

## **The Political Economy of Populist Rule in post-crisis Europe: Hungary and Poland**

### **Abstract**

This paper analyses the economic dimension of populist governance in post-crisis Europe by exploring whether and in what ways populist economic policies diverge from neoliberal orthodoxy. Existing literature on contemporary populism in Central and Eastern Europe is ambivalent on this question and lacks systematic analyses of populist economic policies while in government. The comparative analysis of the Fidesz-led government in Hungary and the Law and Justice government in Poland is used to analyse the policy shifts in different domains. The main claim is that a combination of both domestic ideological change at the level of government and transnationally conditioned structural factors need to be considered to explain the shift towards and the variation in the pursuit of a ‘heterodox’ economic strategy under the two populist governments. The paper concludes by offering a reflection on why the analysed policy changes do not correspond with a more decisive shift towards an alternative trajectory of capitalist development in post-crisis Europe.

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## Introduction

The aftermath of the 2008 financial crisis has seen the sweep to power in Europe of four new populist governments. First the FIDESZ-led government in Hungary in 2010, then the SYRIZA-ANEL government in Greece and the Law and Justice party (PiS) government in Poland in 2015, followed by the Five Star Movement-Lega government in Italy in 2018. With many other populist parties in Europe either playing a junior role in coalition governments or supporting supply and demand partnerships (for example in Austria, Finland and Switzerland), a scholarly agenda analysing the policy aspects of populist rule in Europe is slowly emerging. While comparative scholarship on populism in Europe has so far focused on the impact of populists *in power* on democracy, the rule of law and immigration policy (Mudde and Rovira Kaltwasser 2012; Albertazzi and Mueller 2013; Aslanidis and Rovira Kaltwasser 2016; Karolewski and Benedikter 2017), it has neglected the economic policy dimension of populist governance in Europe.

Existing studies of populism in Europe have focused on the economic programmatic positions of mostly right-wing populist (or far-right, in some parts of the literature) parties while *in opposition*. Some scholars observed that populist radical right parties in Western Europe during the 1990s pursued ‘the winning formula’ of economic liberalism combined with xenophobic exclusion to build cross-class coalitions of electoral support (Betz 1993; Kitschelt and McGann 1995). By late 1990s, scholars started to note a stronger anti-liberal stance among these populist radical right parties when it comes to opposition to free trade and globalisation (McGann and Kitschelt 2005; Kitschelt 2007; Kriesi *et al.* 2012). In Central and Eastern Europe (CEE), scholarship finds a far more protectionist and statist orientation in the economic

programs of right-wing populist and radical right parties during the post-communist transition (Markowski 1997; Mudde 2007). While authors have disagreed on whether economics has an important or only secondary, mostly instrumental, place in the political programme of populist parties in Europe (see, for example Mudde 2007, ch. 5; Kitschelt 2007, pp. 1181–4), there has nonetheless been a common presupposition, at least until recently, that populist parties are far removed from political power and, if they do get into power, their electoral promises hit the hard wall of economic reality, followed by a fall in electoral support.

The enduring electoral success of Viktor Orbán’s governments in Hungary since 2010 and high growth rates under his populist rule dispute this assumption in the literature. Following the coming to power of a populist nationalist government led by the PiS party in Poland in 2015, initial analyses of the economic policies of the two populist governments have noted elements of left-wing economics (in the case of Poland) and market-constraining state interventionism (in both cases) (see Kornai 2015; Johnson and Barnes 2015; Szanyi 2016; Moses 2017, pp. 147–70; Miszerak and Rohac 2017; Voszka 2018). These developments raise the question of the extent of change in the economic strategies of the populist governments from the orthodox economic strategies of their predecessors in the region, but even more importantly, how to go about analysing the relationship between populism and economics. While existing political economy analyses have convincingly documented how contemporary populism in Europe arises as a political reaction to neoliberal globalisation (Kalb 2009; Shields 2012; Saull 2015; Rodrik 2017; Voss 2018; Stankov 2018; Ryner 2018), the international political economy literature has so far neglected or underestimated the extent of change populist governments can have on the conduct of economic policy. The literature on populism during the post-communist transition in CEE provides an important building block for this analysis.

In this paper, I will analyse the economic policy dimension of populist rule in post-crisis Europe by focusing on the economic strategies of Orbán's governments in Hungary and the PiS government in Poland, while probing the extent to which they represent a shift away from the pursuit of orthodox economic policies by their predecessors. Drawing on analytical insights from the political economy of CEE and comparative populism studies, I will argue that a combination of transnationally conditioned structural factors (past economic transformation legacies; regional and global competition; and the dependent mode of integration into the global economy) and ideological change at the level of government need to be considered to account for the shift towards market-constraining measures and the variation in the pursuit of what I will identify as a 'heterodox' economic strategy by the two populist governments. In this way, the paper contributes to comparative populism studies in Europe by highlighting the structural and institutional hurdles that contemporary populist governments encounter once they get to the implementation stage of their economic programmes, as well as to the comparative political economy literature in CEE by demonstrating how populism can reshape economic strategies through the use of state power and attempt to restructure the pattern of integration into the global economy.

