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Does Financial Sovereignty Pay?

Political Considerations when Deciding between Sovereignty-loss and a Higher Bill

ABSTRACT

Sovereignty has been principally a legal notion throughout its long history. In one of his works, Dreher (2004) is making an interesting connection between a complex, political, sovereignty-related but also economic decision, the conclusion of an IMF agreement and a clearly political point, the re-election of debtor governments. I will write about how the connection between sovereignty and finance evolved until recently and I will study whether the results of Dreher's research are applicable for the EU Member State Hungary. Hungary was the first EU Member State at the 2008 global financial crisis to apply for a joint EU-IMF(-IBRD) loan to avoid bankruptcy. The country was again hit by an economic shock near the end of 2011 which was around a downgrade into non-investment category by a credit rating agency (Moody's, 2011). Hungary had two different governments in these two scenarios, two different outcomes with the IMF and also two different results at elections. The incumbent socialist-liberal MSZP-SZDSZ government after concluding an IMF-arrangement in 2008 has lost the next elections in 2010. The next, right-wing conservative Fidesz-KDNP party alliance after securing funding from private markets during 2011-2012 won again in 2014 with another landslide victory. These outcomes prove the right of Dreher, but with an addition.

Keywords: sovereignty, IMF, Hungary, global financial crisis, election

INTRODUCTION

Sovereignty has been principally a legal notion throughout its long history. Shortly, this is the ability of the sovereign or state to decide its next steps freely. The legal aspects such as *de jure* and *de facto* sovereignty, whether as a contract or a basic right, were the subjects of a lot of research. Today, when the ability to make policy choices is affected by several economic factors, it might be worth taking a wider perspective and looking back at the development of sovereignty and what part has been played by economic policy factors.

Since the 16th century sovereignty approaches have changed significantly until today. On the other hand, economic considerations were, when articulated, mostly related to taxes. This was expanded in the 20th century when other approaches started to link political and economic factors, for example in monetary policy or in critical geopolitics. At the same time, the increased importance of international organizations offered political and economic help and other benefits for their sovereign members. These offerings were linked to shared or limited sovereignty because of membership reasons, or due to conditions attached for the instalments of money.

Democracy, sovereignty and their potential future ways have been very much debated recently, and their connection was tested during the 2008 financial crisis and in later years as well. In the European Union Hungary can be an excellent choice to test the corresponding literature and to present the main outcomes and the potential moral when sovereignty was reduced and when it was not. We might also discover linkages between economy and politics, in addition to sovereignty, and along the way the price that the political leaderships are paying and the benefits that they are reaping.

In Hungary the political leadership has agreed with IMF deal in 2008 during the global financial crisis. At the turn of 2011-12 with the intention to negotiate, ultimately the consecutive Hungarian government managed to avoid an IMF conditionality-led (IMF, 2016) deal. On the political level the former leadership has lost the upcoming elections while the latter one secured its re-election.

I am testing these developments against the previous research of Dreher who studied the connection between the conclusion of IMF agreements and re-election probabilities, the relationship between politics and economy and its potential results.

SOVEREIGNTY AND ECONOMICS

Sovereignty in relation to finance or economy means largely the economic sovereignty for many researchers, which is an area of monetary policy. However, in contrast to this topical approach, it might be worth going back a few centuries to the roots of central banks and the respective developments in sovereignty. By adding a political, and more precisely, an economic policy layer to the developments, we might discover a broader interpretation of sovereignty.

Bodin (1955) in the 16th century was the founder of the concept of sovereign state. He wrote about sovereignty as the constant and absolute power of the state. The concept of sovereignty for him meant the essence of the political community which no longer is dependent on a reigning dynasty, but rather on the state itself. Sovereignty is also the source of laws defined only by God and Nature. He described sovereignty by nine characteristics. On the economic side, the sovereign no longer owns the state – for example its estate is also separated from the others. It is however the sovereign who has the right to set taxes as well as providing immunities from such levies. The sovereign has the power to issue legal currency – together with the proportion of precious metals in it – which is a fundamental tool to make individual commitments.

Hobbes (1983) later was of the view that the contract is not between the people as a community and the sovereign monarch. Instead, first, the people as individuals are making an agreement to transfer their rights. From the state of nature, which is civil war, "homo homini lupus" – everyone's fight against each other, emerges the Leviathan which is the state itself, created by a contract for peace and self-defence. Here, the contract can be terminated, and power is a key element in social relationships and also between states. His economic views were not much accentuated.

Locke (1965), his contemporary, had a completely different view from Hobbes. He managed to reconcile the unitary nature of sovereignty with the plurality of its uses, mainly through a conception of the dual, vertical separation of functions, which implied degrees rather than kinds of sovereignty. The community, established by a fundamental, single contract, is divided into "society" — to fulfil the function of legislation, which means the potential sovereignty of the community, so as to cultivate common law; and into "government" — to undertake the execution, meaning the actual sovereignty of the monarch, of common law so as to procure common wealth. While private property was also important for him, as the individuals create their right to it by working, but the main economic question of his era was also taxation. According to his views, taking away some part of the property is only justifiable if the owner directly or through the representatives agreed to it.

Rousseau (1999) in the 18th century took a further step by defining the sovereign as all citizens acting collectively. Here the basis of sovereignty is the people, which delegates it to the government, therefore the general will, "la volonté générale" unite them. In his concept there might be a tension between the public good of the citizen and the private interests of the bourgeois. According to his views, natural laws are deformed, and because of this deficiency, people are engaging each other in a competition. From an economic perspective, Rousseau was not content with the concept of laissez faire and was a critic of contract theories. For him these were flawed as the richest members of society deceived the others and cemented inequalities. He found corruption, inequalities as evil, which however can be prevented by wise administration, with good morals and the influence of the general will. Rousseau was largely criticised by Kant.

