Final Research Report

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The Austrian Banking Experience in Hungary and Poland

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Executive Summary

This paper assesses the performance of Austrian bank subsidiaries in Hungary and Poland in light of increasing "unorthodox" economic policies in the respective states following the global financial crisis. Analyzing the effect of the bank levy imposed by the Orbán government from 2010, this paper finds that it has made units operated by Austrian banking groups in Hungary unprofitable. These only reported gains once the government reduced the tax in 2016. Moreover, Austrian banks have been included in Orbán's drive to boost domestic ownership of the banking sector. The government successfully acquired a minority stake in Erste Bank Hungary and nearly aided the purchase of Raiffeisen's Hungarian subsidiary. In Poland, increased state intervention as part of the PiS-led renationalization of the banking industry burdened Raiffeisen's business operations and ultimately led to the sale of its unit in the state. Finally, this paper identifies the continuing risks faced by Austrian banking groups with operations in Hungary and Poland given the uncertain political climate in the respective states.

Introduction

Following its transition to a market-based economy in the early 1990s, Hungary and Poland, like other Central and Eastern Europe countries (CEE), embarked on a path of "dependent financialization," the development of financial markets with the presence of foreign actors. The growth of the eastern economies primarily depended on foreign direct investment by Western manufacturers who produced in CEE at low cost. Foreign banks followed their corporate customers doing business in the East (Nölke and Vliegenthart 2009; Bohle 2018).

Given their geographical proximity and historical ties to the region, Austrian banks were among the first to move into Hungary and Poland. The low degree of bank intermediation and higher economic growth rates (nearly twice that of western European economies) offered Austrian financial institutions higher growth prospects than at home. Three major banks established local subsidiaries and initiated large-scale cross-border and indirect lending, which has contributed to the overall profitability of the Austrian banking system (Feldkircher and Sigmund, 2017).

Foreign banks, including units operated by Austrian banking groups, facilitated a massive inflow into CEE. Hungary and Poland both experienced rapid growth in foreign-currency loans, the majority of which were denominated in Swiss francs and euros. In Hungary, the outbreak of the global financial crisis (GFC) caused a severe financial/liquidity crisis in the country and threatened a balance of payment crisis due to the substantial levels of public and private sector indebtedness. International funding helped reign in the public deficit, but the uncertainty led to

an exchange rate depreciation that undermined households' ability to repay their loans (Banai et al. 2011; Bohle 2014).

Disenchantment with the government's ability to combat the economic misery set the stage for the landslide election of Viktor Orbán and his right-wing Fidesz Party in 2010. Orbán's electoral victory has induced a shift in economic policymaking in the country. At the heart of his economic program is the fight for independence from "a world symbolized by banks, multinationals, and a bullying IMF." Orbán has sought to punish banks and expand the role of the state, introducing aggressive measures to regain public control over the banking sector (Mérő and Piroska 2016).

In Poland, decreased autonomy and decision-making powers of Polish-based bankers in foreign subsidiaries in the wake of the GFC induced an illiberal shift in economic policymaking and a renewed increase in state control. Interventionist measures in the banking sector, most notably the domestication of foreign-owned banks, increased following the coming to power of the populist-nationalist government led by the Law and Justice Party (PiS) in 2015 (Toplišek 2019).

This paper studies the exposure of Austrian bank subsidiaries to the increasing financial nationalism in Hungary and Poland. The first part briefly describes the transformation of the CEE banking sectors. The second part details Austrian banks' market entry into the region. The third part provides an overview of the academic literature on financial nationalism, with a particular focus on the developments in Hungary and Poland. The fourth part examines the effect of Orbán's radical policies on two major Austrian subsidiaries – Erste Bank Hungary and

Raiffeisen Bank Hungary – and state intervention by the PiS. The fifth and final part draws a conclusion from the analysis and identifies the continuing risks facing local units operated by Austrian banking groups.

Banking Market Transformation of CEE

The transformation of the Hungarian and Polish political economies tends to be likened to the broader transformation of financial capitalism in the CEE region (Sebők and Simons 2021). Since the fall of communism, the CEE transition economies have experienced radical changes, with their banking systems transforming from operation under socialism to one under a market economy. The first step was the move from a state-owned (mono-bank) system[1] to a two-tier banking system with a clear separation of central and commercial banking activity (Banai et al. 2011). The collapse of the old system acted as a shock to the CEE economies, triggering a deep recession and a series of banking crises throughout the region. Due to banks' central role in the functioning of the economy, the banking sector became an area of reform (Barisitz and Gardó 2009).

CEE countries experienced two major waves of banking reform to achieve sustainable market-oriented development. The first, initiated in the early 1990s, consisted of initial liberalization and tightening efforts. Yet, banks quickly became undercapitalized and got involved in bad debt, some of which they inherited from the communist era and accumulated by continuing to lend to bankrupt state-owned enterprises. Continuing problems in the banking

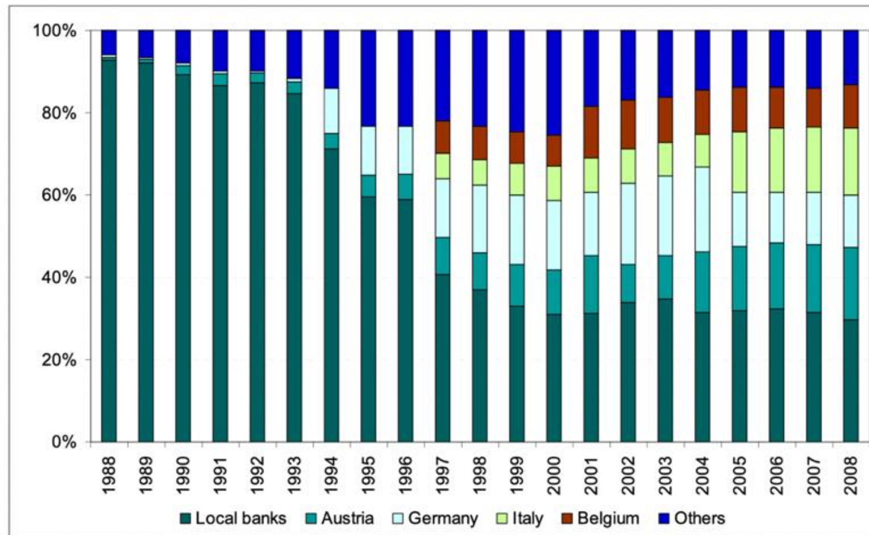
[1] In the Soviet-style mono-bank system, a single bank was responsible for carrying out both central and commercial banking operations.

sector called for a second reform, which introduced hard budget constraints for banks and the corporate sector and privatization. Aiming to attract foreign capital and raise banks' competitiveness, CEE countries opened up their banking sectors to foreign strategic investors.[2] Foreign investors were attracted by the untapped profit potential of the CEE banking markets. As a result, Western European investors acquired the lion's shares of the region's banking sector (Barisitz and Gardó 2009).

In Hungary, the share of foreign ownership in the banking sector only amounted to roughly 5 percent in 1990 (see figure 1). However, so-called "greenfield" - Austrian, Italian, German, and Benelux – banks slowly entered the region soon after. Following a banking crisis in 1993, the state implemented a series of state loan, debtor, and bank consolidation programs to improve the portfolio and capital position of state-owned credit institutions. Yet, this only partially solved the problem, as state assets were insufficient. Therefore, Banai et al. (2011) argue privatization with the participation of foreign actors was necessary. Foreign banks also imported "know-how." By the early 2000s, foreign ownership in the Hungarian banking sector totaled 70 percent (see figure 1).

[2] Poghosyan and Poghosyan (2010) argue that foreign ownership of banks enhances competition and efficiency in Central, Eastern, and Southeastern Europe (CESEE).