The remainder of this paper is organised as follows. First, I briefly review the economic programmatic positions of populists in CEE during the post-communist transition. The next section lays out the key analytical building blocks for differentiating between neoliberal and post-neoliberal economic strategies. In the following two sections, I provide the empirical evidence for the policy shifts in populist economic policies in Hungary and Poland, identifying the key similarities and differences, and then explain the heterodox shift in their policies by examining the underlying structural factors. The last part summarises findings and assess the significance of policy change under the two populist governments.

## **Political economy of populism in CEE**

In the early 1990s, the literature on the post-communist transition in CEE was replete with concerns that the recessionary effects of rapid market reforms would provoke the mobilisation of populist and authoritarian political forces. This fear was largely based on the experience of a wave of popular protests against neoliberal reforms and electoral volatility in Latin America in the 1980s (Przeworski 1991; Greskovits 1998). As part of the transformation from previously state-controlled planned economies to market economies, post-communist political elites in CEE embarked on shock therapy strategy of privatisation, deregulation, trade liberalisation and fiscal consolidation (Gowan 1995). Between 1990 and 1991, CEE economies contracted by more than 10 per cent and in many recession lasted for more than three consecutive years (Milanovic 1998, p. 25). Despite a rise in unemployment, income inequality and a fall in real wages, the region did not encounter a reversal of the transition to capitalism and liberal democracy by the end of the decade as some scholars expected.

The kind of populist policies that many orthodox economists feared were of the type seen in Latin America in different periods over the 20<sup>th</sup> century, which are encapsulated by the concept of economic populism. The orthodox position associates populism with specific economic policies that emphasise (1) growth and income redistribution, (2) deemphasise the risks of inflation and deficit finance, as well as external constraints and the reaction of economic agents to non-market policies (Rudiger and Dornbusch 1989; Sachs 1989). Whereas the orthodox position equates populism with macroeconomic mismanagement, a heterodox position separates macroeconomic mismanagement from microeconomic structural policies, such as inward-oriented import-substitution industrialisation or liberalisation (Rodrik 1996; Rodrik 2018). Moreover, the heterodox position also recognises the diversity of governmental

ideologies and regime types, whether democratic or autocratic, right-wing or left-wing populist, that can accompany economic populist policies. During the post-communist transition, economic success was measured by the speed and extent of privatisation and integration into the global economy, as well as by regulatory harmonisation with the EU *acquis communautaire* by the late 1990s. Any alternative economic policy options that distracted from this chartered trajectory were condemned as populist and misguided by the international institutions and Western economists.

Although the 1990s did not bring any radical reversals of the transformation agenda, the degree of social dislocation and economic hardship, however, was severe enough to produce voter demand for populist politics during the first decade of transition and opened the possibility for reshaping the previously pursued transition strategy. In Hungary, an agrarian populist Independent Holders' Party, which formed part of the first post-communist coalition government in 1990, called for increased state intervention, market protection and subsidisation of products (Bozoki and Sükösd 1993). István Csurka, an MP of the radical right-wing populist wing of the Hungarian Democratic Forum, warned against the domination of the international financial superstructure over Eastern Europe and criticised the foreign-oriented privatisation strategy pursued by Hungarian post-communist elites, arguing that it would lead to 'dependent capitalism' (Greskovits 1998, p. 121). There was also populist backlash in Poland, where the Solidarity candidate Lech Walesa used populist rhetoric against parts of the Balcerowicz shock programme during the 1990 presidential campaign, in order to defeat a populist nationalist Stanisław Tymiński (Weyland 1999, p. 396). While populist backlash did lead to a slowing of privatisation in early 1990s, by the end of the decade, a combination of bad macroeconomic fundamentals, pressure from international institutions and domestic elite support for 'a return to Europe' meant that all countries in the region eventually aligned with a foreign-led capitalist model of development (Bohle and Greskovits 2012).

Vladimir Mečiar, two-time prime minister in independent Slovakia and leader of the largest electoral force Movement for a Democratic Slovakia (HZDS) in the 1990s, was an important outlier in the first decade of the transition in that his populist nationalist rhetoric did not translate into concrete change in the transition strategy pursued. HDZS aspired to building an inward-oriented national capitalist model of development by cancelling the second wave of voucher privatisation and selling state enterprises directly to Slovak enterprise managers (Gould 2003). Between 1994 and 1998, the Mečiar government pursued an active industrial policy through large infrastructure projects, a domestic banking sector in service of industry and a growing private sector responding to both market price signals and state objectives. This was supported by trade liberalisation, welfare paternalism and restrictive macroeconomic policy (Haughton 2001; Bohle and Greskovits 2012). Despite criticism from the West for his autocratic style of government and suppression of the media, which resulted in a delay in EU accession negotiations with Slovakia, the 1998 World Bank report praised the government for ‘one of the best growth performances in the region’, with the real GDP growing by more than 6 per cent on average, and bringing inflation down to around 6 per cent, one of the lowest in CEE at the time (World Bank 1998, p. ix).