Kant's (1991) thought is committed to state sovereignty while providing the grounds for a profound critique of its existence. Sovereignty is ambiguous in Kant's political theory due to his understanding of human freedom. He opposed democracy, which at that time meant direct democracy, believing that majority rule posed a threat to individual liberty. Democracy for him was necessarily despotism, because it establishes an executive power in which "all" decide for or against one. And this "all", who are not quite all, make decisions. The fact that they decision is a contradiction of the general will with itself, and with freedom. The contract which creates the state is from practical reason and its role is positive. According to Kant, everything has either a price or a dignity. Whatever has a price can be replaced by something else as its equivalent; on the other hand, whatever is above all price, and therefore admits no equivalent, has a dignity. Kantian ethics affects economics in several ways. For example, a more complete understanding of human choice, incorporating not just preferences and constraints, but also principles and strength of will or character. Welfare economics generated policies that affect not only the well-being of persons, but also their dignity and autonomy. Kant was largely criticised by Hegel.

Hegel (1977) at the beginning of the 19th century was a monarchist, as he did not want a strong government. He wanted to de-emphasize power. Hegel developed an idealist conception of sovereignty that allows for a monarch to express the unity of the state. For him the individual has "substantial freedom" in the state and "it is only through being a member of the state that the individual himself has objectivity, truth and ethical life". Members of the Hegelian state are happy even to sacrifice their lives for the state. He divides them into classes, which are the agricultural, the acquisitive and the universal classes. He preferred a strong regulation of the economy. He wanted to reconcile the fragmentations. Marx was the direct opposite of Hegel, his aim was to sharpen the opposition to the point of conflict.

Marx (1988) was pursuing an economic interpretation of history with a fight between classes of society and that revolution is inevitable. He divided the states into three main groups, reflecting different stages of development. Pre-capitalist states, states in the capitalist (his) era, and the state (or absence of one) in a post-capitalist society. Additionally, his perception about the state changed throughout his works. First, there was a pre-communist, or a "young Marx" phase, before the 1848 revolutions throughout Europe; and then his mature, more nuanced works. After the European uprisings, he modified his theory considerably to allow increased autonomy for the state. According to him, the bourgeoisie has found that the advantages of wielding direct power were outweighed by the costs and disadvantages, so they were willing to accept an aristocratic or even a despotic government if it does not harm detrimentally their interests (Elster, 1986). Weber also criticised capitalism but differently.

Weber wrote in Politics as a Vocation (2013) that a fundamental characteristic of statehood is the monopoly on the legitimate use of force within a territory. Weber applied several caveats to his discussion of the state's monopoly of violence. The "monopoly" here does not mean that only the government may use physical force, but that the state is the human community which successfully claims for itself to be the only source of legitimacy for all physical coercion or adjudication of coercion. He described the state as a system of administration and law. He prefers the laissez faire approach in regulation for the sake of not only civil democracy but also for free competition. Beside competitiveness, taxation was a key element for him too, as the capacity of a state is often measured in terms of its fiscal capacity, meaning the state's ability to recover taxation to provide public goods.

Sovereignty and its economic aspects have changed in the twentieth century. However, as they are not directly related to this topic, I will not cover the totalitarian states nor the self-determination theories.

In the 20th century, a new approach, critical geopolitics, which instead of primarily military and geographical factors considers other elements like the economy as well, connected sovereignty and the economy. Muir (1997) was studying the challenged political certainties by the global forms of economic integration. The challenges are many towards the survival of the sovereign nation-state. Grimm (2015) was connecting the evolution of historical events from religious conflicts centuries ago and contemporary globalization developments.

The concept of democracy is also at the centre of key contemporary debates. On the global level Holden (2000) edited a book about the most significant different approaches regarding the concept of democracy and its future possible ways. It covers structures and processes such as international institutions like the United Nations, the European Union, state sovereignty and the process of democratization. In the book Paul Hirst and Grahame Thomson rejected the view that global economic integration and competition contributed to the end of state sovereignty as in their view states continue to retain enough autonomy over macroeconomic and social policies. Jonathan Perraton in the same book agrees with Hirst and Thomson adding the European Union, arguing that for Member States there was no collapse of national democratic political control. Perraton at the same time warns against the significant challenges that globalization brought for example in international finance.

Krasner (1999) is on the view that sovereignty was never quite as vibrant as many contemporary observers suggest. The conventional norms of sovereignty were always challenged. He adds that very few states had full power and autonomy during their history. As a modern example, he cites the United Kingdom which is though outside the Eurozone but still inside the European Union. He pinpoints that governments complain that multilateral institutions like the IMF overstep their authority by promoting universal standards for economic and monetary policy in this case. According to Krasner's views state control could never be taken for granted. Monetary policy is an area where state control expanded and then ultimately contracted. Before the 20th century, states had neither the administrative competence nor the inclination to conduct independent monetary policies. Not knowing before about any potential Brexit, Krasner was on the view that the European Union is not a conventional international organization because its Member States are so closely linked with each another that the withdrawal is not a viable option. He also added that the EU is inconsistent with conventional sovereignty rules. Its Member States have created supranational institutions (the European Court of Justice, the European Commission, and the Council of Ministers) that can make decisions opposed by some Member States. On the one hand, the European Union is a product of state sovereignty because it has been created through voluntary agreements among its Member States. But, on the other hand, it fundamentally contradicts conventional approaches of sovereignty because these same agreements have undermined the juridical autonomy of its individual members.