Developments in the ownership structure of the Hungarian banking system



Note: We considered the OTP group as entirely domestic-owned.

Sources: Magyar Nemzeti Bank (MNB), PSZÁF.

Figure 1.

Source: Banai et al. (2011)

Between 1989 and 1993, the number of banks in Poland increased rapidly. Foreign banks entered on a large-scale from 1995, acquiring local banks and opening subsidiaries in the state. As a result, in 1999, foreign investors controlled over half of the Polish banking market in terms of capital and outstanding loans. By the end of September 2003, foreign banking groups owned roughly 77 percent of Polish banks' capital, which made up 67 percent of the banking sector's total assets (see figure 2).

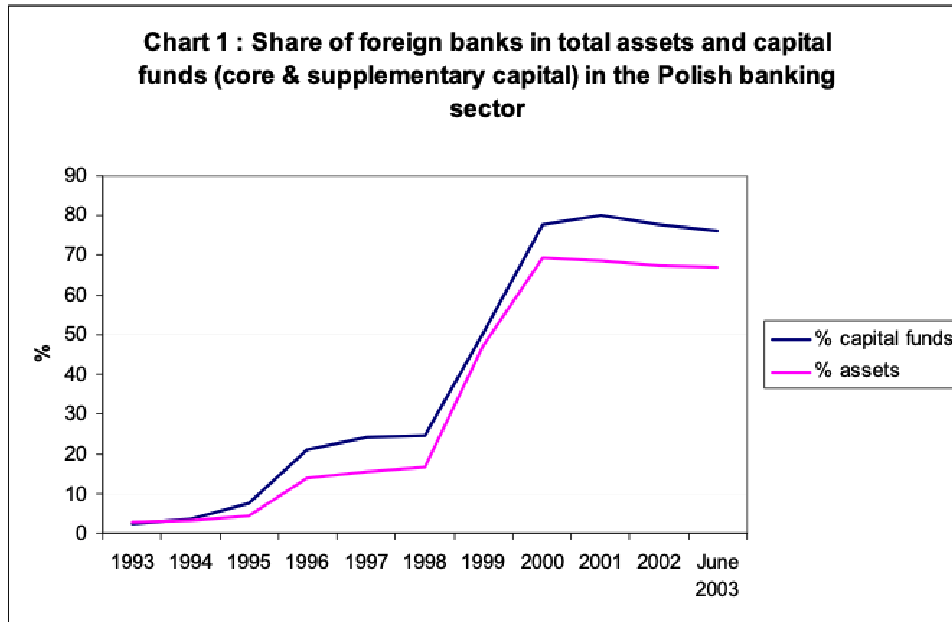


Figure 2.

Source: Farnoux et al. (2004).

Austrian Bank Market Entry

Austrian banks were quick to seize the opportunities presented by the new market in their eastern neighborhood, expanding into the region as early as the mid-1980s.[3] They were primarily motivated by a high return on equity (ROE). Given the low degree of bank mediation, CEE appeared like an attractive market for the banks; it exhibited an above-average growth rate and offered a larger profit potential relative to the domestic market. The profitability of the Hungarian and Polish banking systems surpassed the performance of the parent bank countries by 50 and as much as 100 percent (Banai et al. 2011). Creditanstalt and Bank Austria were the first to establish their presence in CEE, arriving in Hungary even before the coming down of the

[3] Many are surprised that Austria entered the region before Germany, the region's biggest trading partner, but German banks were busy dealing with the repercussions associated with the unification of Germany.

Iron Curtain in 1987.[4] Raiffeisen ZentralBank (RZB) and Erste Bank followed soon after. The Raiffeisen group opened its Polish subsidiary in 1991.

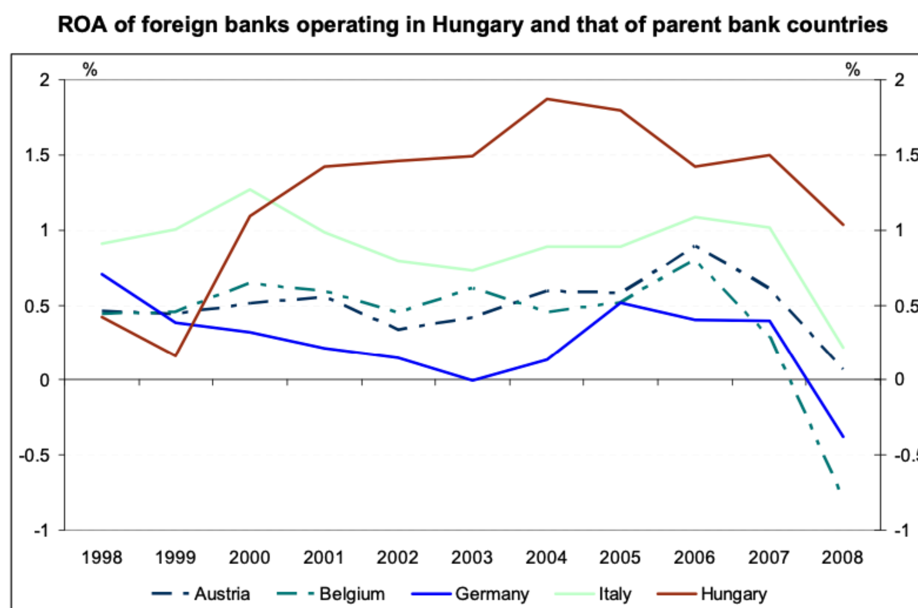


Figure 3.

Source: Banai et al. (2011)

Austrian banks initially focused on the corporate segment. This required lower investment than the retail segment, whose barriers to entry were high, due to the fierce competition of local banks, high information asymmetry, and the need for an extensive branch network and staff capacity to serve clients. Expansion into the corporate segment was aided by the arrival of multinational firms. Austrian banks, experienced in commercial banking, could offer customers more favorable conditions than the local banks. However, as competition between major foreign

[4] Creditanstalt and Bank Austria merged in 1997 (BA-CA). BA-CA was bought by German bank HVB in 2000, which was in turn acquired by UniCredit in 2005. Both HVB and UniCredit were predominantly interested in BA-CA's business divisions in CEE.

banks eroded the profitability of the corporate segment, banks also expanded into the retail segment (Banai et al. 2011)

It is important to note that Austrian banks established subsidiaries rather than branches in CEE. Subsidiaries are independently capitalized on levels in line with local regulations. These tend to be subject to stronger national control, but can therefore compete with domestic financial institutions. The upside is that subsidiaries have broad access to host markets. Furthermore, they can lend based on their own capitalization, rather than the group's. Thus, parent banks can let them go under in times of crisis with limited financial repercussions to the banking group as a whole (Epstein 2014).

Austrian subsidiaries were uniquely positioned to develop the CEE credit markets. They could access foreign sources of credit expansion by borrowing from their parent banks. Moreover, they could initiate the development of new market segments, such as cross-border and mortgage lending. Margins on retail loans were twice as high as in the euro area (Banai et al. 2011; Bohle 2014).

