Varieties of Debt Management in Central and Eastern European Countries

An Institutional Investigation of International Financial Transactions

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VARIETIES OF DEBT MANAGEMENT IN CENTRAL AND EASTERN EUROPEAN COUNTRIES: An institutional investigation of international financial transactions

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Abstract

The paper focuses on the foreign debt management of the Hungarian and Slovenian policy makers in the global financial markets. The proposed argument combines a theoretical refinement of international financial markets as locally embedded social relations with a domestically oriented institutional analysis of foreign debt management. I argue that in order to understand the differences between the two states' debt management strategies, it is important to look at the institutional differences within which the strategies were proposed, rejected or accepted. At this level of analysis the paper also considers the links between globalization of finance and the changing role of the state.

1. Introduction[1]

The global reconfiguration of financial markets has been attracting the attention of analysts from various fields of social sciences. This study addresses the issue from the point of view of politics and tries to reveal the political motives behind the financial market transactions carried out by the Central and East European policy makers and their international counterparts. The paper focuses on the foreign debt management of the Hungarian and Slovenian state actors in the global financial markets, as well as in their home markets. The puzzle - the selected comparison seeks to investigate - lies in the finite difference of the debt management strategies the two CEE countries followed in the early 1990s in relation to a fairly similar amount of debt burden. With regards to the Hungarian foreign debt, policy makers opted for a rather passive and internal oriented debt management policy whereas their Slovenian counterparts engaged in active and externally oriented debt re-negotiations.

The argument proposed here combines a theoretical refinement of international financial markets as locally embedded social relations with a domestically oriented institutional analysis of foreign debt management policies. I argue that in order to understand the differences between the two states' debt management strategies, it is not enough to analyze the structural differences of the debts or the two economies but it is as important to look at the institutional differences within which certain strategies were proposed, rejected or accepted. As every possible structural constraint allows for a variety of policy solutions, in order to understand why the selected strategies were pursued, the analysis should be conducted at the level of institutions within which a given policy paradigm counteracted with the local, historically contingent relations. At this level of analysis it is also possible to ask questions of the relations between the globalization of finance and the changing role of the state in these two transition prone Central and East European countries.

[1] This paper was first presented at the third meeting of the European Political Economy Consortium (EPIC) in Florence Sept. 2002. Thank goes to all the participants of the workshop series. I am also grateful for critiques and comments to Amy Minett, Morten Ougaard, Anna Khakee, and Anna Leander.

In the following, I first present the strategies of the two states' policy makers, second, I compare the institutional background of the two policies and finally I conclude with the reconfiguration of politics.

2. The research interest

The early 1990s brought changes in numerous Central and Eastern European countries' debt management strategies. Poland successfully lobbied for debt relief at the Paris Club, Bulgaria defaulted on its foreign obligations, Slovenia managed to reduce its share of the Yugoslav foreign debt by a relatively high portion, while Hungary refinanced the whole part of its giant debt in due time. Outside the region the Baker Plan and later the Brady Plan alleviated the debt problem of many Latin American countries for some time. It seems to me that the pure diversity of the solutions the international financial community found for the debt problems qualifies some of the early observations on the structural reconfiguration of the global financial markets: the diminishing room for maneuvering of the state. The term globalization of financial market has been most often applied by IPE scholars to describe those structural changes in the international financial architecture which alleviated the cross border flow of capital[2] (money)[3]. These changes were said to require a general liberalization and opening up of domestic financial markets, which then further circumscribed the role of the state in financial matters.[4] This paper is interested in these changes in the role of the state in international finance. [5]

[2] See for example: Maxfield S. 1998. Effects of International Portfolio Flows on Government Policy Choice. In *Capital Flows and Financial Crises*, ed. Kahler M., Ithaca, New York: Cornell University Press

[3] This refers to Susan Strange's analytical distinction between money and finance: Money is considered as the determination of currency values, which refers also to the international monetary system used to exchange currencies. Finance (credit here) is the system whereby credit is created, bought, and sold. (1990: 259, Review of International Studies, 16, 3, 259-74.), different end-purposes to each.

[4] Keohane R.O., and H. V. Milner, ed. 1996. *Internationalization and Domestic Politics*. Cambridge: Cambridge University Press, Epstein G. 1996. International Capital Mobility and the Scope for National Economic Management. In *States Against Markets: The Limits of Globalization*, ed. Boyer R., pp. 211-27. London, New York: Routledge

[5] See for example: Pérez, Sofia A. (1997). *Banking on Privilege: The Politics of Spanish Financial Reform*. Ithaca, London, Cornell University Press. Loriaux, Michel, Meredith Woo-Commings, Kent E. Calder, Sylvia Maxfield, and Sofia Perez (1997). *Capital Ungoverned: Liberalizing Finance in Interventionist State*. Ithaca, New York, Cornell University Press. Kurzer, Paulett (1993). *Business and Banking: Political Change and Economic Integration in Western Europe Ithaca*, Cornell University Press. Haggard, Stephan, Chung H. Lee, Sylvia Maxfield, Ed. (1993). *The Politics of Finance in Developing Countries*. Ithaca and London, Cornell University Press.