Sovereignty limits can be of many nature that is why it is worth separating legal restrictions from others. Contractual obligations, like the ones from international treaties mean similar barriers as memberships in international organizations. While in the majority of such international bodies a veto from any member is a fundamental characteristic, in the European Union there is a gradual tendency of shifting more and more areas out of this field and creating a rather federal system where majority support only will be enough for decision-making. Such tendencies are restricting Member States' sovereignty. On another level the sovereignty of countries is limited by different players as well. Internationalization and globalization are important challenges to state sovereignty. The internationalization of production for example together with global markets affects heavily the tax policy and workforce of a country as more favourable options elsewhere might easily drain out financial and human capital. Countries and their currencies are also divided and "bundled" into groups (e.g. emerging markets). As a result, failures in ones' position might easily trigger a negative perception on other states in the group, irrespective of their own situation and efforts. This latter is not a legal but rather a de facto limit on sovereignty however with not less potential effects for example on sovereign bonds.

Dreher (2004) is making an interesting connection between a complex, political, sovereignty-related but also economic decision, the conclusion of an IMF agreement and a clearly political point, the re-election of debtor governments. In his model he covers 96 countries between 1976 and 1997 and tests the corresponding data. He finds that country leaders are less willing to take IMF loans before elections. IMF agreements might signal an incompetent image to voters which might be key during the actual voting. An additional result is that the state of the economy influences the decision to make an agreement even at election times.

As Williams (2011) argues, IMF loans could be very costly for political leaders. Borrowing money from international organizations means large costs for the receiving nation. The loans provided by the IMF can be grouped in three categories. The main lending facilities are the Stand-By Arrangement, the Flexible Credit Line (with its broader scope version the Precautionary and Liquidity Line), the Rapid Financing Instrument, the Extended Fund Facility and the Trade Integration Mechanism. For low-income countries the Standby Credit Facility, the Rapid Credit Facility and the Extended Credit Facility are available. In addition to concessional loans some low-income countries are eligible for debts to be written off under the Heavily Indebted Poor Countries and the Multilateral Debt Initiatives. In practice the purpose of IMF lending has changed significantly since its creation. Over time it transformed and today it serves three main purposes. According to the IMF Review of Recent Crisis Programs "… financing is generally tied to policy conditions to ensure predictable access to financing, buttress policy credibility, and reduce payment risks", implicating that where risks are high policy conditions are of similar level as well. The decisions to accept such loans and whether or not to implement the related prescribed reforms are made with high stakes in mind. Domestic leaders are most likely facing punishment for the current economic crisis, but what might be their incentive to implement the arrangements if the costly reforms associated with the loans may reduce their ability to satisfy their supporters? To fully understand this relationship, Williams developed a theory which explains leader tenure in the post-reform period as a function of the rational decision to accept a loan. Leaders who expect to be safe in the adjustment period are more willing to accept the conditions that are linked to the loans rather than try to withstand the crisis on their own. By the use of his model he comes to the conclusion that if no other factor is changing (”ceteris paribus”) then a democratic leader is less likely to participate in IMF loans while authoritarian leaders on the other hand are more likely to do it.

WHAT IS FINANCIAL SOVEREIGNTY? DOES IT PAY?

I understand by financial sovereignty the connection between the ability of state leadership to make unrestricted political decisions and the potential financial costs and gains and vice versa the political side as well. The payout of political decisions is reflected and can be measured very well at general elections. To link the political results at the elections with the liberty of making financial decisions I will base my study on the works of Dreher (2004) who researched into the influence of IMF programs on the re-election of debtor governments. The conditionality element of the IMF agreements is making them a good example of restrictions on the ability of governments to pursue their goals freely. According to Dreher the acceptance of an IMF agreement in most of the cases may signal the incumbent's incompetence and voters use this signal when deciding upon his re-election. In order to demonstrate competence, politicians may therefore decide not to conclude IMF programs prior to elections. The model also shows that re-election probabilities of politicians who nevertheless conclude arrangements at election times depend on the state of the economy.

HYPOTHESIS

I assume that Dreher's work on the IMF-agreements and the re-election of debtor governments will bring the same outcomes for an EU Member State as well. This means that a country which is already in a sovereignty-limiting alliance (EU) will produce the same outcome as others which have more room for manoeuvre to make unrestricted decisions.

WHY HUNGARY?

Hungary was the first EU Member State in the 2008 global financial crisis to apply for a joint EU-IMF(-IBRD) loan to avoid bankruptcy. The country was hit again by an economic shock near the end of 2011 which was around a downgrade into non-investment category by a credit rating agency. Hungary had two different governments in these two scenarios, two different outcomes with the IMF and also two different results at elections.

DATA AND METHODS

My research builds on the previously mentioned works of Dreher (2004) who studied the influence of IMF programs on the re-election of debtor governments. To be able to respond to the question whether financial sovereignty pays, and how we can quantify the outcome, I will study both the political and economic aspects of Hungary. The political side means the influence on sovereignty as according to Dreher IMF agreements have political effect with conditionality – therefore posing a certain limit on the freedom of choice of governments – and the political price will be the effect on public support, and ultimately on elections. The economic side covers the circumstances of IMF programs when the decision was made and also the corresponding environment at the consecutive elections. The economic price is the difference between market-priced loans and IMF-subsidised loans.

To test the findings of Dreher in an EU environment, more precisely in Hungary, various political and economic data will be used. Political ones include for example public support from polls and other relevant related polls. For the economic findings I will also use several types of economic data. I will look for data comparable with Dreher's research from international sources. Such indicators will be widely known figures like GDP or inflation from IMF sources as this ensures comparability as well. These data are required to properly identify the situation of the studied countries in Dreher's model.