The Slovak national capitalist project was abandoned under the reformist Dzurinda government from 1998 onwards, which marked the alignment of all CEE economies on state FDI-promotion through competitive tax regimes and the transnationalisation of production, thus fulfilling a key EU accession requirement (Bandelj 2010; Bohle 2018). In 2000s, the literature on populism in CEE notes the predominance of centrist populism, where the emphasis is on newness, competence and an anti-corruption agenda, rather than challenging the transition policies and offering an alternative economic programmatic agenda (Hanley and Sikk 2016; Stanley 2017). Even in the case of radical right-wing populist parties, such as the Law and Justice (PiS) party-led coalition government between 2005 and 2007 in Poland, once in

government, these parties continued with neoliberal policies, despite discursive sympathy with state interventionism and solidarity with the losers of the transition (Szczerbiak 2007; Kalb 2009; Shields 2012). This seems to have brought the economic policies of populists in CEE closer to those in Western Europe by early 2000s, where populist radical right parties have combined culturally conservative policies with welfare chauvinism and neoliberal economic policies (Mudde 2007; Kriesi *et al.* 2012), at least until the 2008 financial crisis.

Taking the literature on the economic policies of populists in CEE in the 1990s and 2000s together, and if we exclude the Mečiar case, one could say that populists in government have little effect on the change of economic policy. This would also corroborate the thesis in the political economy of CEE that governmental ideology does not fundamentally change the developmental strategy pursued (Drahokoupil 2009, p. 201), as well as the assumption in comparative populism studies that economic issues are only secondary in importance to the cultural programmatic positions of populist radical right parties in Europe (Mudde 2007). Turning attention of the paper to the economic policy strategies pursued by the Fidesz-led government in Hungary after 2010 and the PiS government in Poland 2015, I will instead argue that ideological change at the level of government can have an effect on the developmental strategy pursued. This will be demonstrated through a systematic analysis of the interplay between populist ideas and the corresponding shifts in economic policy.

### **Differentiating between neoliberalism and post-neoliberalism in post-crisis Europe**

Before we proceed with case study analysis, I need to provide some analytical clarification as to how we can distinguish between different economic policy strategies pursued by populist governments and empirically assess the extent to which state policy change marks a shift away



from an orthodox economic policy strategy to an alternative one. Although radical populism arises in response to neoliberalisation in CEE (Stanley 2017), the economic policy strategies of populist parties once in power vary depending on their governmental ideology and the structural and institutional constraints that they encounter when implementing policy.

Neoliberalisation will be understood as a variegated state-led process of regulatory reorganisation in state-economy relations by imposing, extending and consolidating market competition in different areas of social and economic life (Brenner *et al.* 2010, p. 330). A key dimension of this process is the emergence of transnational rule-regimes that through supervisory and disciplinary power impose restrictive rules of the game on the conduct of economic policy. In the CEE context, this process has been supported by domestic political elites in conjunction with international financial institutions and the EU with a view to increasing the role of transnational markets in CEE economies and thus strengthening EU's competitiveness in the global economy (Meardi 2002; Shields 2012).

Neoliberal restructuring can be schematically divided into two different phases in CEE, which correspond with similar changes in other parts of continental Europe at the time. The first transition phase in the 1990s followed the orthodox transitological paradigm: the depoliticisation of ownership, the depoliticisation of allocative mechanisms, the marketisation of the economy and the imposition of hard budget constraints (Shields 2012, 23–4). This was achieved through privatisation, deregulation, trade liberalisation, fiscal consolidation and restrictive monetary policy. The second was a phase of neoliberal regulatory deepening, which took place from the late 1990s onwards to the 2008 financial crisis. This stage of neoliberalisation saw the abandonment of national capitalist projects, liberalisation of economies to FDI (mostly from Western Europe), FDI promotion through special tax incentives and reduction in corporation tax rates to boost competitiveness (Drahokoupil 2009; Bandelj 2010). CEE states also undertook (partial) privatisation of pensions and healthcare,

flexibilisation of labour markets, privatisation of strategic economic sectors, such as banking, telecommunications and utilities, and regulatory alignment with EU's single market and competition rules in preparation for the 2004 accession (Bohle and Greskovits 2012). As part of their preparation for entry into ERM II and Eurozone, they continued with restrictive macroeconomic policy and adopted austerity measures and welfare reforms to tackle budget deficits (Dyson 2006).

Counter-neoliberalisation, on the other hand, involves economic strategies that are market-constraining and represent qualitatively different agendas, for example, centred on national sovereignty (Brenner *et al.* 2010). The 2008 financial crisis, followed by the 2010 sovereign debt crisis in Europe, represented a significant intellectual blow to neoliberal economic orthodoxy. Although neo-Keynesian and protectionist approaches to crisis-management followed, including renationalisation of financial institutions and industry, these were only temporary and directed towards salvaging the existing neoliberal model (Bruff 2014, pp. 120–1; Voszka 2018). To analytically distinguish between neoliberal and post-neoliberalism, alternative economic strategies need to be legitimised by a long-term anti-establishment ideological-state formation and politicise the role of the state in terms of ownership, its allocative mechanisms and management of the economy.

In concrete terms, economic strategies that involve the following policy shifts will be considered as challenging neoliberal orthodoxy in Europe: (1) opposition to Euro adoption and tighter economic policy coordination at the EU level; (2) stopping privatisation and renationalisation of strategic economic sectors as part of a long-term developmental strategy; (3) greater concern with developmental outcomes and minimising dependence on FDI for industrial upgrading; (4) imposition of capital or exchange controls, protectionist measures for domestic industry in a discriminatory way; (5) subordination of domestic capital to nationalist or redistributive goals; (6) favouring domestic private capital over foreign sources; (7)

increased public spending in infrastructure and state aid; (8) loose monetary and fiscal policy; (9) increased welfare spending and redistribution; and (10) decommodification or levying of selective controls over prices of basic social needs, such as utilities, transportation or housing.