For this purpose, out of the Central and East European region, the comparison of the debt management policies of Slovenia and Hungary stand as the most indicative.[6] There are several reasons behind this choice. First, the different debt management of Latin American and African countries have often been discussed in relation to the globalization of financial markets, and there has been little attention directed to the CEE countries' debt policies from a global angle. Second, Slovenia and Hungary are apt candidates as their debt structure was the closest among CEE countries (with comparable shares of commercial bank, sovereign and IFI debts, and financial bonds). Furthermore in the early 1990s both countries' policy makers continued a lengthened struggle to get the balance of payment closer to equilibrium (unlike Poland which received debt relief or the Baltic states, whose governments denied any sort of Soviet debt financing), and none of the two states opted for default (like Bulgaria did). Finally both countries' debt management had serious implications for the states' banking sector policies. Yet, these two newly democratized countries have followed very different policies in relation to their inherited debt burdens. Therefore, the research question is: What accounts for the differences in the two states' debt management in the era of the globalization of financial markets?

2.2. On data

There is a certain unease with providing data for my arguments. Not simply because records on debt negotiations are generally kept secret, but also because the Slovene debt issue was simply not resolved till 1995. Therefore the Slovene policy makers whenever asked by think tanks, or International Financial Institutions (EBRD, IMF) provided data which clearly favored their own interpretation of the debt issue. It is also indicative that none of the political and economic risk assessing Rating Agencies (Moody's or Standard & Poor's) were invited to Slovenia before 1996, because these institutions could have brought up delicate questions in relation to the level of indebtedness of Slovenia. Nevertheless, what seems crucial for the case selection is that the Yugoslav debt before

[6] Clearly, I select cases on the dependent variable (debt policy) which is not recommended by KKV. However, they also neglect the discussion of Mill's method of most different cases which prioritizes, in the case of two countries' comparison, the selection on dependent variable.

the dissolution of the country in 1987 exceeded 21 billion USD[7] and the comparative Hungarian number was 21.5 billion USD[8] in 1990 and it was far from clear how much of the Yugoslav debt Slovenia should take over.

The following table is an example of the Slovene authorities' understanding of the level of indebtedness of Slovenia, which in the course of the following discussion of the Slovene debt management policy, I hope to clarify:

Gross external debt (USD mn)

	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
Slovenia	1741	1873	2258	2970	4010	4176	4959	5491
Hungary	21644	24566	28526	31660	28043	24395	27280	29279

Notes: In the case of Slovenia unallocated debt of Yugoslavia is not included till 1995
Source: WIIW(2000): Countries in Transition 2000, Handbook of Statistics, WIIW, Vienna and WIIW(1996): Countries in Transition 1996, Handbook of Statistics, WIIW, Vienna

3. The debt management of Slovenia and Hungary

3.1 Slovenia

From June 1991, the constitution of Slovenia, which declared the independence of the new state, asserted the continuity of the existence of the Slovene state. It implied that Slovenia was an inheritor of the Slovene Republic of the former Yugoslavia: it was an inheritor both of its assets and liabilities, including a due share of its foreign debt. The aim of this section is to draw a general outline of the bargaining between the Slovene authorities and the foreign creditors in relation to the inherited foreign debt from Yugoslavia.

[7] OECD Development Center, Technical Paper N° 54 "Debt Conversions in Yugoslavia", by Mojmir Mrak, Research Programme on Financial Policies for the Global Dissemination of Economic Growth, Head of Project: Jean-Claude Berthélemy, February 1992, p. 48.
[8] WIIW(2000): Countries in Transition 2000, Handbook of Statistics, WIIW, Vienna, p 443.

3.1.1 The heritage

The foreign debt of the former Yugoslavia consisted of three different kinds of debt portions: Yugoslavia borrowed from sovereign lenders (the members of the Paris Club), it contracted loans with private commercial banks (the members of the London Club) and drew loans from the International Financial Institutions, namely the World Bank, the IMF and the EBRD.[9] As a consequence of the nature of these contracts, from 1991 until the agreement with the London Club in 1995, the Slovene authorities faced external pressure to reimburse the whole amount of money the former Yugoslavia once contracted with the London Club. (in the calculation of Mojmir Mrak, the chief debt negotiator this debt stood at 15 billion USD).[10] The comparative Hungarian amount of gross foreign debt as of 1990 was roughly 21 billion USD.[11] Both numbers represent countries well above the red line of the most indebted countries in the world.

Before entering into the details of the negotiations, it is important to stop for a moment and ask: Why did the Slovene authorities not consider refusing to reimburse the Yugoslav debt, since these contracts were not initiated by the Slovene state? (As for instance the Estonian, Lithuanian and Latvian governments proceeded to do in relation to the Soviet debt.) The answer is connected to the origins of the sovereignty of Slovenia, which the new authorities of Slovenia were striving to have acknowledged. Independent Slovenia was at the same time a new state in the international system, as well as an inheritor of the Yugoslav past. Following this logic, the Slovene negotiating team had to insist on the willingness of Slovenia to reimburse a part of the Yugoslav debt, because if the debt was

[9] The contracts were severely modified in 1983, when at the height of an international financial crisis, Yugoslavia declared a moratorium on financing its foreign obligations. The new financial agreements signed by the London Club members incorporated two new elements: a sovereign state guarantee from the Yugoslav federal state and the so called ‘joint and several liability clause’.