Dreher in his referred paper categorizes the leading politicians of countries into two different categories: they are either competent or incompetent. His approach is based on the research of Collier, who wrote that the conditionality of IMF loans could signal the incumbent political leadership's incompetence. Accordingly, competent governments indicate their aptitude by not concluding IMF deals. In Dreher's model the voters of a country are choosing at the elections between the incumbent and the opposition. Like the incumbent, the challenger political force can also be either competent or incompetent. However, these categories are not set in stone, as politicians might change: an incompetent can become competent, and vice versa. The utility of voters is a function of the current economic performance and the economic situation expected by them for the next term of the political leadership in the future. Each term depends on the government's competence which can be either high or low. He adds to his model that a negative shock hits the economy in each period. The magnitude of such shock can be high, medium or low. His working assumption regarding this shock is that voters do not know exactly which type of shock hit the domestic economy at that time. However, they form expectations about the probabilities associated with each type of shock. In contrast, the government immediately realizes the type of shock, they have complete information about it. In order to reduce the negative consequences of the shock on economic performance, foreign credit is needed if the economy is not in the best shape, performs worse than c4. Provided that the government is able to raise these loans, economic performance depends on the extent of shock and the incumbent leadership's competence. One of four different states of economy is achieved, with 1 being the worst and 4 being the best state.

Table 1. Dreher (2004): Economic performance

	Low shock	**Medium shock**	**High shock**
Incompetent incumbent	c3	c2	c1
Competent incumbent	c4	c3	c2

Loans could be provided by the IMF or on a bilateral basis by another third party (by other countries or from the international capital market). Voters are informed immediately about the conclusion of a loan. They also know the situation which arises depending on the shock and the incumbent's competence and can observe the current economic performance. Dreher used the findings of Vaubel (1991) and Ergin (1999): the IMF mainly lends money in case of financial difficulties to incompetent governments (adverse selection), since politicians who are unwilling or unable to make reforms are less creditworthy in the private market and have to turn to the IMF more often. While money from the Fund as discussed earlier is highly subsidized for most borrowers, it is associated with strict conditionality. IMF conditionality reduces the politicians' leeway for the duration of the agreement. On the other hand, the interest rate subsidy provided by the IMF increases their leeway.

Dreher's model with complete information refers to election periods. The results are the same in non-election periods, even though in this case the politicians' decisions do not influence electoral outcomes. If the incumbent's competence is known, the competent politician is always re-elected, while the incompetent one never wins.

At the time of a shock the reigning government has to decide whether to negotiate an IMF arrangement. They face a trade-off between the interest rate subsidy and conditionality. However, incompetent leaders cannot get loans on a bilateral basis. After (negative) shocks, therefore, they try to negotiate an IMF arrangement as long as the improvement in economic performance outweighs a potentially negative direct effect of the program. If the economy is in really bad shape, the politicians' incompetence is observable. This is because an economic performance of c1 can only be due to incompetence. The IMF in this case can thus justify its lending only if the government credibly promises to comply with tough conditionality. With small and medium shocks the Fund's conditionality is softer.

Since in a scenario with complete information the politicians' competence is known, their behaviour does not influence their re-election. Dreher assumes that competent politicians could attract bilateral credits sufficient to finance the effects of medium shocks. After those shocks, they can, therefore, choose whether to borrow from the market or from the IMF. Thus, the trade-off between conditionality and subsidized loans is critical for the decision to negotiate an arrangement.

If politicians have no influence on their re-election probability, the decision to turn to the Fund is independent from election dates: incompetent politicians negotiate an arrangement with low and medium shocks, since after high shocks the net effect of a program for the incumbent is negative. Competent politicians turn to the Fund with medium and high shocks. They do not need loans after low shocks (and cannot further improve economic performance).

If there is imperfect information about the competence of the political leadership, rational voters use available information to identify their competence. Only competent politicians have access to bilateral loans. With some states of the economy, they could therefore choose to signal their competence by borrowing from the market or other countries instead of concluding an IMF arrangement. As signals from past periods, however, do not influence re-election probabilities, in non-election periods all politicians behave exactly the same as in the case of complete information about their competence. However, this is not true in election years.

With states of the economy c1 (or worse) and c4 at the expiration of the loan, voters directly identify the incumbent's competence. Competent incumbents get re-elected, incompetent ones lose the election. If the state of the economy is c2, both competent and incompetent incumbents conclude an IMF arrangement. Competent politicians face only loose conditionality, so they derive a positive net direct effect of a program. Incompetent ones probably have to accept harder conditions.

Voters observing an economic climate c2 and conclusion of a program, use this information to update their beliefs about the incumbent's competence.

With a perceived economic climate c3, both competent and incompetent politicians would conclude a program in non-election years. In election years, however, the incumbent's decision whether to turn to the Fund can influence his re-election probability.

Table 2. Dreher (2004): Do governments conclude an IMF arrangement?

	Competent incumbent		**Incompetent incumbent**	
Economic performance	Non-election year / complete information	Election year	Non-election year / complete information	Election year
c4	No (not necessary)	No (not necessary)	/	/
c3	Yes (better than private credit)	No (private credit to show competence)	Yes (no private money available)	Yes (no private money available)
c2	Yes (private loans insufficient)	Yes (private loans insufficient)	Yes (no private money available)	Yes (no private money available)
c1	/	/	No (tough conditionality)	No (tough conditionality)

Dreher has an important extension in his work, which enables the use of his model for the 2008 situation with the global financial crisis, which is a model with global shocks. It is assumed that voters can observe whether neighbouring countries have concluded IMF arrangements. Again, politicians know the exact extent of the shock, whereas voters only form probabilities about their occurrence.