Austrian banks issued mortgage debts denominated in foreign currency. According to OENB survey data from Q4 2008, 47 percent of all indirect loans provided by Austrian subsidiaries were denominated in foreign currency, predominantly in euro and Swiss francs (see figure 4). Since interest rates were typically higher in CEE than in the eurozone, Western financial intermediaries could offer loans on more favorable terms (lower interest rates), which allowed foreign banks to expand the mortgage market and make loans affordable for consumers. The

prospect of CEE entry into Europe's economic and monetary union (EMU) motivated banks to issue foreign currency loans. All actors involved assumed interest rates would converge and the currency would appreciate in the run-up to EMU, which seemingly minimized exchange rate risk for borrowers.[5] (Bohle 2014; Puhr et al. 2009)

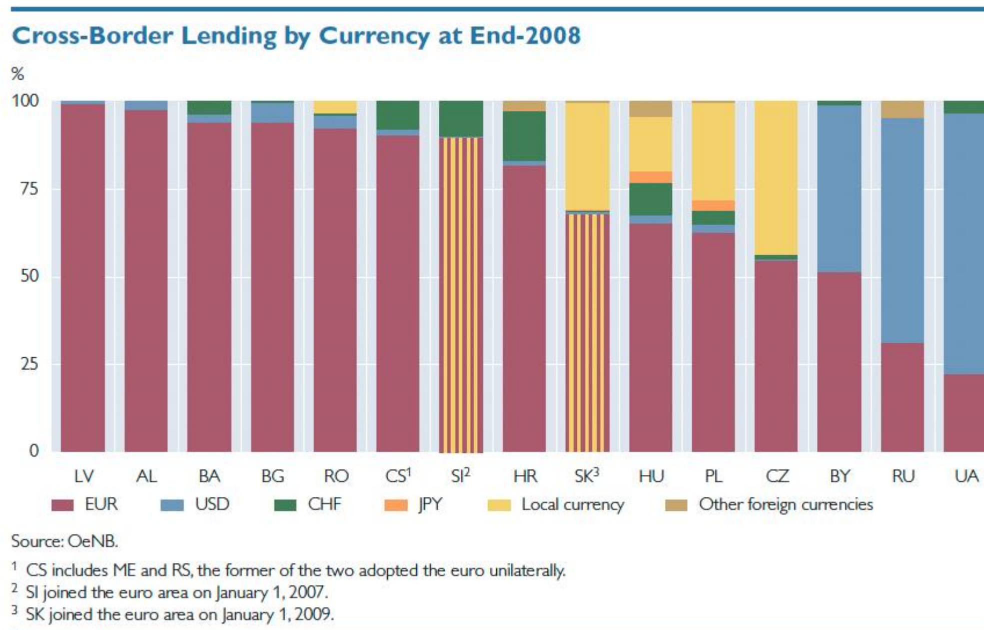


Figure 4.

Source: Puhr et al. (2009)

[5] New CEE members could not opt out of EMU, so in the early 2000s, Hungary began preparing for a changeover. The government has been planning to replace the current national currency, the Hungarian forint, with the euro since 2003. However, as of writing this paper, there is no official date for the adoption of the euro.

The Roots of Financial Nationalism in Hungary

With the arrival of Western banks in Hungary, foreign currency loans grew at a rapid pace, partly also due to a political stalemate over financing public welfare. In the late 1990s, the government subsidized housing loans, predominantly issued by local banks in Hungarian forint. It rolled back this policy in 2003-2004, thereby generating space for the expansion of the foreign exchange market (Banai et al. 2011). Additionally, to stabilize the national currency and force the government to tighten its budget, the Hungarian National Bank (*Magyar Nemzeti Bank,* MNB) raised interest rates. This made it easier for banks with access to foreign currency to undercut local banks (see figure 5). Moreover, since Hungary eventually intended to join the eurozone, EMU conditionality required it to maintain a stable euro-forint exchange rate. Thus, both lenders and borrowers believed that such loans held little currency risk (Bohle 2014).

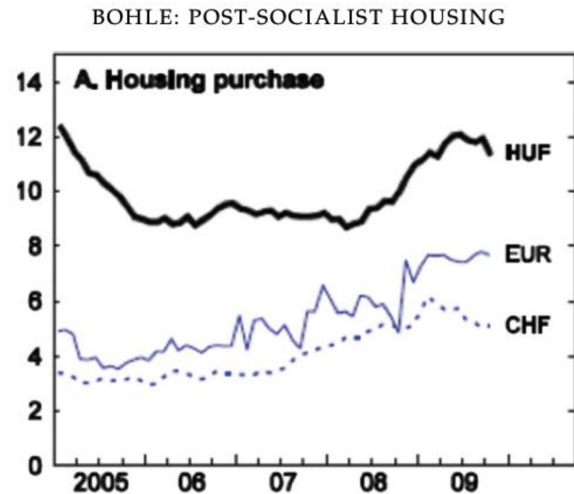


Figure 5.

Source: Bohle (2014)

When the global financial crisis began and triggered the Hungarian forint to depreciate against major loan currencies (particularly the Swiss franc), the foreign currency mortgage debts turned into non-performing loans (NPLs). The Ministry of National Economy, the monthly repayment rates of an average mortgage rose from approximately 40,000 HUF in 2007 to 57,000

HUF by spring 2009, and 65,000 in June 2011 As a result, mortgage holders could no longer repay their foreign-currency-denominated loans (Bohle 2014).

The government, struggling to reign in its high public debt and deficit, accounting for roughly 69-80 percent, failed to address the household debt issue, and was forced to turn to the IMF for help. It accepted a joint 20 billion euro loan from the IMF, World, Bank, and the EU in exchange for strict austerity measures. These included cuts in wages and pensions, and the elimination of the 13-month salary for government employees. To mitigate the pain felt by households, the government in 2009 separately announced a bailout program to lower the exchange rate risk. However, because the conditions were relatively restrictive, the number of participants was low (Bohle 2014).

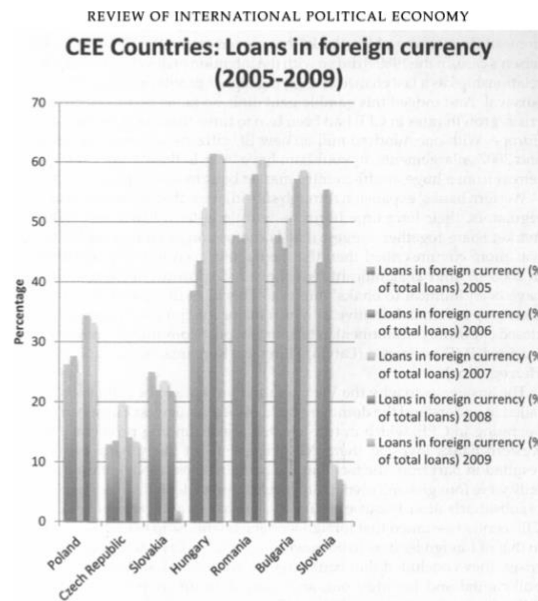


Figure 6.

Source: Epstein (2014)

The Roots of Financial Nationalism in Poland

Poland's catch-up with the West has historically been characterized by strategic intervention by the state. This dates back to the inter-war period, during which the state-owned *Bank Gospodarstwa Krajowego* (BGK) financed major projects, such as the construction of the seaport of Gdynia in northern Poland. Following the fall of communism, numerous domestic institutions, including the Industrial Development Agency (ARP) and the Polish Agency for Enterprise Development (PARP) among others, supported the restructuring of state-owned enterprises (SOEs) and fueled industrial growth. Access to EU funds helped facilitate these undertakings (Naczyk 2022).

The Polish state also had pre-existing control of the financial system. Polish authorities have a long tradition of closely monitoring foreign investment by selecting investors and issuing conditional licenses. The government aimed to diversify the origin of the parent bank and encourage the entry of well-capitalized Western banking groups. Therefore, between 1995 and 1998, the government required potential investors to bail out loss-making or low-profitable banks in exchange for a banking license. Moreover, authorities only authorized so-called "greenfield investment" in cases where the potential investor's nationality was not yet represented or the investor would create new banking activities. Authorities also pressured foreign-owned banks to list on the Warsaw Stock Exchange to ensure a high level of accounting transparency and give domestic investors access to these companies (Farnoux et al. 2004).