When these measures are combined with orthodox measures, for example, continued state promotion of FDI, privatisation of strategic enterprises or closer economic policy coordination at the EU level under the current EU treaties, the economic strategy pursued will be classified as *heterodox*. The continuation of neoliberal deepening by increasing the power of transnational markets and relinquishing of economic decision-making to the supranational level will instead be considered as *orthodox*. The analytical focus should be on the role of the state in the economy and how it is legitimised ideologically rather than simply on the amount of state intervention, since state involvement is a given in any type of economic strategy pursued (Schoenman 2005, pp. 69–70). Furthermore, as structural analyses of post-neoliberal economic strategies in Latin America have shown (see, for example, Levitsky and Roberts 2011; Wylde 2016; Gezmiş 2018), once the extent of the restructuring of economies is taken account of, the transformation is not as radical a break from neoliberalism as it first seems. I now turn to the two country cases to examine the domestic process of policy shifts in the economic strategies pursued and whether they represent a decisive shift towards an alternative trajectory of capitalist development.

### **Comparative analysis: Hungary and Poland**

Both countries have seen the electoral victory of right-wing populist parties on the back of the electorates' frustration with mainstream political elites and their handling of the economy. Viktor Orbán's FIDESZ party won a two thirds parliamentary majority in alliance with a

satellite party the Christian Democratic People's Party (KDNP) in 2010 at the height of the financial crisis in Hungary. Such electoral breakthrough was made possible by a preceding political crisis, which was triggered by the loss of public support for the governing social liberal MSZP party and the unpopularity of fiscal consolidation policies under the technocratic Prime Minister György Gordon Bajnai. The FIDESZ-KDNP alliance was re-elected with another two thirds majority in 2014 and another in 2018. In Poland, Jarosław Kaczyński's Law and Justice (PiS) party came to power in 2015 with an absolute majority for the first time since Poland's introduction of full democracy. Despite being the only EU economy to have avoided an economic recession since the outbreak of the 2008 financial crisis, Poland has been experiencing a lingering high unemployment rate and widening social and regional inequalities. By capitalising on the growing dissatisfaction of the electorate with the post-communist transition, especially in the Eastern parts of Poland, and politicising the issue of material inequality, PiS successfully ousted the centre-right liberal Civic Platform from government after eight years in power.

Both parties' discourse is staunchly nationalist, anti-immigrant and Eurosceptic. It is constructed in a characteristically populist manner where European technocrats, liberal post-communist elites and globalist forces are pitted against the national interests and values of Hungarian and Polish people. They are both scornful of free market economics and of the dependent developmental model that their predecessors in respective countries have been pursuing during the post-communist transition. Under the Morawiecki economic plan, the PiS government identified 'the middle-income trap' and an excessive dependency on foreign capital as the main challenges for Poland's future developmental trajectory. To tackle them, the government has vowed to stop the privatisation agenda of previous governments and reindustrialise and 're-polonise' parts of the economy. A similar nationalist agenda has been pursued by the Hungarian Prime Minister Viktor Orbán ever since his 2010 election campaign.

In a speech following his party's electoral victory in 2014, Orbán declared the establishment of an illiberal democracy as a key objective of his government to serve as an alternative model to Western liberal democracy in the global economic competition:

In my opinion, the most provocative and exciting question surfacing in the Western world during the last year can be summarized as follows, applying necessary simplification: competition existing among nations in the world, competition existing among alliances and forces of the world has been supplemented by a new element... I would articulate this as a race to invent a state that is most capable of making a nation successful... a state that is most capable of making a nation competitive ... [T]he new state that we are building is an illiberal state, a non-liberal state. It does not deny foundational values of liberalism, as freedom, etc. But it does not make this ideology a central element of state organization, but applies a specific, national, particular approach in its stead. (Orbán 2014)

In the same speech, Orbán pointed to Singapore, China, India, Turkey and Russia as some examples of illiberal political regimes, which according to him were making their nations successful in the increasingly competitive global economy (Orbán 2014).

Notwithstanding the shared ideological objectives by the two populist governments in Hungary and Poland, I will now examine how the nationalist-populist discourse and ideology translated into concrete policy changes and a shift to a heterodox economic strategy. In particular, I will focus on the measures undertaken to (1) decrease their dependency on foreign capital through the renationalisation of strategic sectors of the economy, (2) their monetary and fiscal policy, (3) their social policy and (4) their openness to foreign investors and trade.

### *Renationalisation of strategic economic sectors*

After coming to power in 2010, Orbán resisted the pressure from the International Monetary Fund (IMF) and the European Commission (EC) to impose a strict austerity programme on public spending and instead started to enact ‘crisis’ taxes on the retail, telecommunications and energy sectors, which were dominated by foreign investors. The EC launched infringement proceedings against the telecommunications tax, but dropped legal action in 2013 after the European Court of Justice (ECJ) ruled against EC’s claim in a similar tax involving France (US Department of State 2014). He also introduced the highest bank levy in the world, mostly affecting the large foreign-owned institutions, which more than tripled banks’ tax burden (Capelle-Blancard and Havrylchuk 2017). Contrary to other governments in the region, Orbán’s government forced the banks to convert the foreign currency mortgages after the devaluation of the Hungarian forint during the crisis with the intention of protecting the Hungarian mortgage owners. Additionally, the government effectively nationalised the mandatory second-pillar private pension fund. While these unorthodox fiscal measures were putatively employed to balance the budget and stop government debt from increasing further during the European sovereign debt crisis, the government was also adamant to renationalise what it identified as the strategic sectors of the economy. By the end of 2017, the foreign ownership of the banking sector decreased from 80 per cent to just below 50 per cent, with two-thirds of the domestic share owned by the state (EBF 2018). Following the gradual enforcement of reductions in utility prices, the government bought privately owned subsidiaries of the German utility RWE and the French utility GDF, while other retailers, such as the subsidiaries of E.ON and ENI, ceased their operations and handed back their licences to the state regulator, further concentrating the state control of the domestic energy sector (International Energy Agency 2017).