In case of global shocks, voters also observe their own country's economic performance and – additionally – the performance of one neighbour (''benchmark'') country. Depending on the relative performance of the two economies and their re-election probability politicians again decide upon whether to conclude an IMF arrangement. Voters observe this decision and economic performance at the time when they decide whether to re-elect the incumbent one. The next table presents the possible combinations in country A of election results and program conclusions depending on economic outcomes in both country A and B.

Table 3. Dreher (2004): Conclusion of IMF programs with benchmarking

Country A	**Country B ("benchmark country")**			
	c1	c2	c3	c4
c1	Not re-elected, no IMF	Not re-elected, no IMF	/	/
c2	Re-elected, IMF	Re-elected, IMF	Defeat, IMF	/
c3	/	Re-elected, IMF	Depends on type	Defeat, IMF
c4	/	/	Re-elected, no loans	Re-elected, no loans

According to Dreher, most of the results are obvious. Since the shocks in both countries are identical, voters know the competence of their incumbent if one economy performs better than the other. As a consequence, the competent politician wins the election whereas the incompetent one is replaced. Therefore, incumbents turn to the IMF according to their preferences. Competent politicians conclude an IMF arrangement with medium and high shocks, incompetent politicians with small and medium ones.

As in the previous section, however, competent politicians could signal their competence if they did not borrow from the IMF. Since rational voters expect their (rational) incumbent to give that signal, politicians can only win the election by not turning to the Fund. Competent politicians get re-elected; incompetent ones lose the election (and negotiate a Fund agreement).

If voters can compare the outcomes in their own economy with a benchmark country the results range between those obtained in non-election years and those with unknown competence without a benchmark. Compared to the result without a benchmark, incompetent politicians can be identified more often with the result that they lose the election (with economic performance c2 in the considered country and c3 in the benchmark country).

Dreher used several macroeconomic variables in his empirical test. In order to be able to compare Hungary with regional peers, I will use the macroeconomic indicators from the IMF flagship report World Economic Outlook. From these reports I will use the real GDP, inflation and current account figures to compare the economic situations of Hungary and neighbouring, regional countries. From Dreher's findings it is clear that only real GDP growth rates are significantly correlated with re-election prospects so this will be the major figure to consider.

Dreher also finds that if neighbouring countries perform relatively better in terms of growth, re-election probabilities decrease significantly for the reigning government. He also found that the likelihood of losing an election is also higher when other countries in the same region experience higher GDP growth.

HUNGARY 2008

In 2004, shortly after the country joined the EU, the Excessive Deficit Procedure was launched against Hungary (EU Council, 2004) to correct its economic imbalances. However, as at that time the risk appetite was high in the financial markets, Hungary was able to finance its payment obligations, therefore no pressure was on the country nor on the leading politicians to change the governing policies. This situation changed rapidly and heavily in 2008 when with the global financial crisis the markets became very cautious in lending money to borrowers with high risk of non-repayment or even default. Investors cut their potential losses and exposures in emerging markets where risks rose with the previous potentials and invested their capital in markets with smaller yields but with greater safety. At that time Hungary was one and more importantly the first of such borrowers and it had to apply for a joint EU-IMF(-IBRD) loan (IMF, 2009) to avoid bankruptcy.

Table 4. The economic figures for Hungary (2006-2009)
Selected Emerging European Economies: Real GDP, Consumer Prices, and Current Account Balance (Annual percent change unless noted otherwise)

	Real GDP				**Consumer Prices (annual averages)**				**Current Account Balance (Percent of GDP)**			
			Projections				Projections				Projections	
	2006	2007	2008	2009	2006	2007	2008	2009	2006	2007	2008	2009
Emerging Europe	6.7	5.7	4.5	3.4	5.4	5.7	7.8	5.8	-6.0	-6.6	-7.1	-7.2
Central Europe	6.2	6.1	4.6	3.6	2.1	3.4	4.9	3.5	-3.6	-3.7	-4.4	-5.0
Czech Republic	6.8	6.6	4.0	3.4	2.5	2.8	6.7	3.4	-2.6	-1.8	-2.2	-2.5
Hungary	3.9	1.3	1.9	2.3	3.9	7.9	6.3	4.1	-6.1	-5.0	-5.5	-6.1
Poland	6.2	6.6	5.2	3.8	1.0	2.5	4.0	3.3	-2.7	-3.8	-4.7	-5.7
Slovak Republic	8.5	10.4	7.4	5.6	4.3	1.9	3.9	3.6	-7.1	-5.4	-5.1	-4.7
Southern and south-eastern Europe	7.0	6.0	7.3	4.5	6.2	5.1	8.8	6.4	-10.7	-14.1	-14.8	-14.0
Bulgaria	6.3	6.2	6.3	4.2	7.4	7.6	12.2	7.0	-15.6	-21.4	-24.4	-21.5
Croatia	4.8	5.6	3.8	3.7	3.2	2.9	7.0	4.9	-7.9	-8.6	-10.1	-10.2
Romania	7.9	6.0	8.6	4.8	6.6	4.8	8.2	6.6	-10.4	-14.0	-13.8	-13.3

Source: IMF (2008)