Foreign Banks During the GFC

By 2008, CEE governments feared foreign banks would "cut and run" from the region (Epstein 2014). With the onset of the financial crisis, banks faced issues raising funds, thus their commitment to the CEE countries was no longer guaranteed (Bohle 2014). West European states and even the European Commission attempted to limit western banking groups' activities in CEE by implementing nationally-oriented bailout schemes favoring home markets over foreign ones. They promised to rescue their own banks, but they did not promise to cover the banks' loan books in the East. In fact, national regulators urged their banks to deleverage from eastern Europe or leave the region altogether. Additionally, western authorities set lending targets for assisted banks. For example, the Austrian government required supported banks to make 200 percent of state participation capital available to Austrian businesses (Bohle 2014).

To prevent a banking crisis, the IMF and ERBD in January 2009 jointly launched the so-called Vienna Initiative, a series of agreements signed by 10 major European banks to maintain exposures in the region.[6] Parent banks promised to support their subsidiaries, roll over their credits, and re-capitalize them. In countries that signed stand-by agreements with the IMF, banks made their commitment conditional on host countries' governments. The Hungarian government was separately forced to bail out its domestic banks. It provided loans of roughly 700 billion forints to the OTP Bank, FHB, and the Hungarian Development Bank (Bohle 2014).

Yet, even without the plan, Epstein (2014) argues that foreign banks, particularly Austrian banks, would have remained in the region. First, due to the battle for market share in CEE, a

[6] See https://vienna-initiative.com.

large portion of the loans were long-term and could not be called in during a crisis. Moreover, the competition for local clients meant that banks wanted to work through non-performing loans rather than seize their collateral, which had anyway declined in value due to the crisis. Furthermore, Austrian banks had no place else to go. The domestic market of eight million people is over-banked with slim margins. Thus, operating in the east was their "last chance" to enjoy higher profits (Epstein 2014).

Financial Nationalism in Hungary

The measures taken by the international community helped prevent a banking crisis but failed to improve the Hungarian economy. By 2010, the issues facing the state became highly politicized and began to symbolize the ineffectiveness and unfairness of the policies created by the then-ruling socialist-liberal coalition. This set the stage for the landslide election of Orbán and his Fidesz party, which secured a two-thirds in the Parliament in May 2010. The government radically altered the country's political and economic institutions (Sebők and Simons 2021).

Upon taking office, Orbán launched an attack on foreign-owned banks, which he promptly blamed for the economic troubles and tried to sideline, labeling them as "outsiders." (Johnson and Barnes 2015).[7] They were an easy target for the prime minister, for they introduced foreign currency loans that proved devastating to the Hungarian economy. Thus far, he has aimed to reduce the influence of foreign-owned banks and foreign currencies and increase Hungary's

[7] The authors argue that Orbán's electoral dominance enabled the implementation of his unorthodox financial nationalist policies. In addition to the supermajority in parliament, Fidesz candidates won mayoral races in 22 of 23 major cities and the control over all 19 country assemblies in October 2010. Moreover, the opposition is weak and divided, which has removed domestic leverage for international actors who could appeal to the opposition (Johnson and Barnes 2015).

monetary sovereignty, and privilege national insiders. Orbán has introduced numerous policies to punish the banks, including special bank levies, a ban on foreign currency lending, and changes to bank ownership structure (Bohle 2014).

On June 8, 2010, the Hungarian government announced the first banking tax directly aimed at foreign-owned banks. It amounted to 770 million to comply with the budget deficit targets set by the IMF. The levy required financial intermediaries to pay 0.15 percent on their first Ft billion ($226 million) of 2009 assets and 0.5 percent on assets beyond this limit. This amounted to roughly 0.53 percent of the banks' adjusted balance sheet (Erste Bank Annual Report 2010). The banking tax introduced by the Hungarian government taxes was triple that in other European countries. As a result, more than half of banks became unprofitable in 2010 (Bloomberg).

Furthermore, Orbán declared that Hungarians should control at least 50 percent of the domestic banking sector and thus legitimized the re-nationalization of the financial sector. Prior to the 2008 crisis, state ownership in Hungary was below the EU average. Unlike in developed countries, where most nationalizations in the 2008-2009 period involved rescuing financial institutions, CEE countries did not extend ownership.[8] Government bailouts of banks were typically not necessary in the region, as the foreign parent companies provided capital to their subsidiaries.[9] The value of assets owned by the Hungarian state rose two-and-a-half times and nearly doubled as a proportion of GDP between 2010 and 2015 (Voszka 2018).

[8] The United States spent over $270 billion on this and the European Union some 300-400 billion euro, accounting for 1.9% and 2.4-3.1% of GDP respectively.

[9] The exception is the Slovenian banking system, which is dominated by domestic shareholders.

Nationalism in the Hungarian banking sector began in 2012-2013. The government has intervened in the ownership structure of seven banks, of which four have the highest balance sheet (see figure 7). With the acquisition of the fourth largest bank the Hungarian Foreign Trade Bank (*Magyar Külkereskedelmi Bank* – MKB) from Bayerische Landesbank and Budapest Bank from General Electric Capital, state ownership in the banking sector rose slightly above 50 percent (Erste Bank Annual Report).

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Table 1 Banking interests aligned with the government's strategic plan

Bank	Previous owners	State measures	New (beneficial) owners
MKB Bank	Bayerische LB	Nationalization, recovery, re-privatization	Mészáros Lőrinc (Metis-Konzum), Szemerey and (until 2018) Balog (Bankonzult, Promid)
Budapest Bank	GE Capital	Nationalization, re-privatization plans	Corvinus Inc. (MFB Group)
Takarékbank integration	DZ Bank (until 2012), Takarék cooperatives	Central organization to integrate the network, assumption of ownership rights. State acquires ownership stakes (of varying magnitude)	MFB, Magyar Posta, (pro tempore) FHB, Takarék cooperatives
GRÁNIT Bank	West LB then Wallis	Minority stake acquisition by the state (49%), then sold to management	Éva Hegedüs, MKB Group
Széchenyi Bank	Offshore holding	Minority stake acquisition by the state (49%), then bankruptcy	István Töröcskei
NHB Bank	Kulturbank, Indosuez, Hanwa	MNB deposits, transfer of clients from Buda-Cash	Tamás Szemerey
Erste Bank	Erste Group	Minority stake acquisition by the state (15%)	ERSTE Group, EBRD, Hungarian state (Corvinus Inc.-MFB)

Figure 7.

Source: Sebőck and Simons (2021)

Financial Nationalism in Poland

Poland's relatively strong economic performance during the financial crisis induced a nationalist and state-centered turn among members of the government. Poland was less severely affected by the Lehman fallout than the rest of the CEE states and was the only EU member state that managed to avoid a recession.[10] Even when the entire EU went into recession in 2009, Poland grew at 2.6 percent (Brookings).[11] The government, led by a coalition whose senior partner Civic Platform (PO) traditionally defended liberal economic policies, took pride in the state's strong economic performance. Then-Prime Minister Donald Tusk boasted Poland had remained a "green island on a red background of falling GDP." The prime minister claimed Poland's success was attributable to the government's "common sense" as opposed to the "pseudo-expertise" of "doctrinaire" economists in other states. This helped crystallize the belief that the Polish state should strengthen its control of the economy to promote national champions and catch up with the West. During the 2011 legislative campaign, Prime Minister Tusk pressed for a new and more ambitious, nationalistic economic agenda that would, in the wake of the crisis, "bring the Poles and the Polish economy a new competitive advantage." At the same time, Jarosław Kacyński, the leader of the main opposition party, the Christian-Conservative Law and Justice (PiS) Party, and an open admirer of Orbàn, openly called for a "new economic patriotism." (Naczyk 2022).

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[10] The Polish government did, however, negotiate a special "flexible credit line" with the IMF for strongly performing economies.