In some respects, the PiS government in Poland took a less combative approach and was more willing to listen to the recommendations of the EC and private investors. Despite criticism from the ECB and Poland's central bank, the government imposed a levy on the banking and insurance sectors in 2016 (Matusik 2016). It also introduced a turn-over based tax on the retail sector, dominated by big foreign-owned supermarket chains, but the EC later ruled the tax was in breach of the EU state aid and competition rules. The PiS government took further steps to 're-polonise' the domestic banking sector, which was dominated by the subsidiaries of foreign private owned banks, and increased state control from 30 per cent to over 50 per cent (Miszerak and Rohac 2017). The government climbed down from its campaign pledge to force banks to convert foreign currency loans into zloty and, after fears of destabilising the financial system, opted for a less radical measure, requiring banks with portfolios of foreign currency mortgages to make quarterly payments into a new mortgage relief fund, which would help the borrowers to meet their financial obligations (Moody's 2017). In the domestic energy sector, the government increased its control after the state-owned PGE bought the assets that were owned by France's EDF. Furthermore, the government ordered state-run utility companies to reduce or stop paying dividends in order to increase investment and help finance government spending needs. Unlike in Hungary, the PiS government only nationalised 25 per cent of the assets held by the mandatory second-pillar private pension funds (OFEs) and transferred the rest into new mutual funds. However, this measure came on top of the previous government's step in 2014, which nationalised 51.5 per cent of the assets from OFEs, mostly government bonds.

However, the renationalisation agenda in Hungary did not stop just at what would normally be seen as the strategic sectors of the economy in European countries. Orbán's government also nationalised smaller air transport companies, a mass transportation company *Pécsi Közlekedési Zrt* and the telecommunications company *Antenna Hungaria* amongst other

service companies. Moreover, the populist government took control of small firms in the meat industry, Hungarian Aluminium, Dunakeszi Vehicle Repairs and the automotive company Rába Works (Voszka 2018).

### *Monetary and fiscal policy*

When it comes to macroeconomic policy-making, Hungary can be said to be abiding by fiscal discipline while undermining central bank independence, whereas Poland is pursuing a more orthodox approach in monetary policy, while in fiscal policy it is diverging from orthodox economic principles under the PiS government. Since 2011, Hungary's government debt-to-GDP ratio has declined from 79.7 per cent to 73.9 per cent in 2016 and is set to decline by a further 3 percentage points by 2019. Following the 'Structural Reform Programme 2011 – 2014' (Ministry for National Economy 2011), this was achieved through fiscal consolidation and 'the declining share of foreign owned and foreign currency denominated debt' (EC 2018a, p. 14). Since 2012, the government has also maintained a government budget deficit below 3 per cent of GDP, reducing it to -1.9 per cent of GDP in 2016. On the monetary side of policy, Orbán's government appointed his own Minister of Economy, György Matolcsy, as the new governor of the central bank MNB in March 2013 after the sitting governor's term was coming to end. Contrary to his predecessor, Matolcsy has been readier to pursue a looser monetary policy in order to stimulate the economy and encourage lending, by gradually reducing the key interest rate from 7 per cent to 1 per cent in 2016 and maintaining the 3 per cent medium-term inflation target. To tackle increased risk aversion and ease credit conditions, the MNB has used unconventional monetary policy instruments by restructuring the MNB's active balance sheet, such as introducing the Funding for Growth Scheme (FGS) and the Market-Based Lending Scheme (MLS) to support SMEs in accessing credit (Matolcsy 2016, 2017). Through the



creation of the Self-Financing Programme, the MNB encouraged banks to invest their excess liquidity in liquidity securities and this way contribute to reducing the country's external vulnerability (MNB 2016).

Compared to Hungary's innovative monetary policy, Poland under the PiS government has maintained a more orthodox approach and refrained from impinging on the independence of the central bank NBP. Although the government appointed Adam Glapiński in 2016, a former economic advisor to the late president Lech Kaczyński, as the new central bank's governor, the new governor has vowed to maintain a conservative monetary policy and keep the key interest rate at 1.5 per cent, while pursuing the medium-term inflation target at 2.5 per cent. Since the Great Recession, Poland's government debt-to-GDP ratio has stayed below 60 per cent. While the debt ratio was projected to decrease close to 50 per cent under the previous government, under the PiS government the debt ratio increased to 54.11 per cent, raising the medium-term fiscal sustainability risks. Government budget deficit has been gradually reduced under the EU's excessive deficit procedure to below 3 per cent of GDP in 2015. Under the PiS government, however, due to the public spending increases to fund election pledges, the structural deficit is predicted to increase (EC 2018b, p. 8, p. 18). This marks a potential shift from the strict fiscal policies of previous governments.