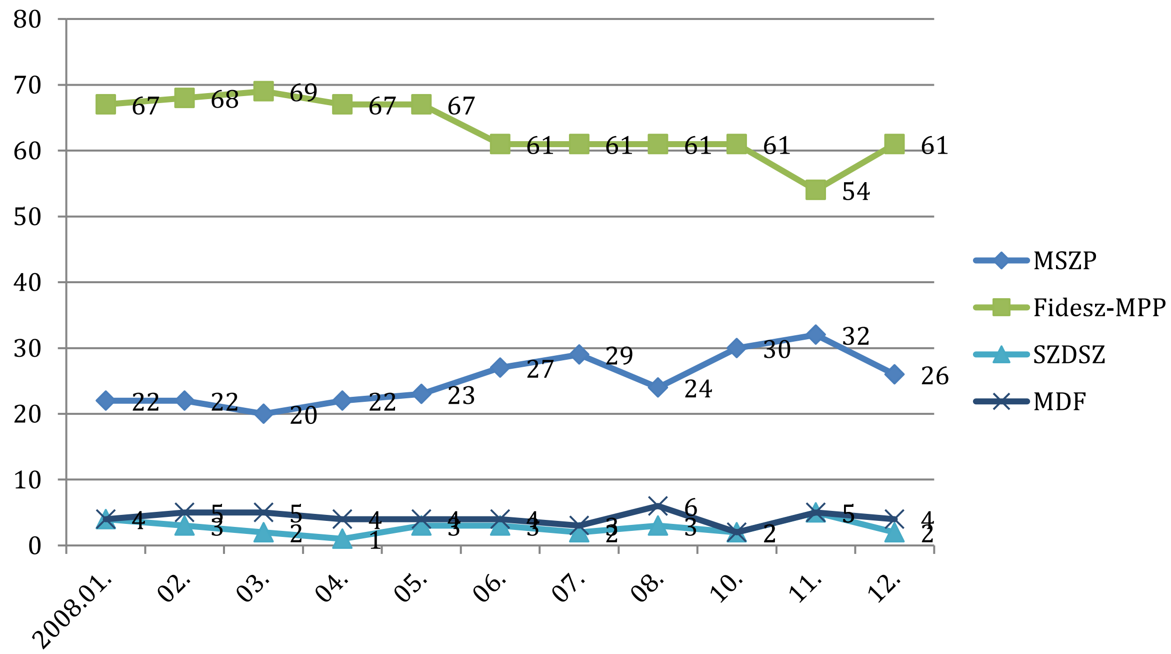
From these figures of fall 2008 we can see that the Hungarian economy was on a declining path in 2006 and 2007 and with expectations for a smaller recovery in 2008 and another minimal increase for 2009. Inflation has been targeted by the Hungarian Central Bank, MNB, to 3% since 2005 (MNB, 2005). Despite this target, consumer prices were also on an unfavourable, in this case, climbing path with the final data of 3.9% and 7.9% respectively for the first two years, then, towards an expected normalization of 6.3% for 2008 and 4.1% for 2009. Current account balance was negative for each year though the amount was not fluctuating. These figures in themselves only would show us the image of an economy which is in bad shape and on a principally downward path. These signs point us into considering the incumbent Hungarian government of 2008, the coalition of socialist and liberal parties, MSZP and SZDSZ, as incompetent.

However, we should not forget about the bigger scope, namely the global financial crisis. The 2008 financial crisis hit EU Member States particularly hard. This crisis undoubtedly qualifies as a global shock. Dreher's work at the same time covers this possibility with the option for voters to compare their government's actions and also the state of their economy to others'.

Using the same data for Central European countries we can observe the following. The Hungarian real GDP rate is the worst for the years with already known data. In 2007 the 1.3% GDP-increase is only around one-fifth of the second worst ones in the list and of the regional average, as well. For that same year, consumer prices increase of 7.9% was more than the double of other regional peers' and of the regional average as well. The current account balance did not deviate that much from other countries – while that is an indicator less tangible by voters than consumer price increases and also less accentuated than the GDP changes.

These data point us to considering again at the MSZP-SZDSZ governing coalition in Hungary in 2008 as incompetent. Dreher's research would therefore suggest that they will not be re-elected. I will cover that political angle at the time of the agreement and then at elections in the following section.

Figure 1. Hungarian political landscape in 2008:

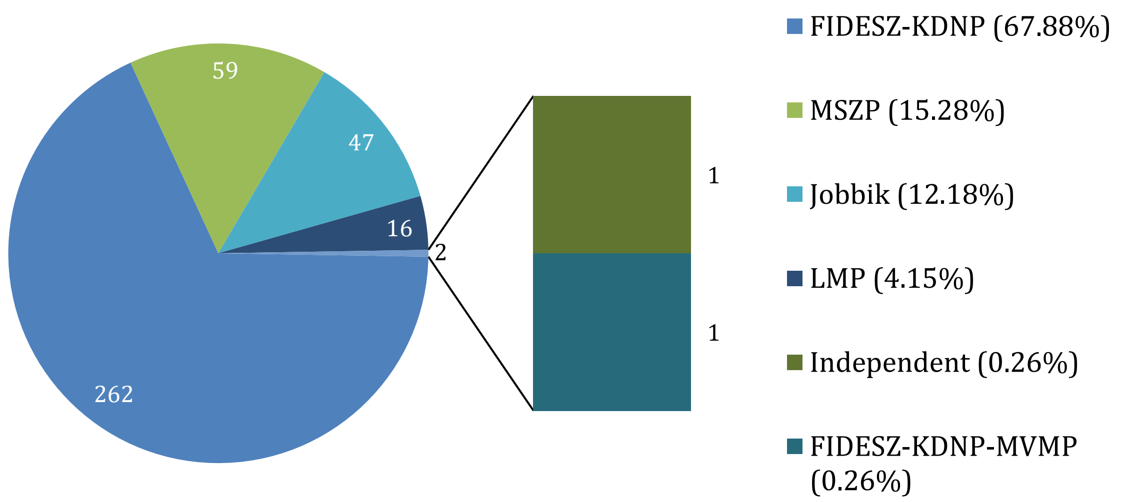


Source: Tarki (2008)