[11] Poland's impressive performance resulted from numerous factors, including a timely fiscal and monetary stimulus, a significant depreciation of its domestic currency (zloty), and its relatively large domestic economy that limited its exposure to declining international trade. Moreover, EU funds helped support domestic growth and restore confidence among Polish consumers and business. Banks remained liquid, well-capitalized, and continued to lend to the private sector amid the crisis, fueling economic growth (Brookings).

Moreover, moves by foreign banks as a result of the GFC sparked a revival of developmentalism[12] and caused a paradigm shift in Polish economic policy-making in the 2010s. Foreign banks' withdrawal of assets from CEE subsidiaries frustrated Polish-born bankers, who saw their autonomy and decision-making authority decrease.[13] When this happened to Jan Krzysztof Bielecki, who became Tusk's chief economic advisor in early 2010, the government took an illiberal turn. Bielecki had previously been the CEO of Bank Pekao S.A. – Poland's second-largest bank and a subsidiary of the Italian banking group UniCredit. He resigned from the position in 2009 over a dispute with the majority shareholder, who planned to limit the decision-making powers of the bank's Polish-based executive committee. Furthermore, since parent banks took some of these actions under the pressure of the governments in their home states, it helped anchor the notion that state intervention in the economy was acceptable (Naczyk 2022).

Both the PO-led and the PiS-led governments developed policy instruments that provided special advantages to firms controlled by domestic capital or the state. In late 2012, the Tusk government established the Polish Investments for Development (PIR) fund to finance infrastructure projects proposed by indigenous firms. The PIR morphed into the Polish Development Fund (PFR) in 2016 and began funding start-ups, providing financial capital to listed companies via domestic pension funds, and, among other things, supporting the "repolonization" of foreign-owned banks. Moreover, the State Treasury, Poland's privatization

[12] In the academic literature, developmentalism is defined as a desire for national catch-up and export competitiveness via strategic interventions by the state to promote national strength in a hostile and competitive world (Naczyk 2022).

[13] Additionally, they feared the drying up of foreign credit lines would cause an economic crisis in the country.

agency, partnered with the management of SOEs. Its primary objective included preventing hostile takeovers and promoting Warsaw as an international financial hub.[14] This includes measures to protect some of the largest domestic firms from hostile takeovers, to increase the market share of banks controlled by domestic capital, and elements of state-coordinated industrial policy (Naczyk 2022).

By "repolonizing" Polish banks, the PiS-led government aimed to restore state control over the domestic banking industry.[15] In 2015, the state-owned insurance company PZU acquired a 25 percent stake in Alior Bank. Alior bought – and then merged with – Bank BPH, one of the banks spun out from the National Bank of Poland in 1989, from GE Capital group in the following year. In 2017, PZU and the PFR jointly purchased a combined 33 percent stake in Bank Pekao, Poland's second-largest bank, from the Italian UniCredit group. As a result, the state's control of the domestic banking sector increased from 30 to 50 percent. This allowed the government to "better control credit policy," according to Mateusz Morawiecki, finance and development minister (2015-2018) and Poland's prime minister (from 2017-). In other words, the government could lend to companies and finance projects picked by the state on political grounds. For example, the PKO BP provided a 3.2 billion zloty loan to the PRF to finance its role in the Pekao transaction (*Financial Times)*.

[14] The Warsaw Stock Exchange introduced provisions within its own corporate chapter in late 2010.

[15] The renationalization of the banking sector was made possible by the exit of Western lenders from the Polish market, to repair balance sheets or comply with EU conditions for state aid.

Furthermore, in 2016, the government imposed a levy on the banking and insurance sectors. It also introduced a turn-over-based tax on the retail sector, dominated by foreign supermarket chains.[16] Initially, the government also called on banks to convert their foreign currency loans (predominantly Swiss franc-denominated mortgages) into domestic currency (zloty) at a fixed rate. However, fearing this would destabilize the financial sector, it withdrew this pledge. Instead, the government introduced a less radical measure and required banks with portfolios of foreign currency mortgages to make quarterly payments into a relief fund. This was supposed to help borrowers meet their financial obligations (Toplišek 2019).

Literature Review

Academic scholars interpret the developments in Hungary and Poland differently. Several authors argue that Orbán's banking policy aims to strengthen the state's role and simultaneously induce a macroprudential shift in Hungary (Mérő and Piroska 2016). According to Johnson and Barnes (2015), financial nationalism is the dominant ideological framework within which financial policies are designed in the state. The authors define financial nationalism as "an economic strategy that employs financial levers to promote national unity, autonomy, and identity." It is reflected in five policy choices: autonomous monetary policy, dirty floating currency regime, undermined the independence of the central bank, banking nationalism, and animosity towards foreign international institutions.

Mérő and Piroska (2016) define banking nationalism as a government policy that promotes national interest in all areas of banking policy. Spendezharova (2014) finds that EU countries

[16] The European Commission ruled the tax was in breach of the EU state aid and competition rules.

where foreign ownership in banking is high and domestic internalization is low prefer to preserve national regulatory autonomy. Since the majority of CEE banks are foreign-owned, banking nationalism may serve two purposes: to advance national interest (Johnson and Barnes 2015) and bring national banks into a better position (Mérő and Piroska 2016).

Moreover, banking nationalism in CEE may legitimize controversial government action. For example, policymakers may not simply promote the stability of banking, but rather, also empower domestic actors (Marek Naczyk 2014, 2019). Scheiring (2020) even asserts that banking policies in Hungary are co-designed by representatives of the Hungarian bourgeoisie who are angered by the presence of foreign capital in the country. In a similar sense, Naczyk (2022) argues that such policies are formulated specifically to alleviate the frustrations of Polish-born bankers. Additionally, governments may create a regulatory environment beneficial for local banks. Or, as Oellerich (2022) argues, it can be a form of cronyism, granting rights and channeling funds into the pockets of economic agents with close ties to the government. In fact, Naczyk (2014) calls economic nationalism the "binding agent" between domestic business elites with a predilection for protection and governments representing such ideologies.

Case Study Austria

Erste Bank Hungary

Erste's entered Hungary through its acquisition of the Hungarian Mezöbank in 1997. It was renamed Erste Bank Hungary in 1998 and consolidated with Postabank in 2003. Today, Erste operates the fifth-largest subsidiary in Hungary.

When first introduced in 2010, then Erste Bank Group CEO Andreas Treichl warned Hungary about the bank levy. In an interview with the *Financial Times,* he claimed the group was "angry" about the move and signaled a decrease in parent funding of the Hungarian subsidy (*Financial Times*). According to the group's annual report, the special bank tax cost Erste 49.8 million euros. Net profit decreased from 57.9 million in 2009 to -21.8 million in 2010.

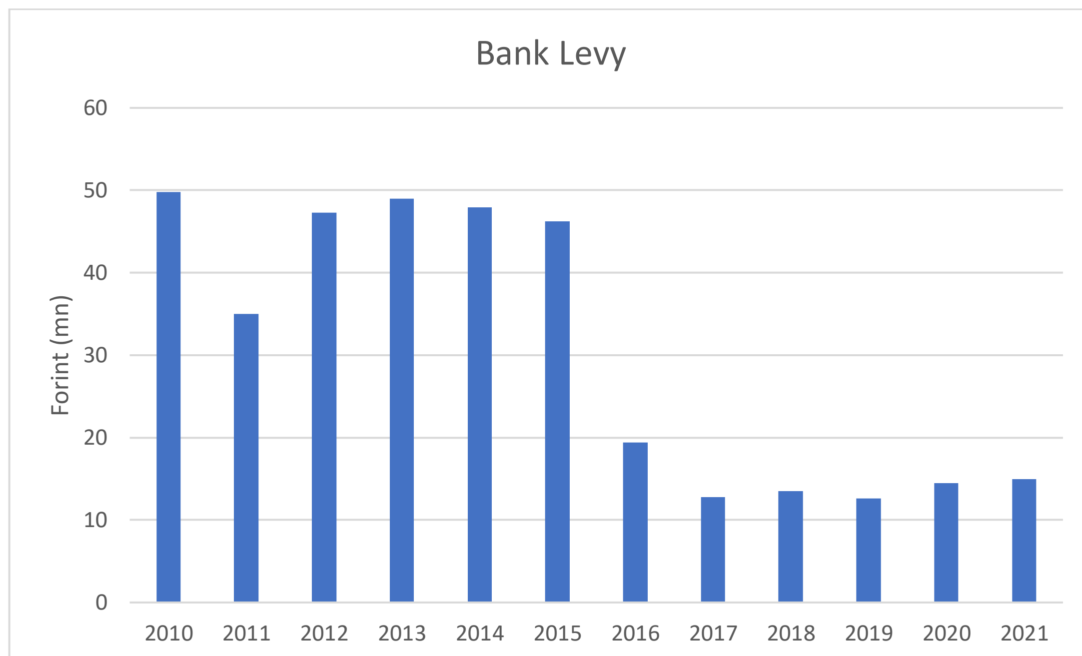

Figure 8.