### *Social policy*

In Poland, the PiS government implemented one of its flagship electoral pledges to increase social spending. The 'Family 500+' programme, which entered into effect in April 2016, disperses a monthly child benefit of 500 zlotys (around £90) to Polish families for every second and subsequent child up to the age of 18, as well as to low-income families with one child. The policy is justified on the grounds of poor demographic trends and redistributing the wealth

created more equally amongst the population. The government also reversed the previous government's unpopular decision to increase retirement age and lowered it back to 60 for women and 65 for men. To curb the use of atypical work arrangements, the government has introduced a new minimum hourly wage at 13 zloty, which also applies to the much-abused civil law agreements that circumvented the existing minimum monthly wage legislation (Patocka and Dubiel 2017).

In Hungary, Orbán's government has pursued a starkly anti-poor and workfarist agenda. Through a constitutional amendment, the government granted power to local authorities to criminalise homelessness. Unemployment insurance has been reduced from 9 to a maximum of 3 months, compensation for low-income earners has been eliminated and active labour market policies have been replaced with a public works programme, which pays at 70 per cent of the national minimum wage and is tied to eligibility for social assistance (Szikra 2014). At the same time, the government has introduced a family tax allowance for working families, where families with two children to the age of 20 were eligible to 35,000 forints (around £100) per month in tax credits and 33,000 forints (around £90) per child in bigger families (CEU 2018). The government has also introduced a flat income tax of 15 per cent, while increasing the minimum wage in 2012 by 19 per cent in order to compensate low-income workers (Myant *et al.* 2013, p. 407). Following positive economic growth outcomes and tightening labour markets, an agreement was reached with trade unions and employers to further increase the minimum wage on an annual basis between 2016 and 2018.

### *Openness to trade and FDI*

Despite introducing new taxes in foreign investor-dominated sectors of the economy, which had a negative effect on investor confidence in the short-term, both countries left the

automotive manufacturing sector untouched. This is understandable in the context of the two countries' reliance on the German automobile industry for their industrial output.

To boost foreign direct investment, Orbán's government lowered the corporate income tax to 9 per cent in 2017, the lowest in the EU. This measure came on top of already existing generous investment incentives, refundable and non-refundable, in the form of tax incentives, low-interest rate loans and land available for free or at reduced prices, as well as negotiation-based 'VIP' subsidy opportunities for investments greater than 10 million euro (HIPA 2017). Mindful of the trap of labour-intensive, low-value added manufacturing and the need to upgrade to advanced manufacturing and innovation, the government has also introduced incentives to support R&D activities and technology-intensive investments. These business-friendly regulatory changes are in line with the government's innovation and industrial development Irinyi Plan and the objective to bring the industrial output-to-GDP to 30 per cent by 2020, while also increasing the number of Hungarian suppliers in the higher value-added parts of FDI-controlled supply chains.

In Poland, the PiS government has rolled out a new system of special economic zones (SEZ), where the exemption from income tax for companies that meet specific conditions is available throughout Poland for a period of 10 or 15 years. The new system introduces more comprehensive eligibility criteria, however, such as the location of the investment, the type of investment, the quality of new jobs created, and cooperation with research centres and academia. In line with the new 'Responsible Development Strategy', the government aims to address the middle-income trap by strengthening the position of domestic capital in relation to foreign investors and supporting the production of innovative and high-value added products. By 2020, the government wants to achieve an increase in industrial output that is higher than GDP growth, a 70 per cent increase in Polish FDI and a GDP per capita at 79 per cent of the EU average.

An important trend in both economies, especially since the 2008 financial crisis, has been the increasing foothold of foreign direct investment coming from the East, namely China, and Russia in Hungary. This development comes as a diversification strategy for Polish and Hungarian exports, but also, as it can be noted in the case of the Hungarian ‘Eastern Opening’ strategy, as a sustained effort to decrease economic dependence on Western European investors and promote the national interests of the Hungarian economy (MFAT 2017). To this end, Hungary has activated the role of the state in assisting the development of the export capability of SMEs by creating state-owned trading houses in emerging economies to mediate between Hungarian SMEs and foreign buyers (Szunomar 2017). By 2016, Poland has become China’s largest trade partner in the CEE region and was the first European country to issue government debt in the Chinese bond market (Kuo 2017).

### **The factors behind the heterodox turn and the variation between the two cases**

While I have outlined the ideological motivation behind the pursuit of a more nationalist economic strategy in Hungary and Poland and the corresponding policy shifts above, structural factors also need to be considered to properly account for the heterodox turn and the differentiated combination of heterodox economic strategies pursued by the two governments. The analysis below focuses on the following transnationally-conditioned factors: (1) *past economic transformation legacies*; (2) *regional and global competition*; (3) *the dependent mode of integration into the global economy*.