2008 covers the year when the crisis hit and the agreement was concluded. We can observe that the governing MSZP-SZDSZ coalition already has less support throughout the whole year than the main opposition party at that time, Fidesz-MPP. Sometimes, on the individual party level, the difference is more than threefold, like in the case of MSZP and Fidesz-MPP in the first four months. The conclusion of the (EU-)IMF-agreement in November, by reflecting an image of an active government might have brought some further increase in the support of the incumbent MSZP-SZDSZ coalition. However, by the end of the year, in December, their support began again to fall, which is the same period when the conditionality elements with the decisions on the necessary laws became more apparent to voters.

We can see the performance of the MSZP-SZDSZ government individually at the next elections in 2010 and can check whether Dreher's model worked for incompetent reigning governments which concluded an IMF-agreement.

Figure 2. Hungary 2010 elections results with percentages and the corresponding number of seats in the Parliament:



Source: valasztas.hu, 2010

We can see from the results of the 2010 general elections that the governing coalition MSZP-SZDSZ of 2008 has lost the voting. SZDSZ even fell out of the Parliament as its support did not reach the 5% mandatory threshold. On the other hand, Fidesz together with KDNP won with a landslide victory, gaining over 67% of the seats.

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After winning the elections the Fidesz-KDNP party alliance in itself started to govern Hungary with its impressive majority in the Parliament. They repeatedly compared themselves to the previous socialist-liberal government and to the steps of the socialists like concluding an IMF-agreement. The new political leadership placed sovereignty in the centre of their rhetoric. The Fidesz-KDNP government also followed not only a different political approach but their economic policies were also varying. However, signalled also by a downgrade to non-investment category of Hungary by the Moody's credit rating agency in November, at the end of 2011 the possibility of another IMF deal with Hungary was anew on the table. I will follow the same steps in this case like for 2008 to check the validity of Dreher's research regarding Hungary for that case as well.

Table 5. The economic figures for Hungary (2011-2013)
Selected European Economies: Real GDP, Consumer Prices and Current Account Balance (Annual percent change unless noted otherwise)

	Real GDP			**Consumer Prices**			**Current Account Balance**		
		Projections			Projections			Projections	
	2011	2012	2013	2011	2012	2013	2011	2012	2013
Europe	2.0	0.1	0.8	3.3	2.8	2.1	0.4	0.8	1.0
Emerging Europe	5.3	2.0	2.6	5.3	5.6	4.4	-6.1	-5.0	-4.9
Turkey	8.5	3.0	3.5	6.5	8.7	6.5	-10.0	-7.5	-7.1
Poland	4.3	2.4	2.1	4.3	3.9	2.7	-4.3	-3.7	-3.8
Romania	2.5	0.9	2.5	5.8	2.9	3.2	-4.4	-3.7	-3.8
Hungary	1.7	-1.0	0.8	3.9	5.6	3.5	1.4	2.6	2.7
Bulgaria	1.7	1.0	1.5	3.4	1.9	2.3	0.9	-0.3	-1.5
Serbia	1.6	-0.5	2.0	11.1	5.9	7.5	-9.5	-11.5	-12.6
Croatia	0.0	-1.1	1.0	2.3	3.0	3.0	-1.0	-1.2	-1.3
Lithuania	5.9	2.7	3.0	4.1	3.2	2.4	-1.5	-1.1	-1.4
Latvia	5.5	4.5	3.5	4.2	2.4	2.2	-1.2	-1.6	-2.8

Source: IMF (2012)

The classification of IMF changed from 2008, Central Europe was left out, but we still have neighbouring countries of Hungary in the list (Croatia, Romania), so the former comparison is possible in this case as well.

First, the Hungarian economy is on a path which fluctuates between the small growth in 2011 and the recession for 2012 then again the small growth for 2013. The Hungarian inflation is still far from the 3% target of the MNB, and is on an upward path for 2012, but the expected normalization is quicker for 2013. The current account balance is positive, which is a very important positive sign if we compare it to the -6% and -5% levels during the previous, MSZP-SZDSZ government's term. I disregard the unemployment as it was not contained by WEO table in 2008, while it did in the previous table.