Source: Author's Own Elaboration Based on Erste Bank Annual Reports.

In addition to the bank levy (amounting to 35 million euros), the Hungarian government in 2011 passed a law enabling retail customers to repay foreign currency loans at fixed rates below market exchange rates.[17] 20 percent of eligible customers opted for it. In total, 730 million euros of loans denominated in Swiss francs were repaid through the end of February 2012. This

[17] The government fixed the exchange rate at a roughly 25 percent discount to the market rate (*The New York Times,* 2011).

resulted in a loss of roughly 200 million euros. Erste incurred a net loss of 566.6 million for the full year.

Citing a “changed political and economic situation in Hungary,” Erste downsized its operations in Hungary in 2011. It reduced its number of branches from 184 to 151 and laid off 15 percent of its workforce. While renewing its commitment to its clients in the region, the corporate business would be selective on its corporate base going forward. Moreover, to reduce the dependence on parent company funding, it would focus on its local currency business from locally sourced liquidity.

In an interview with Bloomberg, Treichl confirmed the group feared potential measures proposed by the Orbàn government. “Our biggest risk is some kind of dramatic move in Hungary,” Treichl said. “We have to react and one of our clear goals is to increase the independence of our countries in terms of funding as much as we can.” (Bloomberg)

Furthermore, in 2012, the government introduced a new foreign exchange borrower support scheme. This allowed indebted households to pay their monthly installments at a favorable exchange rate (specified by the state), with government and banks sharing interest payments exceeding this exchange rate. In addition to the banking tax (which totaled 47.3 million), the government-imposed repayment system at non-market rates adversely affected banks. Erste incurred a net loss of 55.1 million. In 2013, Hungary’s competition authority GHV fined 11 banks 9.5 billion forints for allegedly colluding against this government relief program. Erste paid 1.7 billion forints (Bloomberg 2013; Erste Bank Annual Report 2013)

Erste continued to face difficulty and report losses until 2016 (see figure 9) when the Hungarian government and the European Bank for Reconstruction and Development (ERBD) signed a deal to partially acquire the unit in return for a reduction in the bank tax. Each paid 125 million to take a 15 percent stake in the bank (*Financial Times*). The Orbán government lowered the levy by 60 billion forints in 2016 and announced further plans to lower the tax (Reuters). This has cut the tax cost for Erste Bank Hungary in half, and the group has since earned a net profit in Hungary.

Erste remains the majority owner of the Hungarian subsidiary, holding a 70% stake in the local unit. Hungarian Erste CEO Radován Jelasity claims that not a lot has changed as a result of the transaction. However, the Hungarian government and ERBD have acquired the right to appoint one non-executive member of the Management Board and one member of the Supervisory Board. According to the agreement, Erste can buy back the shares after five years at the earliest. The ERBD can do so between five and nine years following the completion of the deal (Sebőck and Simons 2021).

Purchasing a stake in Erste allowed the government to expand control in the banking sector (Sebőck and Simons 2021). Officially, the deal was presented as an effort to strengthen the domestic banking sector. “The deal will further improve trust between one of Hungary's largest banks and the government," Hungarian Economy Minister Mihály Varga said in a statement.

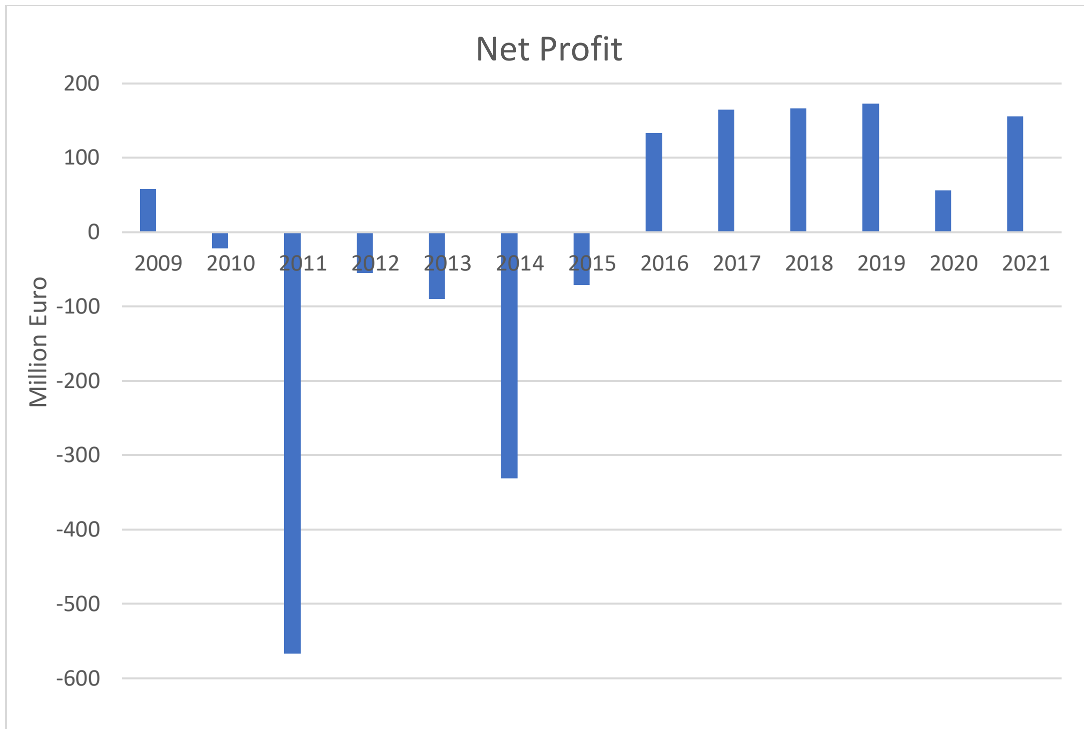

Figure 9.

Source: Author's Own Elaboration Based on Erste Bank Annual Reports.

Raiffeisen Bank Hungary

RBI entered Hungary in 1987. It first served a selective group of multinational companies, launched retail banking in 1999, and began to serve small-medium enterprises in 2001.