[10] It means that if Yugoslavia had not had to dissolve and the other contractor from the part of Yugoslavia, would not have been able or willing to pay, Ljubljanska Banka would have been the same responsible to finance the whole amount.

[11] Countries in Transition WIIW Handbook of Statistics 2000, The Vienna Institute for International Economic Studies, p. 443.

separable, it no longer belonged to any one country but to former Yugoslavia constituent parts.[12]

3.1.2 Entering into the International Financial Institutions

As a first step, the Slovene policy makers set up a negotiating team, co-chaired by the Minister of Finance and the President of the Central Bank, which included several Slovene experts who had gained experience in dealing with international financial partners in Belgrade or abroad.[13] The most important reservation is that within the negotiating team it was possible to discuss rather diverse views on the functioning of 'the economy' and the neo-classical views were not necessarily dominant. The priority of the Slovene negotiating team - in settling the Yugoslav debt - was to gain an official status for Slovenia within the international financial institutions.

The global sphere showed its multi-layered and overlapping characteristics to the Slovene negotiators. First, in order to transmit the support of powerful states for their act of independence to the field of financial matters, the Slovene delegation started negotiations on membership with those financial institutions whose operation had been most tightly linked to the political will of the states. In other words, in settling their financial issues with private actors, they tried to capitalize on the political support of the states. Becoming a member of the IFIs was the key for Slovenia to gain access to new credits from the international bankers' community or from sovereign lenders.[14] In addition, just as in 1991, not all the states of the international community subscribed to Slovene independence, the IMF – an IFI under the dominance of the USA, a supporter of the Slovene independence – was a site of political will-formation of states, which was supposed to facilitate the formation of a consensus of states' opinion in line with the Slovene negotiators' will. Thus, not really surprisingly but still importantly we can see

[12] Irwin Z. T. 1995. Yugoslavia's Relations with European States. In *Beyond Yugoslavia: Politics, Economics, and Culture in a Shattered Community*, ed. L. S. A. Sabrina, P. Ramet, pp. 349-92. Boulder: Westview Press

[13] Interview with Mojmir Mrak 2002

[14] Mojmir Mrak, Janez Potocnik. 2002. The Transition Process in Slovenia: Transformation to an EU-Compatible Economy. *Journal of International Relations and Development* 5: 37-62

how the Slovene negotiators benefited from the overlapping characteristics of the IMF authority in both the field of the private actors and the states.

In order to gain acceptance by the IFIs, the Slovene negotiators, contrary to their initial will[15], started independently from other successor states to ‘clean up the table’. First, they divided up the Yugoslav debt[16]: into allocated and non-allocated debt. The first category stood for “the loans used directly by legal entities based on the territory of the individual Republics”, the second for “the loans used by the federal Yugoslav institutions whose immediate beneficiaries are not ascertainable.”[17]

The negotiations with the EBRD, the IMF and the World Bank on membership lasted almost a whole year. Because the member states of these institutions had to agree among themselves on the crucial question: How to understand the dissolution of Yugoslavia? The consensus reached among the member states of the European Union was born on the basis of the Report by the Badinter Commission of mid-1992, which argued for the dissolution of Yugoslavia as opposed to the unilateral separation of Slovenia. On the basis of this report, Slovenia - before entering into any other financial institution - became a member of the EBRD in August 1992.

Some months later in December 1992, the IMF made its first declaration on the end of Yugoslavia by asserting its dissolution. This decision was extremely important for the Slovene authorities. Since the IMF declared dissolution it had to propose its own principle for the separation of the SDR quota of the former Yugoslavia among the successor states. The IMF proposal was that Slovenia should take over 16.39% of the debt and quota of the former Yugoslavia. By accepting these terms, Slovenia became an official member of the IMF in January 1993. Somewhat later in the same year, the

[15] Their initial idea was to negotiate the allocation of the Yugoslav debt among the successor states.
[16] On the basis of data the Yugoslav National Bank.
[17] Mrak M. 1996. Becoming a 'Normal' Country in the International Financial Community, The Case of Slovenia. In: *Into Europe?, Perspectives from Britain and Slovenia*, ed. Hafner D. F., Cox T., pp. 251-74. Ljubljana: Scientific Library, Faculty of Social Sciences, Ribnikar I, Elton G. McGoun. 2001. The Financial Sector in Slovenia. mimeo, pp. 1-8, Pleskovits B, Sachs J. D. 1994. Political Independence and Economic Reform in Slovenia. In: *The Transition in Eastern Europe*, ed. OJ Blanchard, Kenneth A. Froot,. Sachs J. D, pp. 191-220. Chicago and London, The University of Chicago Press

Slovene negotiators signed an agreement with the World Bank, too. Thus, in a way, becoming a member of the World Bank was preconditioned by becoming one of the IMF.