Although they followed a similar orthodox economic policy strategy during the post-communist transition period, the pace, the sequencing and the selective approach to reforms in individual CEE countries produced different legacies of economic transformation and patterns

of insertion into the European and global economy (Lane 2007; Becker and Jäger 2010; Bohle and Greskovits 2012). When comparing the transnationality index,<sup>1</sup> which is a useful measure of the degree of integration of a particular country within the world economy, Hungary consistently had a higher rate of FDI participation (30.1 in 2002, 33.5 in 2005) than Poland (around 16 in 2002, around 21 in 2005) in the years leading up to EU accession in 2004 (United Nations 2005, p. 16; United Nations 2018, p. 12). This can be explained by faster and more extensive privatisation processes in Hungary in the early 1990s, whereas Poland followed only in the late 1990s as experimentation with national capitalism failed (Gowan 1995; Bohle and Greskovits 2012). By the time of the 2008 financial crisis, Hungary's scale of state ownership was smaller than the EU average or when compared to the new EU member states in CEE (Voszka 2018). Moreover, the direct control of the state over business enterprises has decreased significantly in Hungary between 1998 and 2013, whereas in Poland it has remained almost the same during that period (EC 2016, 17).

Despite both having over 300 state-owned enterprises (SOEs) in 2012,<sup>2</sup> the value added of SOEs' output is higher and more capital intensive in Poland than in Hungary (Böwer 2017). Poland still had major state-owned enterprises in the airline, energy, banking, chemical, insurance, military, oil and rail industries by the end of its transition, whereas Hungary privatised its major state-owned enterprises in the energy sector, manufacturing, food processing and chemistry in the 1990s (US State Department 2018; Export.gov 2018). This difference in the privatisation strategies during the post-communist transition can explain why the Orbán's regime was more aggressive in its approach to renationalisation of privatised companies as part of its economic strategy compared to the PiS government in Poland. Moreover, with state-owned stakes in more capital-intensive production, the PiS government has been able to put forward a more ambitious developmentally-oriented and sustainable industrial strategy by setting out to capitalise on supporting domestic capital in driving

innovation and productivity of the economy, in cooperation with foreign investors. Given the smaller size of its economy and low levels of private investment after the crisis, Orbán's government opted for lowering the corporate tax rate to the lowest level in the EU, flexibilising the labour market and attracting FDI through special tax incentives and strategic partnership agreements, while also noticeably increasing public spending in economic affairs since 2010 due to more extensive involvement in the economy (EC 2018a, p. 13).

Another factor behind the varied combination of heterodox economic strategies pursued by the two populist governments can be explained by the fact that both countries remain embedded in the evolving institutions and processes of (intra-)regional (EU level and within the Visegrád group) and global competition for capital accumulation. Here the neoliberal regulatory regimes established at the EU level (EU competition law, the single market, EU rules on state aid, common trade policy, the Stability and Growth Pact (SGP), the European semester) and at the global level (for example, the World Trade Organisation rules and IMF conditionality) ensure through supervisory and disciplinary power that member states play by the 'constitutionalised' rules of market competition (Shields 2012, pp. 89–100; also see Gill 1998; Soederberg *et al.* 2005; Schmidt 2015). This is evident in the pursuit of stringent fiscal policy by both populist governments under the SGP, although the ideological differences between them account for a more welfare-oriented approach of the PiS government in Poland and a potential relaxation of its fiscal commitments beyond the EC recommendations. Furthermore, by being outside the Eurozone, both Poland and Hungary had more policy room in the use of their monetary policy, which was employed in Poland as a strictly crisis-management strategy, whereas in Hungary currency devaluation came as part of a wider non-orthodox economic policy after the Orbán-backed central bank governor took over in 2013.

At the regional level, EU member states also compete in terms of cost-driven regulatory competition. This is especially notable in the case of the Visegrád group countries (Poland,

Czech Republic, Slovakia and Hungary), which despite strengthening their regional cooperation at the political level in recent years, are still in fierce competition for inflows of investment capital from Western Europe, the United States and increasingly from the emerging economies, most notably China, Russia and India. As privatisation processes wound down by the late 1990s, in order to attract FDI in greenfield investments, the Visegrád countries engaged in fierce tax competition by lowering corporate taxes and offering generous investment incentives (Bohle and Greskovits 2012, 166–72). This trend continued under the Orbán's government in Hungary, as shown above, while the PiS government in Poland overhauled its SEZ system and tightened the eligibility conditions around specific socio-economic and developmental goals.

While Hungary and Poland managed to attract FDI in complex manufacturing as a result of their privatisation strategies (for example automotive and transport industry) in the 1990s and regional tax competition in the 2000s, more than half of FDI in manufacturing went into low- to medium low-technology intensive manufacturing (for example food processing, beverages sectors, consumer durables). Even within the production of high-technology intensive industries, CEE countries, including Poland and Hungary, maintain a comparably lower R&D intensity in high-technology electronics than the high-income countries of the OECD, which shows that CEE countries perform activities in the low value added segments in these industries, such as assembly or production of low-cost components (Stojčić and Aralica 2018, 10; Srholec 2007). Moreover, the bulk of FDI in greenfield investment in the 2000s was in the service sector, such as banking, telecommunications and IT services.

The pursuit of this dependent developmental path based on FDI-led export-oriented industrialisation (Nölke and Vliegenthart 2009; Becker and Jäger 2010) proved to be especially disadvantageous for CEE countries in the aftermath of the 2008 financial crisis as investment flows and export demand from Western Europe slowed down. Furthermore, unlike Poland,

Hungary also showed characteristics of dependent financialisation, as banks relied heavily on external financing before the crisis and households accumulated large foreign-denominated debts to purchase homes or consumer durables (Becker and Jäger 2010, p. 15; Myant *et al.* 2013, p. 403). The position of the two economies in a dependent mode of capitalist development is crucial for understanding the heterodox shift in the economic strategies of the two populist governments, which accord a more developmental role to the state in their industrial policy. Greater prevalence of foreign currency lending and dependence on FDI before the crisis can explain a more aggressive approach taken by the Orbán's governments towards renationalisation and more modest aims with regard to Hungary's reindustrialisation policy. With a greater share of domestic capital and state-owned enterprises in high value-added industries, Poland's industrial strategy is in a better position to upgrade and climb up the ladders of global value chains in these sectors.

