Populist politics in central and eastern Europe : a risk for foreign investors?

A spectre seems to be returning to Europe – populist politicians in central and eastern Europe increasingly becoming aggressively nationalist in tone. But most of these countries seem restrained through membership in the European Union. So what does this mean for foreign investors seeking investment opportunities in these countries?

In 2008 the Slovak Prime Minister Fico warned foreign shareholders of a local gas distributor SPP, the French Gaz de France and the German E.ON, with nationalisation and seizure of their ownership shares in a dispute over retail gas price. In Hungary in 2009 a Member of Parliament from the largest opposition party -already in charge of several local municipalities in Hungary and most likely the next ruling party on national level - FIDESZ, Oszkár Molnár, has warned of “Jewish capital wanting to devour Hungary”.

These developments have brought worried words from foreign observers – including an open letter by nine embassies in Budapest complaining about political non-transparent behaviour hurting Hungary’s investment climate. However, mostly the argument is made that although regrettable, most populist politicians do not have enough clout – as these are bound by restrictions on EU level and as the economic malaise provides them with little room for manoeuvre - to seriously implement their rhetoric.

Unfortunately, recent developments have shown that these populist words do not remain mere rhetoric. In Hungary in October 2009, the local government of Pécs (controlled by the FIDESZ) unilaterally terminated its contract with the French company running the local waterworks - Suez Environment – although the contract should still run for another eleven years. After the local government sent security guards to occupy the waterworks and to prevent the Suez management from entering the facilities, Suez is instituting legal proceedings for breach of contract. It already won a partial success recently, when a court in Budapest ordered that the local waterworks (now run by a new company set up by the local council) return all intellectual property to Suez Environment, including software necessary to run the works. It remains to be seen what will occur next in this case (Suez will most likely receive a compensation but will not regain control as operator) and in further instances once FIDESZ returns to power on national level as well, especially, given FIDESZ’s strong antipathy against foreign investors, privatisation and, to an extent, free-market capitalism in general. This antipathy became blatantly obvious when FIDESZ opposed the government’s reform package of the health care system in 2008, which would have made the health care insurance semi private (albeit under majority ownership of the state). This opposition not only led to the collapse of the socialist-liberal government but also to a reversal of the already passed health care bills.

Another dominant example of populist words not remaining mere rhetoric is provided by recent reform proposals by the government of Robert Fico in Slovakia. The draft bill in question intends to allow the government to buy struggling companies below market value, if the government declares these companies as being “strategic” for the Slovak economy. Which sectors or even companies are to be viewed as being “strategic” is up to the government to decide - as is the price the government views reasonable.

The same commentators arguing that populist politicians would not have enough “clout” to seriously implement their ideas, argue that these examples stand isolated and that in essence the current financial crisis is to blame for an overall anti-business atmosphere and rhetoric in central and eastern Europe. As soon as the economic situation is stabilised, such action will stop.

This argument surely holds some truth. The current economic malaise of all economies in Europe has surely exacerbated social unhappiness and has allowed more populist rhetoric to emerge. Nonetheless, populist and anti-business political reforms are nothing new to central and eastern Europe. One example here is again provided by Slovakia. In 2007 – therefore some time before the economic crisis unfolded - the government of Robert Fico passed a law forcing private insurers to return all their profits from the basic health care provisions back into the health care system. Foreign shareholders of insurers Union and Dovera subsequently took Slovakia to an international arbitration court, seeking compensation worth several hundred million euros. On November 20th 2009 - two years of legal battle later - the European Commission launched an action against Slovakia over concerns that this law violated EU rules, arguing that “the absolute prohibition on privately owned public health insurance providers from using their profits other than for the provision of public health care in the Slovak Republic, constitutes an unjustified restriction on the freedom of capital movements”. The Slovak government now has two months to reply, but further regulation targeted against privatisation and foreign capital particularly in the health care system can be expected. This, particularly as the original plan of the government had been to re-nationalise the health care system completely, allowing only one state-owned insurer. This had been scraped, as the government did not have enough support in parliament to pass the necessary reform package. It does, however, provide insight into what direction the government’s reform plans are heading.

Another example can be found in Hungary. In 1996 – under a previous socialist government - the Canadian company ADC had won an international tender to build Budapest’s new flight terminal, Ferihegy 2B. It invested millions of Dollars in own capital and arranged a syndicated loan of over one hundred million Dollars to finance the project. In return, it received a 12-year contract to operate the new terminal. Viktor Orbán, the charismatic leader of FIDESZ, had repeatedly opposed any privatisation of the airport and had threatened to undo the semi-privatisation that had occurred. And that is exactly what his government did once in office. At the beginning of December 2001, the government informed ADC that the operating contract would be terminated as of December 31st 2001. The government offered no compensation for what was, in effect, a nationalisation and a breach of contract. ADC subsequently began the process of international arbitration and in 2006 – five years later -, was awarded 83 million Dollars in compensation. Orbán again has proposed a similar reform, this time regarding the entire privatization of the Airport to BAA in December 2005 by the new Socialist government. Orbán repeatedly stated that he would contemplate a reversal of the sale when FIDESZ resumes office, which will probably be the case after the 2010 general elections.

It therefore seems important to note that this populist rhetoric does not merely stem from the current economic crisis. Rather, this economic melancholy amplifies the already present problem. This economic situation, however, can be expected to worsen once the consequences of the financial crisis continue to hit the people of the region. Indeed, whereas it appears that western Europe has awaken from the doldrums of the financial crisis, the economies of central and eastern Europe remain in decline and recovery is expected to be slow. This development will force the respective governments to implement further cost cutting measures in the fight to curb national expenditures. As a consequence, further social dissatisfaction and, undoubtedly, further populist rhetoric and action by the political actors are to be expected.

There is no doubt that similar populist voices have also surfaced in western Europe recently, shown most evidently by the success of the Left party in Germany during the latest elections. The situation, however, is different. For a start, the democratic systems seem more consolidated and the expectations of growth will help curtail social frustration. Additionally, reforms of key industries do not seem to be as messy and as extensive as is the case in central and eastern Europe. There is, for example, no serious discussion of re-nationalising health care or energy in any western European country. Where companies were nationalised – as had been the case in Germany with the law allowing the state to nationalise ailing Banks in 2009 – the issue created heavy furore in Germany and was implemented in an extremely cautious and timid fashion. It was made clear that the law in effect would only be used to allow the state control of the Hypo Real estate – therefore a Bank which was regarded as being extremely relevant for the economic stability of Germany and which could no longer survive without state aid.

Consequently, politics in western Europe is not regarded as a player seriously endangering investment security. In central and eastern Europe, however, recent developments prove the opposite. In conclusion, populist rhetoric has not merely surfaced solely as a consequence of the current economic crisis. It is therefore also not likely to vanish should the economies of the region stabilise. The current economic crisis has merely augmented this already present phenomenon. As the economic crisis is still unfolding across central and eastern Europe, populist rhetoric is more likely to intensify as a dominant part of policy making. This can prove worrying for the overall investment climate, especially as political action – already before the economic crisis had hit the economies – has shown that political actors are both willing and able to implement their often awfully populist rhetoric.

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