3.1.3 The deal with the Paris Club

Slovenia started negotiations with the 13 states of the Paris club of *sovereign lenders* soon after gaining independence. The message Slovenia, the Slovene negotiators sent to the member states of the Paris Club was clear: It was willing to take over the Slovenian portion of the Yugoslav debt, but it was not willing to finance the whole amount of it. The negotiations formally started in 1993, after EBRD, IMF, and World Bank membership was achieved. At this time the exact amount Slovenia would take over was clear: the full amount of the allocated debt and 16.39% of the non-allocated debt of Yugoslavia. The member states of the Paris Club after a short hesitation agreed to this proposal and an agreement in principle was signed in June 1993.[18]

3.1.3 London Club, the commercial banks go hard

To strike a deal with the syndicate of the commercial banks was the most delicate issue as it involved the most participants as well as contained the famous clause on joint and several liabilities.[19] This clause was an extra safety belt for the London Club members. It implied that each party to the contract from within Yugoslavia (the Yugoslav state, the individual republics and the commercial banks) was individually responsible for the repayment of the whole amount of the contracted debt. The London Club naturally insisted that Slovenia should start financing the whole amount of the outstanding former Yugoslav debt (7.1 billion USD).[20] In 1992, the Slovenes sent off their calculated share of

[18] Interview with Mojmir Mrak 2002

[19] On the side of the former Yugoslavia, 10 commercial banks and the state had signed the credit contract in 1988. The internal Yugoslav agreement between the republics-based commercial banks and the Yugoslav National Bank, the paying agent, was the following: The commercial banks were responsible for transferring the due amount to the YNB, if they failed to finance, the National Bank of Yugoslavia had the right to block the Republics' budget.

[20] OECD Development Center, Technical Paper N° 54 "Debt Conversions in Yugoslavia", by Mojmir Mrak, Research Programme on Financial Policies for the Global Dissemination of Economic Growth, Head of Project: Jean-Claude Berthélemy, February 1992. p.53.

the debt to the London based agent of the commercial banks.[21] However, the commercial banks considered this amount as a portion of the Yugoslav debt and not as a portion of the Slovene obligations. As a countermeasure, the Slovene authorities stopped the transfer of further money and initiated negotiations. Their suggestion, which was foreseeable, was that they were willing to take over exactly the same share of what they had taken over from the IMF granted debt.[22] As of 1992, the proposition was altogether rejected by the London Club.

The negotiations between the Slovene authorities and the representatives of the London Club lasted for three years from June 1992 till June 1995, when an agreement in principle was signed. Clearly, the Slovene negotiating position was very weak. In early 1994, when according to the 1988 agreement Slovenia had to start reimbursing the principal of the debt, it did not yet have an agreement with the commercial banks on exactly how much to transfer. The situation was dangerous as Slovenia was not meeting the word of the contract, which Yugoslavia had signed with the London Club members and this in principle gave the commercial banks the right to compensate themselves from the Slovene financial reserves held in diverse international banks' accounts. As such, it was a real threat to the financial sovereignty of the country, which inclined the Slovene authorities to extensively lobby the influential states' governments to exert an influence over 'their' commercial banks to accept the Slovene suggestions.[23]

In addition, in 1994, within the framework of banking sector restructuring but also tightly connected to the debt negotiations, the Slovene authorities decided to nationalize the two largest banks. The nationalization step was necessary in order to clarify the ownership of the assets and liabilities of the two banks: among Slovenian end-users, in relation to former Yugoslav federal institutions and finally vis-a-vis other successor states. Although

[21] The last agreement Yugoslavia signed with the London Club members (the 1988 New Financial Agreement) included a five year long moratorium of Yugoslav payments until the end of 1993. During this moratorium the payment was transferred only after the interest.
[22] The whole of the allocated debt and 16.39% of the non-allocated debt.
[23] Interview with Mojmir Mrak 2002

transparency of ownership rights was important for all parties involved, it was most urgently needed to clarify the Slovene share in the Yugoslav foreign debt.[24]

Given these constraints, the final outcome achieved in 1995 was the following: Slovenia accepted to pay over 18% (instead of the proposed 16.39%) of the Yugoslav debt due to the London Club members. But this deal in fact was extremely good for the Slovenians. As whatever the condition reached with the London Club was, it meant automatically that Slovenia was not liable for the rest. The most important observation in relation to the deal between the Slovene state actors and the commercial banks is the political style of the bargain. To agree on terms with each other was not primarily an economic question for the Slovene negotiators but a political issue and concerned the future of Slovene sovereignty.