## **Conclusion**

This paper has set out to analyse the economic dimension of populist rule in post-crisis Europe by examining the cases of populist governments in Hungary and Poland. I have argued that in order to account for the heterodox shift in the economic policy dimension of populist rule in Hungary and Poland, ideological change in conjunction with the underlying structural conditions need to be considered. While ideational factors at the level of government can explain the shift towards market-constraining state interventionism in some areas of economic policy-making at the national level (banking, energy sector, media), the alternative economic strategy is still embedded within neoliberal regulatory frameworks at the EU and global level. The dependent position of the two economies at the lower segments of global value chains



dominated by foreign investors and the threat of a middle-income trap have been the main motivating structural factors behind market constraining measures and more developmentally oriented state intervention by the two populist governments. However, these same structural conditions have meant the continuation of FDI attraction and their dominance in the automotive and electronics industries, retail and telecommunications, despite attempts to thwart market competition in the latter two sectors in Hungary.

It is important to note that the market-disciplinary power of EU institutions acted as a buffer against many of the proposed changes by the two populist governments. Apart from the short two-year period in the immediate aftermath of the financial crisis, during which EU member states were given more policy space in their crisis-management strategies, the EU institutions have continued to enforce market discipline on member states through the excessive deficit procedure, the European System of Central Banks, the European semester and legal proceedings (or threat of) at the ECJ, amongst other means. As Bruszt and Vukov (2017, p. 666) have noted, whereas ‘the EU has relatively stronger capacities to create and impose uniform rules and policies... it has much weaker capacities to anticipate and alleviate negative developmental consequences in the less-developed member states’.<sup>3</sup> To take the example of the recently unveiled new EU industrial policy strategy, while the strategy provides sector-specific focus (for example space technology, defence, automotive and steel industries, AI and innovation in key enabling technologies) and measures to support industrial policy cooperation among EU countries, it is doubtful the extent to which CEE countries will be able to participate, given their deficiencies in high-technology production and abolishment of state support for leading domestic industries in the run up to EU accession.<sup>4</sup> The renationalisation of strategic sectors of the economy in Hungary and increased state support for domestic capital in innovation and the internationalisation of their exports in Poland can be understood as attempts

to address the developmental gaps and catch up with the West in terms of living standards by pursuing of a more sustainable growth strategy.

The findings from my empirical analysis also raise pertinent questions about the extent of change that can be achieved by organised political opposition against globalisation and neoliberalism, whether they be social democratic, socialist or populist nationalist, from within the current neoliberalised framework of international institutions and global production networks (see Brenner *et al.* 2010). The current developments in Hungary and Poland, but also in Italy, can be described as forming part of ‘disarticulated counter-neoliberalization’, where political forces are enacting (or attempting to) market-restraining or market-transcending regulatory strategies at the national level, ‘while still being embedded within geo-institutional contexts that are dominated by market-disciplinary regulatory arrangements and policy-transfer networks’ (Brenner *et al.* 2010, 341). Considering the continuing economic competition between the Visegrád countries and their dependency on FDI for industrial upgrading in the CEE region, the longer-term reproducibility and the move towards a more orchestrated counter-neoliberalisation remain doubtful for now.

## **Acknowledgments**

I am grateful to the participants of the British and Comparative Political Economy PSA Specialist Group workshop at King’s College London, 30 May 2018, and the ‘Europe After Brexit’ conference at SOAS, 21–22 September 2018, for their insightful comments on the earlier versions of the paper. I also thank two anonymous reviewers for their constructive suggestions and feedback, which have been very helpful in improving the manuscript.

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<sup>1</sup> Transnationality index is an average of four different components: three-year average of FDI inflows as a percentage of gross fixed capital formation; FDI inward stocks as a percentage of GDP; value added of foreign

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affiliates as a percentage of GDP; and employment of foreign affiliates as a percentage of total employment (United Nations 2005, 15).

<sup>2</sup> According to the OECD data on the size and composition of national state-owned enterprise sectors, Poland had 336 state-owned enterprises (majority-owned listed, minority-owned listed, majority-owned non-listed, and statutory and quasi-corporations) in 2012, whereas Hungary had 373 (OECD 2012). Bower at the IMF puts the number of SOEs in Poland at 2097 and 98 in Hungary for the 2012–2014 period.

<sup>3</sup> Arguably, the allocation of EU's structural funds is one such mechanism aimed at reducing intra-national regional disparities. However, recent research has shown that they have in fact contributed to intra-regional inequality due to uniform eligibility criteria for both more developed and backward regions in CEE (Medve-Bàlint 2014; also see Bruszt and Vukov 2018).

<sup>4</sup> This point has been made by Bartlett (2014) in relation to South East Europe, but it also applies to CEE countries given the composition of their manufacturing sector and their dependent position in the global supply chains.