communist space and why some have started to fade while others keep holding strong.
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