3.2 Hungary

The peculiarities of the Hungarian external debt management of the early 1990s rest in the absence of its externality. As much as in the past, Hungarian policy makers since the first free elections ruled out any sort of rescheduling, debt relief or other form of contract breaking and insisted on timely financing the Hungarian debt. Their aim was to maintain the unique debtor history of Hungary: a highly indebted country which never defaulted. In the case of Hungary, globalization of finance seems to work in line with its classical presentation:[25] The Hungarian policy makers saw no alternative to the refinancing of their giant foreign debt, as the global financial markets presented an external pressure on state policy formation and the state 'had to' adopt the neo-liberal suggestions. The argument of this paper is that the extent to which Hungarian policy makers were 'forced' to follow

[24] According to the Bank of Slovenia, the fact that these two banks' balance sheets did not reflect their 'actual' assets was due to the inclusions of those claims and obligations, which belonged to the former federal institutions. Therefore, the Parliament of the Republic of Slovenia on July 27 1994, adopted an amendment to the Constitutional Law. By this law, the Nova Ljubljanska Banka and the Nova Kreditna Banka Maribor were established, taking over the operations and part of the assets of Ljubljanska Banka and Kreditna Banka Maribor. All claims and liabilities to former federal institutions, and obligations of end-users of loans from other republics of former Yugoslavia were cleared and only those guaranteed by the Slovenian government remained. Bank of Slovenia, Annual Report, 1994, p14-15.

[25] Hay, C., and Rosamond, B. 2002. Globalization, European integration and the discursive construction of economic imperatives. *Journal of European Public Policy* 9 (2):147-167.

neo-liberal considerations was largely determined by their own, past driven interpretation of and reaction to the nature of these constraints.

The aim of this section is to outline the most important decisions and strategies of the Hungarian authorities in relation to the country's giant foreign debt in the first part of the 1990s. The exploration of the Hungarian foreign debt management strategy gives an insight not only into the marked differences to other states' debt management strategies, but it also allows us to see the indeed high, but altered 'state-intervention' requirement of many neo-liberal policies.[26]

3.2.1 The debtor history of Hungary

Hungary like many developing countries extensively borrowed from the cheap credit available on the international financial markets throughout the 1970s. In the two financial crises of the 1980s, when many Latin American and Central and Eastern European countries declared a moratorium on their external obligations, Hungary came out unharmed. During the first crisis in 1982, when the credit markets dried up for Eastern European countries, the Hungarian policy makers after long political consideration decided to join the International Monetary Fund. The negotiations with the IMF were conducted by the reformists of the National Bank of Hungary, an institution, which, then already for long, enjoyed the exclusive right in Hungary to negotiate with foreign creditors and the IMF. The key decisions concerning the external debt were the exclusive domain of Janos Fekete, whose authority derived from his personal contact with the Communist Party's leadership.[27]

In the 1980s, the problem with the foreign debt was that Hungary was not able to generate sufficient export revenues to service current debt payments, thus Hungary had to

[26] Clark I. 1999. *Globalization and International Relations Theory*, Oxford University Press, Oxford, p.92.
[27] Bruszt L., Stark D. 1998. *Post-socialist Pathways: Transforming Politics and Property in East Central Europe.* Cambridge: Cambridge University Press, Bartlett D. L. 1997. *The Political Economy of Dual Transformations: Market Reforms and Democratization in Hungary*. Ann Arbor: The University of Michigan Press, Andor L. 2000. *Hungary on the road to the European Union : transition in blue*, Westport, Conn.: Praeger

assume new credits and draw on hard currency reserves in order to cover its outstanding debt obligations.[28] Since 1985 the debt structure has been increasingly modified: less sovereign credit, more commercial bank credit (mainly German and Japanese) and increasingly commercial bonds and International Financial Institutions (IFIs) balance of payment credits were contracted. Nevertheless, in the period 1984 to 1986, the gross convertible currency debt nearly doubled.[29] As mentioned above, in 1990 Hungary was responsible for the reimbursement of roughly 21 billion USD, an amount comparable with the debt level to that of Mexico, Brazil, Poland, Bulgaria or the former Yugoslavia.

At the end of the 1980s, with the mounting dissatisfaction of the political system, foreign financial obligations being one of the most important reasons, the opposition leaders claimed this made regime change inevitable. Yet, besides some quiet murmuring, not even the opposition leaders went so far as to strongly demand debt relief for Hungary on the international scene.[30]

3.2.2 Internal oriented foreign debt policy

After the free election in 1990, the newly elected Prime Minister, Jozsef Antall, after a secret effort in Washington, ruled out any future Hungarian demand for rescheduling. He did so at the moment when international commercial banks had just concluded the Brady Plan: a debt and debt service rescheduling agreement with Mexico, and a year before Poland gained complete debt relief from the members of the Paris Club.[31] Until the reimbursement of a significant part of the foreign debt in 1995, no other unofficial or official attempt was made by Hungarian policy makers to start a negotiation procedure.

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[28] Kornai J. 1996a. *Adjustment without Recession: A Case Study of the Hungarian Stabilization*. Budapest, Kornai J. 1996b. Paying the Bill for Goulash Communism: Hungarian Development and Macro-stabilization in a Political Economy Perspective. *Social Research* p. 63.
[29] The net debt position got even worse as Hungary borrowed in yen and Deutsch Mark while placing the bulk of Hungary's hard currency assets in dollar whose value jumped after the Park Plaza Accord on currency realignment. (dollar depreciation).
[30] Szakolczai Á., Horvath, Á. 1989. *The Dissolution of Communist Power, The Case of Hungary*. London and New York: Routledge
[31] Ibid. p. 52.