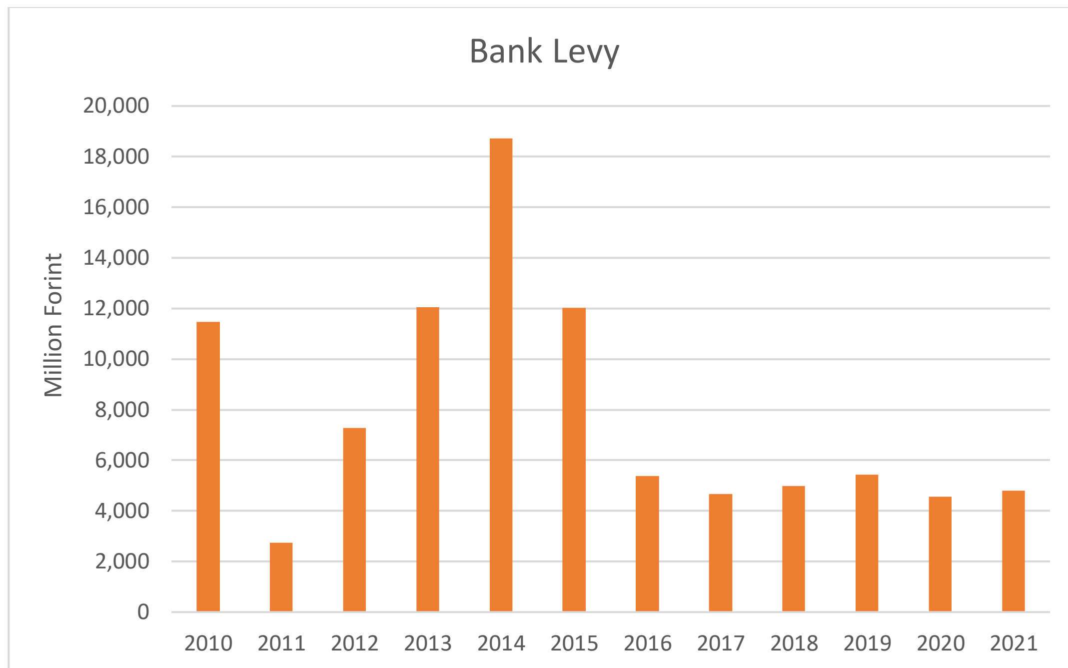

Figure 10.

Source: Author's Own Elaboration Based on Raiffeisen Bank Hungary Annual Reports.

The "special" bank levy cost Raiffeisen roughly 12 billion Hungarian forints in 2010.[18] Overall, the bank recorded a loss of roughly 5.6 billion forints for the year, compared to a loss of 3.9 billion forints in 2009. In 2011, the bank only paid 2.8 billion forints for the bank tax, yet an increase in NPLs and weak business activity resulted in a net loss of 89 billion forints. In the following year, the bank levy cost 7.3 billion forints, resulting in a net loss of 57 billion forints for the year. In 2013, on top of the bank levy (which amounted to 12 billion forints), the government's debt relief scheme, the group's Hungarian subsidiary incurred a loss of 80 billion forints.

[18] Raiffeisen Bank Hungary reports its results in forint.

Top executives at the Hungarian subsidiary have repeatedly hinted at a potential exit from the market. Raiffeisen Hungary CEO Heinz Wiedner indicated that the group has not ruled out leaving despite the high bank tax and the general anti-bank atmosphere in the state. “We are still loss-making, but last year our loss was significantly lower than a year before,” he said in an interview with website portfolio.hu (Reuters).

In a 2013 interview with *NZZ,* then-parent CEO Karl Sevelda explained the group “basically” wanted to remain in Hungary, since “a lot of heart and soul was poured into it.” However, in light of the regulatory environment, the bank had reached its “tolerance limit.” (*NZZ* 2013) In addition to the losses it incurred from the bank levy and debt relief scheme, the bank was fined 2 million euros by the MNB for allegedly colluding with other banks for blocking the government debt relief scheme. It reported a loss of 25.6 billion forints in the first half of 2013, and net profit amounted to a -39 billion forint loss for the full year. As a result, the parent group was forced to re-capitalize its Hungarian subsidiary with 200 million euros (ORF).

In 2014, Raiffeisen entered talks with the partially state-owned Szechenyi Bank to sell its Hungarian unit. The group, however, turned down the offer by the local bank, majority-owned by the head of the government debt agency and the rest by the state. According to Reuters, Raiffeisen was offered a “knock-down price,” while Szechenyi’s majority owner Istvan Torocskei blamed “hasty leaks” for why the reason the deal fell (Reuters).

The group has introduced numerous measures to cut operating expenses at its Hungarian unit. In 2015, it closed 67 out of 127 branches. This essentially meant the closure of every third

branch office in Hungary. By the end of 2016, it cut the number of full-time employees by 15 percent.

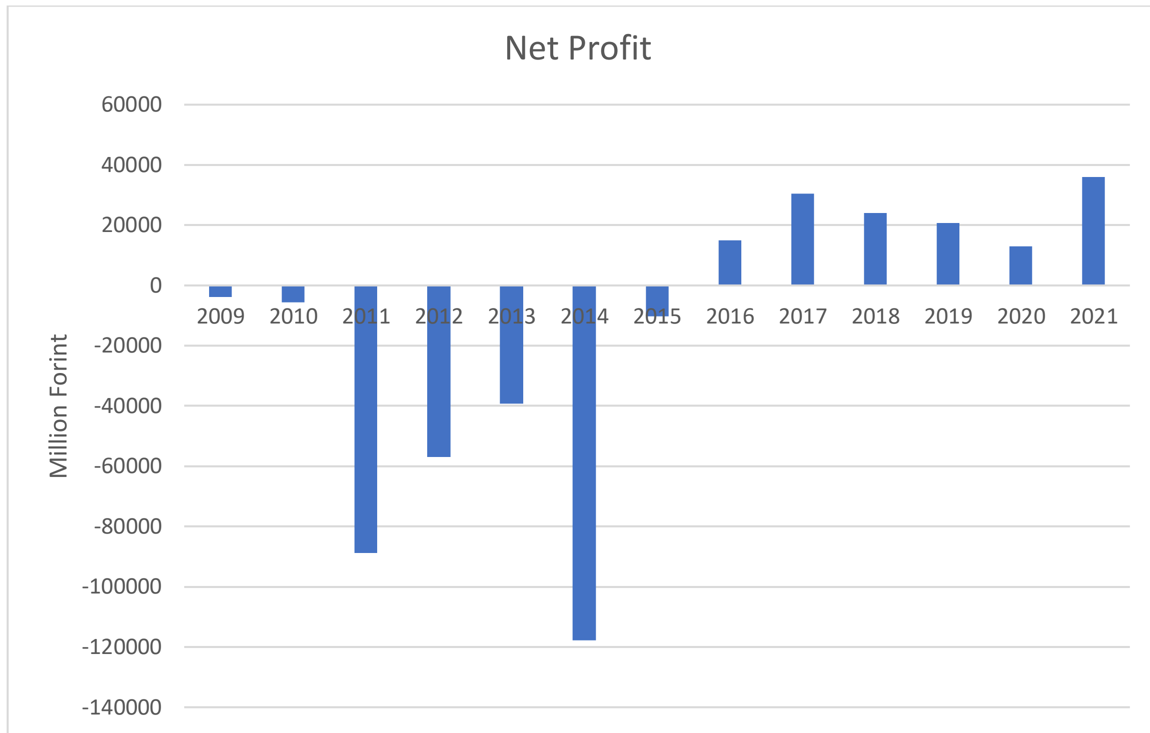

Figure 11.

Source: Author's Own Elaboration Based on Raiffeisen Bank Hungary Annual Reports.

Raiffeisen became profitable again once the government reduced the bank tax in 2016. Net profit for the year amounted to 15 billion forints, compared to a net loss of 10 billion forints in 2015. The bank levy only cost the bank approximately 5.4 billion forints, roughly 50 percent less than the year prior. The bank has since made gains in the country, reporting 31 billion forints in profit in 2017, 24 billion forints in 2018, 21 billion forints in 2019, 13 billion forints in profit in 2020, and 36 billion forints in 2021.

Raiffeisen Bank Poland

RBI opened its Polish retail business, known as Raiffeisen Bank Polska S.A., in 1991.

In 2012, RBI announced plans to purchase a 70 percent stake in the unprofitable Polbank EFG Eurbobank Ergasias S.A. for 490 million euros, making it Poland's sixth-biggest lender. The acquisition of the Greek-owned Polish bank was conditional on approval by EU, Greek, and Polish regulators, and on Polbank gaining a banking license in Poland (Bloomberg). The terms set out by the Polish regulator KNF was that Raiffeisen must list a portion of its business on the Warsaw Stock Exchange by mid-May of 2016. The watchdog gave RBI two options: either float 15 percent of its Polish subsidiary if it also embarked on a secondary listing on the Warsaw Stock Exchange or list 25 percent of its Polish subsidiary on the bourse. Initially, RBI announced it would sell its Slovenian and Polish units to help clear its balance sheet and hit a core capital ratio of 12 percent by the end of 2017 (Reuters).[19] The Polish Financial Supervisory Authority, however, insisted on conducting the IPO before approving the sale of Polbank. Additionally, Andrzej Jakubiak, the KNF's head, stated that the regulator would prefer if RBI sold to an investor that was not already present in Poland and had some credit rating. KNF also required that Raiffeisen refinance its 29 billion euro portfolio of Swiss franc-denominated mortgage loans (Bloomberg).[20] Thus, RBI announced it would float its shares on the Warsaw bourse by June of that year while stressing that the terms and timing were dependent on market conditions.[21] When

[19] At the time, Raiffeisen received numerous bids from domestic financial institutions. Poland's state-owned insurer PZU as well as PKO Bank Polski submitted separate offers to purchase RBI's Polbank (*Financial Times*).

[20] The regulator's stance was that investors exiting the Polish market had to take responsibility for their Swiss-franc loan portfolio such that domestic entities would not be burdened with additional risk.

[21] RBI wanted to postpone the IPO due to uncertainty over its Swiss franc-denomination loan portfolio, which was valued at 2.7 billion Swiss francs at the end of the second quarter of 2017. The group worried investors would offer a much lower price for the Polish banks' shares than it was willing to accept, for they perceived the mortgage

RBI failed to complete the sale, the regulator subsequently pushed back the deadline to mid-May 2018. It threatened that it would levy sanctions against Raiffeisen, such as stripping it of its voting rights in Polbank if the IPO was not completed by that date. To make its listing more attractive to investors, RBI requested establishing a separate bank to carve out its toxic assets. However, the Polish watchdog rejected this spin-off. Ultimately, RBI was forced to list and sell its retail operations to BNP Paribas for 775 million euros. According to the group, the transaction valued the assets at 0.95 their book value (*Financial Times*).

Furthermore, the bank levy introduced by the PiS government cost the Raiffeisen group roughly 34 million euros in 2016. In 2017, RBI paid another 31 million euros for the levy (Raiffeisen Annual Reports).

Concluding Remarks

This paper analyzed the effect of Orbán's and the PiS government's increasing nationalistic policies on two major Austrian banking groups with operations in Hungary and Poland – Erste Bank and Raiffeisen Bank.

Following Johnson and Barnes (2015), as well as Sebőck and Simons (2021) and other scholars, the developments in the two CEE states can be interpreted as financial nationalism based on the governments' self-interested strategies to expand their influence over the domestic banking system. Orbán held foreign banks responsible for the country's economic misery

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portfolio as a long-term risk to the banks' profitability. RBI's IPO price range was set at 25.5-28 zlotys per share, which investors would have found too high. The group did not want to sell the stake at lower than book value, however, at the same time, investors were unlikely to buy Polbank's shares if priced at more than 0.4 times book value (*Financial Times*; Reuters).

following the financial crisis. Similarly, the PO-led and PiS-led governments exploited the frustration of domestic bankers whose authority had decreased following the crisis.

Since 2010, Orbàn has imposed direct bank taxes and has taken ownership stakes in numerous banks whose acquisitions were funded with credits by the state or through various forms of state aid. This has allowed the governments to strengthen their state control of the domestic banking sectors, improve the position of local lenders, and empower individuals with close ties to the regime.

Austrian subsidiaries operating in Hungary felt the direct blow of Orbàn's policies. Due to the implementation of the bank levy in 2010, Erste Bank's unit immediately became unprofitable, posting a net loss for the year. The Raiffeisen group's experience was similar. When the government introduced its foreign-currency mortgage relief scheme in 2011, Austrian banks made further losses. As a result, Erste Bank decided to scale down its operations in the country, closing branches, laying off employees, and cutting parent funding. Similarly, Raiffeisen announced a series of measures to decrease operating expenses, including cutting staff and closing some of its local outlets. Austrian banks only became profitable once the bank levy was reduced in 2016. Thus, Orbán's tax and debt relief policies exacerbated Austrian banks already struggling to make a profit in the increasingly challenging Hungarian banking market. While the policies did not trigger an exit from the market, they induced downsizing and a substantial decrease in investment in the groups' local units.

Moreover, Austrian banks were included in Orbàn's drive to boost state ownership in the domestic banking sector. Erste Bank, having sold a minority stake in its unit to the Hungarian government, has been directly affected. Most importantly, the transaction occurred in return for a decrease in tax, which has benefitted all banks operating in Hungary The extent to which the bank remains free from state control is unclear, however, given that the Austrian banking group retains the majority share of the unit, state influence is assumed to be minimal. On the other hand, Raiffeisen managed to avoid state control, as the purchase by the partly state-controlled Szechenyi Bank in 2014 failed.

Following the financial crisis, the PiS-led government embarked on a quest to take up a leading role in Poland's economy. Regaining firm control over the domestic banking industry was part and parcel of the government's new program, which would enable it to funnel credit to specific projects chosen on exclusively political grounds. Polish-born bankers angered over their decreased decision-making authority resulting from the reorganization of multinational banks in the post-GFC era additionally spurred the "repolonization" of foreign-owned banks.

The Polish government's renewed drift towards a state-dominated banking industry hit RBI hard. The conditional approval of Raiffeisen's purchase of the Greek-owned Polbank in 2012 marked the first step of the government's domestication efforts. The Polish authorities' demands, including the listing of Raiffeisen's subsidiary on the Warsaw Stock Exchange, which aimed to favor domestic investors and turn the bourse into an international financial hub, burdened RBI's operations in the state. Furthermore, the regulator's demand that RBI refinances its toxic portfolio consisting of Swiss franc-denominated mortgages as well as the imposition of the 2016

bank tax further burdened the group. Ultimately, intensified intervention by the Polish state led Raiffeisen to divest its Polish business and list its shares at the same time. This was more than an unfavorable outcome for the Austrian banking group, which has been forced to retain a presence in the region due to its Swiss franc mortgage portfolio, which in 2021 still amounted to 12.6 billion zloty (Bloomberg).

The political situation in Hungary remains uncertain and continues to threaten Austrian banks' future performance in the state. The Fidesz-led government has signaled that it remains willing to undertake self-interested measures against foreign banks. Most recently, Orbán introduced a new two-year windfall tax amounting to 250 billion forints.[22] The tax payment is equivalent to roughly 37% of the Hungarian banking sector's total 2021 profit, according to S&P Global Market Intelligence data. On top of the existing taxes, Erste Bank Hungary is set to pay about 19 billion forints and Raiffeisen Bank between 16-20 billion forints (APA). While the Hungarian banking market still remains profitable for Austrian banking groups, with margins and return on equity significantly higher than other European markets, the windfall tax adds additional burdens to the group and increases uncertainty in the foreign investment climate in Hungary (S&P).[23]

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[22] The government enacted the tax in response to growing energy prices, central bank hikes, and ongoing war between Russia and Ukraine. Hungarian lenders are set to contribute.

[23] The sector's ROE is expected to remain at 10% to 12% over the medium term, according to S&P Global Ratings.

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