In the early 1990s, as a continuation of past conduct, in which a closed political system only allowed for the carefully selected members of the National Bank to be in contact with western creditors, the issue of foreign debt was kept under the auspices of the National Bank reformers.[32] However, the increasingly powerful National Bankers freedom of action was circumscribed with strengthened institutionalized political checks. It was the new Law on Central Banking which codified the National Bank's operational control over debt policy. Against this new legal framework, the leadership of the National Bank formulated a strategy aiming at stabilizing Hungary's debt position, which utterly ruled out any form of negotiations with foreign creditors. The authorities of the National Bank argued – as in the 1980s – that what was decisive was not the literal size of the country's external debt but the country's capacity to sustain net capital inflow. The National Bank economists' strategy of stabilizing the net debt position of Hungary comprised four factors[33]:

First, the Central Bank had to change the structure of outstanding debt. This meant lengthening the maturity profile of the debt by shifting from short to long term financing and lowering interest-payment by replacing bank loans with low cost bonds.[34] This reliance on debt financing circumscribed opportunities for *ex post* debt rescheduling. Unlike syndicated bank credits, which comprised a group of creditors who could negotiate rescheduling under the auspices of London Club, bonds involved a multitude of private investors who lacked institutionalized means of renegotiating debt relief.

This strategy and its result was often presented in public discussions as the major obstacle impeding the Hungarian policy makers from asking for debt relief or debt rescheduling in the early 1990s. On the one hand, it was asserted that commercial banks could not be pulled into political bargaining; on the other, the investors of the stock markets were presented as a faceless community whose identity was unknown and hence it was impossible to initiate negotiations with them. For the present purpose, in order to qualify

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[32] Varhegyi E. 2002. Bankvilag Magyarorszagon, Helikon, Budapest

[33] This part draws on or indeed summarizes the empirical findings of: Bartlett D. L. 1997. *The Political Economy of Dual Transformations: Market Reforms and Democratization in Hungary*. Ann Arbor: The University of Michigan Press. p. 175-181.

this argument we do not have to go so far as to develop credible counterfactual arguments against this line of reasoning.[35] It is enough to acknowledge that the swap option was not forced upon Hungary but was rather the result of the Central Bankers' conscious decision, which indeed could have been different as of 1985 through to approximately 1991. At the same time, political bargaining with commercial banks, as we saw in the case of Slovenia, was possible as of the early 1990s.

Second, the National Bank's strategy of managing the net debt required quick improvement in Hungarian exports towards a convertible currency area. Third, the National Bank and the Ministry of Finance had to maintain tight monetary growth and fiscal spending. However, to keep the budget expenditure tightly curved proved to be a difficult task to sustain in times of high political pressure for compensating the victims of the communist regime. Fourth, maintaining a net capital inflow required increases in foreign direct investment, which would bolster hard currency reserves and relieve the National Bank's dependence on external credit to finance the economy's financial needs. The legal framework established by the communist party in the late 1980s and the long reputation of Hungary as being the most open of the communist countries proved to be good indicators for potential foreign investors.[36]

Finally, it is important to note that in the first Hungarian government, lead by the conservative Jozsef Antall, there was little interest (and expertise) in finding a long term solution for the threatening indebtedness of the country despite the mounting debt problem. (i.e. a debt management strategy). The newly elected politicians were much more concerned with setting up a new democratic architecture and, as a result, the questions regarding the reorganization of the economy were usually addressed with some delay.[37] Also, in the international political turmoil of the early 1990s, the lack of a clear political strategy towards the debt was in a way the continuation of the practice of the Socialist Party: a strategy of balancing on the edges of world politics.

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[34] Hungary began issuing bonds in 1985, the first communist country to do so.
[35] Jochen Loretzen developed a very illustrious counterfactual explanation.
[36] Between 1990 and 1994, total FDI in Hungary approached 7 billion dollar more than the other East European countries combined.

By 1994, at the time of the new elections, the foreign debt question had become a pressing political factor for the election of the socialist-liberal government who promised a more 'professional' management of Hungary's external obligations.[38] It included the privatization of important elements of the banking sector and other strategic sectors, combined with a harsh austerity program, the famous Bokros package. As a result, by 1996, Hungary managed to reimburse a large enough portion of its external debt obligations.

4. Contrasting foreign debt policies

The core contrast I see in the two countries' debt management is that in Slovenia the foreign debt was taken as a part of the process of building up international recognition for Slovenia, or indeed as the chief debt negotiator called it, the establishment of an identity for Slovenia in the international financial community. In the meantime, in Hungary, the foreign debt was considered as a proof of the non-viability of the socialist regime, and its reimbursement as another inevitable price the country had to pay for the long run benefit of economic growth, which is the reward of creditworthy countries. In Hungary, the financing of the debt was considered as an integral part of the game a state has to play, which constitutes the 'market economy'.

In more detail, there appear to be three different areas of the social construction process constituting the foreign debt management strategies in the two countries which can help us to understand the differences in the outcomes. First, there was a marked difference in the discursive construction of the meaning of foreign debt service. It was considered a political issue in Slovenia and as an economic matter in Hungary. Second, there was a marked difference in the institutional underpinnings of the debt management. In Slovenia,

[37] Eva Varhegyi(2002): Bankvilag Magyarorszagon, Helikon, Budapest

[38] The new Prime Minister, Gyula Horn, wrote a letter to Khol, asking for sovereign loan, but Khol suggested a neoliberal policy to implement before he would grant a loan with such conditions - as Bokros observed - if Hungary had been able to implement the suggestions, it would not have needed the loan any more. Rádai E. 2001. Pénzügyminiszterek Reggelire: Rádai E. Beszélget Békési Lászlóval, Bokros

a negotiating team was formed to deal with the debt, which comprised of professionals with considerably diverse backgrounds allowing for a non-neo-liberal reading of the economy, whereas in Hungary debt management was the exclusive domain of the economists of the National Bank and the Financial Ministers. Finally, there was a difference between the influence of the IFIs on national policy makers. Historically, the Slovene authorities were not that much exposed to IMF - or other IFIs - initiated training of a neoliberal understanding of the economy as the Hungarian leading economists. These three factors, with the help of many other non-explored were present and constituted the different debt management strategies. As all of them are linked to socially embedded agents, we can see a possibility for their eventual different course.

I would like to start by exploring the discursive struggles over the meaning of 'foreign debt', which characterized the Hungarian and Slovenian social reality during the early 1990s. I will also try to show that the new political and economic institutions, in which the foreign debt policies were embedded, were disseminating similar assertions to many other policy areas. First, it seems that the nature of financial debt was articulated as political in Slovenia and as economic in Hungary. In Slovenia the political nature of the foreign debts meant that the concerns surrounding the foreign debt problem were tightly linked to the establishment of the "identity of Slovenia in the International Financial Community"[39]. In Hungary, foreign debt management was understood within the confines of neoclassical economics, which equates the availability of new credits with sound economic policies and 'good' debtor behavior.[40] These two concepts are the most important factors which constitute what Maxfield called the 'creditworthiness of a country'[41]. Thus, creditworthiness was the primary target of Hungarian policy makers. The global financial markets as globally institutionalized financial practices presented a constraint for Hungary.

Lajossal, Kupa Mihállyal, Medgyessy Péterrel, Rabár Ferenccel, Szabó Ivánnal, Budapest, Helikon/ Beszélő, (Inteview with six Ministers of Finance of Hungary)

[39] Mrak M. 1996. Becoming a 'Normal' Country in the International Financial Community, The Case of Slovenia. In *Into Europe?, Perspectives from Britain and Slovenia*, ed. Hafner D. F., Cox T., pp. 251-74. Ljubljana: Scientific Library, Faculty of Social Sciences

[40] Lorentzen J. 1995. *Opening up Hungary to the world market : external constraints and opportunities*, Houndmills, Basingstoke, New York: Macmillan, St Martin Press p. 39.

Second, why creditworthiness was the main target is not very difficult to discover once one looks at the institutional organizations of the Hungarian foreign debt issues. As many researchers have described,[42] the Hungarian National Bank since the early 1980s onward managed to accumulate a formidably large array of technical and informational resources. It was able to oppose any suggestions in policy shift. Indeed, not only foreign debt management but also the foreign exchange policy of post-communist Hungary bore the imprint of the Central Bank.[43] The Slovenian institutional organization of foreign debt management, however, shows a marked contrast to the Hungarian solution. Here, shortly after the declaration of independence a negotiating team was built comprising of the Prime Minister's advisors and co-chaired by the head of the Central Bank and the Minister of Finance, which included many experts with diverse experience.[44]

Third, in Slovenia, as opposed to Hungary, the wide-ranging views of the negotiators on the nature of the economy were all the more assured as few of the members of the negotiating team had had a close, intimate relation with the IMF in the past. Because the heavily indebted Yugoslavia's negotiations with the IMF took place in Belgrade at the National Bank of Yugoslavia.[45] And as Slovenia in the early 1990s was not in need of IMF initiated medicines to cure its economy, the Slovene debt negotiators were not exposed so intensively to IMF training as the state employed financiers in other Central and Eastern European countries. Since the early 1980s the IMF was deeply involved in the Hungarian economy's restructuring: initially as an observer, later more directly via the conditionality assigned to new *tranches* of IMF loans. As Hungary was a member of

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[41] Maxfield S. 1997. *The gatekeepers of growth: the international political economy of central banking in developing countries*, Princeton, NJ: Princeton University Press.

[42] Bartlett D. L. 1997. *The Political Economy of Dual Transformations: Market Reforms and Democratization in Hungary*. Ann Arbor: The University of Michigan Press, Bela Kiraly AB, ed. 1995. Lawful Revolution in Hungary, 1989-1994. New York: Columbia University Press, Csikos-Nagy B. 1990. Appreciation of the IMF and World Bank Activity in Hungary. Acta Oeconomica 42: 253-66, Shugart M. Haggard R., Kaufmann M. 1997. Politics, Institutions and Macroeconomic Adjustment: Hungarian Fiscal Policy-Making in Comparative Perspective. Budapest: Collegium Budapest, Greskovits B. 1998. Bothers-in Arms or Rivals in Politics? Top Politicians and Top Policy Makers in the Hungarian Transformation. Budapest: Collegium Budapest

[43] Bartlett D. L. 1997. *The Political Economy of Dual Transformations: Market Reforms and Democratization in Hungary*. Ann Arbor: The University of Michigan Press p. 178.

[44] Interview with Mojmir Mrak

the IMF, its training and past experiences with IMF negotiation the Hungarian National Bankers accumulated, formulated the core of how the Hungarian central bankers, the responsible for debt management, perceived the nature of the economy.

To sum up, debt policy management was embedded in both countries in a rich web of norms, rules, concepts and social practices. I have spelled out the meaning of foreign debt and considered the institutional organization of foreign financial issues in the two countries. As we can not possibly know exactly why certain decisions were taken and not others, I hope these matrices are useful tools to guide our understanding.

5. Conclusion

I would like to conclude with a few observations in relation to the changing role of the state in the globalizing financial sphere. First, with regards to Hungarian debt management policy, the above comparison showed that the "there is no alternative" approach to the re-financing of the debt of the Hungarian National Bankers was a particular social construct and as we saw in the case of Slovenia there was indeed a possibility to follow a different course of management in the early 1990s. Thus more broadly, the effect of the globalization of finance on state conduct largely depended upon the local institutionalization of financial matters, namely who had control over what kind of decisions and what was the power of these particular institutional fields. Nevertheless, I do not intend to climb too high on Ian Hacking's classifications[46] of the political relevance of the reflection on the constructed nature of our social reality (to what extent a social construct is amendable). Here it is enough to assert that the most important impact of globalization on state policy formation was not simply the external force of international creditors which demanded the refinancing of the debt. Rather, as Saskia Sassen and others[47] have pointed out, globalization is materialized by the local

[45] Woodward S. 1995. *Balkan Tragedy*. Washington, DC: Brookings Institute. pp. 1-81
[46] Hacking I. 1999. The Social Construction of What? Cambridge, Mass: Harvard University Press
[47] Sassen S. 2000. Excavating Power: In Search of Frontier Zones and New Actors. *Theory, Culture and Society* 17: 163-70, Bourdieu P, Wacquant L. 1999. On the Cunning of the Imperialist Reason. *Theory, Culture and Society* 16: 41-58.

institutionalization of global norms (this time the neo-classical views in the Central Bank), which internally exercised power on the state's debt policy.

Second, in relation to Slovenian policy makers or debt negotiators' struggle to have acknowledged the sovereignty of Slovenia within the international financial community, globalization of finance showed its heterogeneity. This concerns the alleged paradox between financial globalization as a state autonomy curbing force and the increasing number of new states in world politics. This paradox was observed by many and loosened by Zygmunt Bauman, who argued for the complementarity of the two processes – the increasing mobility of capital and the expansion of new (and weak) states - as they together constitute what he called the global reallocation of freedom to act or freedom of movement.[48] While this observation seems to hold in many cases, in relation to the Slovene debt negotiators or in general policy makers, this study showed a rather active and uncompromising attitude on the side of the "weak" state's representatives. That is while it is true that the first and foremost priority of the new Slovene elite was to enter International Financial Institutions and assure the European Union of its wish to join, thus curb the newly gained sovereignty, a reconfiguration of the above paradox still applies: Throughout the 1990s, the Slovenian authorities simultaneously sought to protect their national state interest in relation to the debt (but also in relation to finance in general), while becoming a member (in the case of the IMF) or preparing for membership (in the case of the European Union) of such institutions that clearly prioritize the separation of economic and political[49] and promote the compliance of all parties to the laws of the free market as a prerequisite to long term development.[50] In order to account for this paradox, globalization of finance once again should be brought down to the level of domestic politics so that these sorts of controversies - embedded in the process - become evident.

Finally, this analysis was not meant to be a critique of any of the two countries' debt management strategies. I have simply attempted to understand a set of foreign debt

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[48] Bauman Z. 1996. *Globalization: The Human Consequences*. Oxford: Polity Press p68-69.
[49] Patomaki H. 2001. *Democratising Globalization: the Leverage of the Tobin Tax*, London Zed Books
[50] Lindstrom, Nicole (2000): Rethinking Sovereignty: The Politics of European Integration in Slovenia, in: *The Fletcher Forum of World Affairs*, Vol. 24, No. 2, 30 – 45

related decisions from within the context in which they transpired, in Hungary and Slovenia. By focusing on the questions of different institutionalization of conducting foreign debt management, I have hoped to shed some light on how the global and local considerations jointly shaped the policy makers' decisions in the two countries. This involved looking beyond the flows of foreign capital and structural characteristics of world markets and trying to see the making of foreign debt policies as social processes.

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