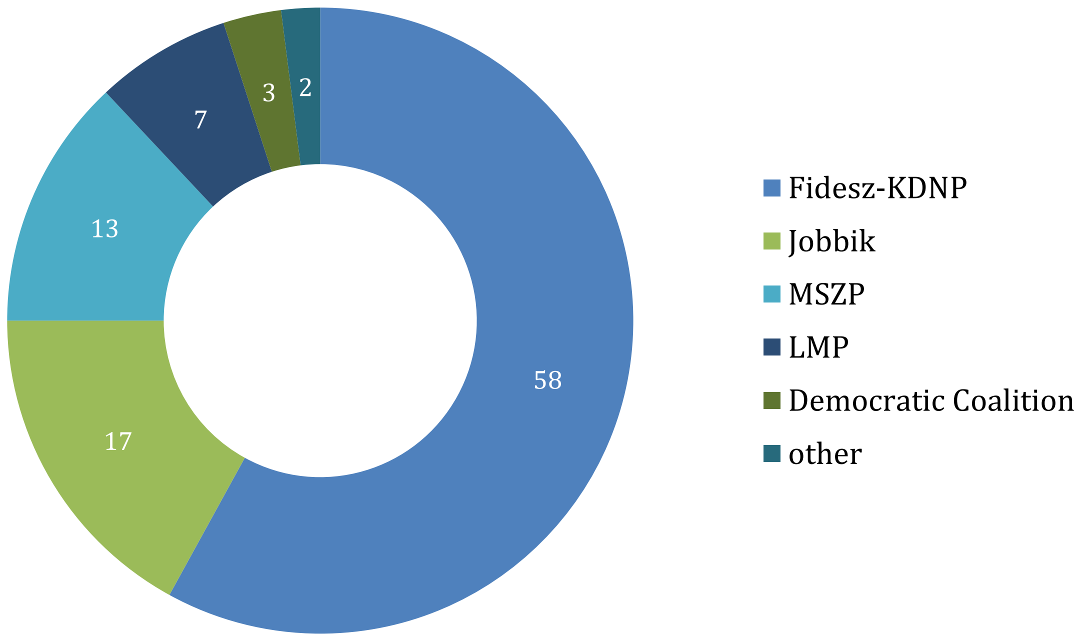
The phenomenon at end of 2011 can also be linked to a bigger picture. The Greek crisis similarly made investors uneasy regarding investments in potentially vulnerable markets, in the Eurozone and stricter screening for the EU overall as well. This larger scale enables again a wider comparison. If we check real GDP developments in a wider area for 2011 we can see that Hungary is still not on the top. However, compared to the figures during the MSZP-SZDSZ government, in 2011 there are countries in the list that perform worse than Hungary and it is true for the 2012 projections as well. If we compare the Hungarian consumer price levels with those of the regional peers, the size is less than the double of the ones in the neighbouring countries in the list. While the current account is still not very tangible for voters, the Hungarian figure is the only positive with Bulgaria in 2011 and for the later years Hungary is the sole country with a positive number in the whole Emerging Europe region.

These data are not giving a similarly obvious picture about the Hungarian economy than in the previous case in 2008 when the MSZP-SZDSZ coalition was governing. Therefore from comparing the Hungarian economic situation with regional peers, for Hungarian voters it was less clear whether the Fidesz-KDNP government qualified as a competent or an incompetent one.

The outcome of the IMF negotiations might help to find that answer from Dreher's model. The Fidesz-KDNP government in 2012 spring did not make a sovereignty-limiting IMF deal, instead secured funding from private markets. According to Dreher's model this is the case if a government wants to show a competent image to voters.

As they did not make an IMF agreement, Dreher's research would suggest that they will be re-elected. I will cover the corresponding political angle when the idea of an IMF-agreement emerged and the results at the next elections in the following.

Figure 3. Hungarian political landscape in December 2011:

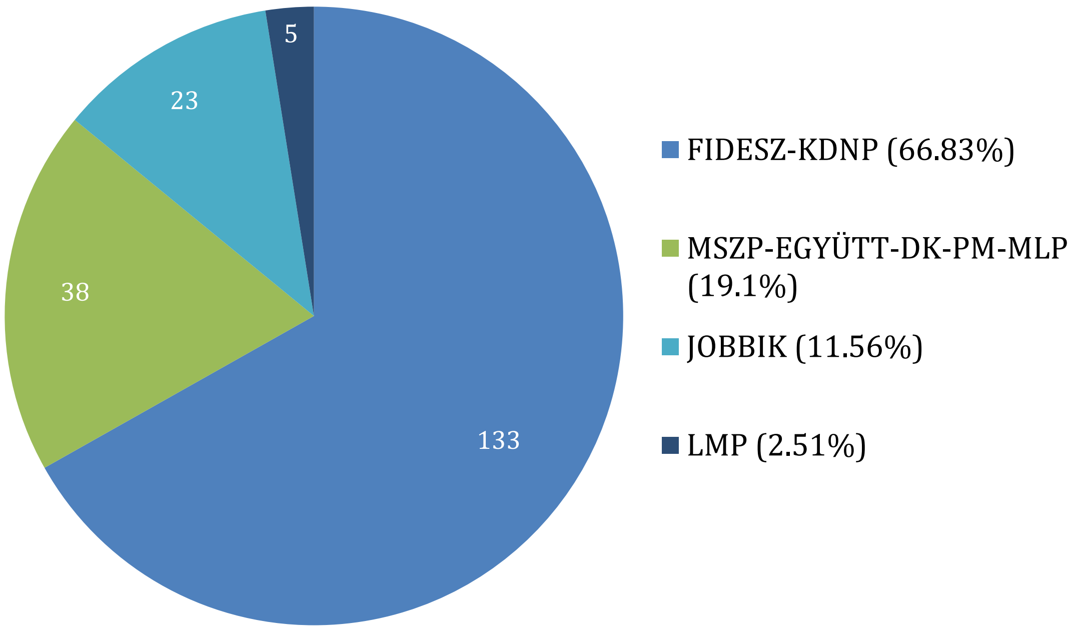


Source: Nezopont Institute (2011)

From the December 2011 data we can see that the support for the governing Fidesz-KDNP has fallen since the elections last year, but they still have majority among voters. MSZP could not profit from from the decrease in the support of Fidesz-KDNP as they also have smaller figures than in 2010.

We can check the performance of the Fidesz-KDNP government at the next elections in 2014 as well and verify whether Dreher's model worked for an incumbent government which wanted to appear as competent by not concluding an IMF-agreement.

Figure 4. Hungary 2014 elections results:

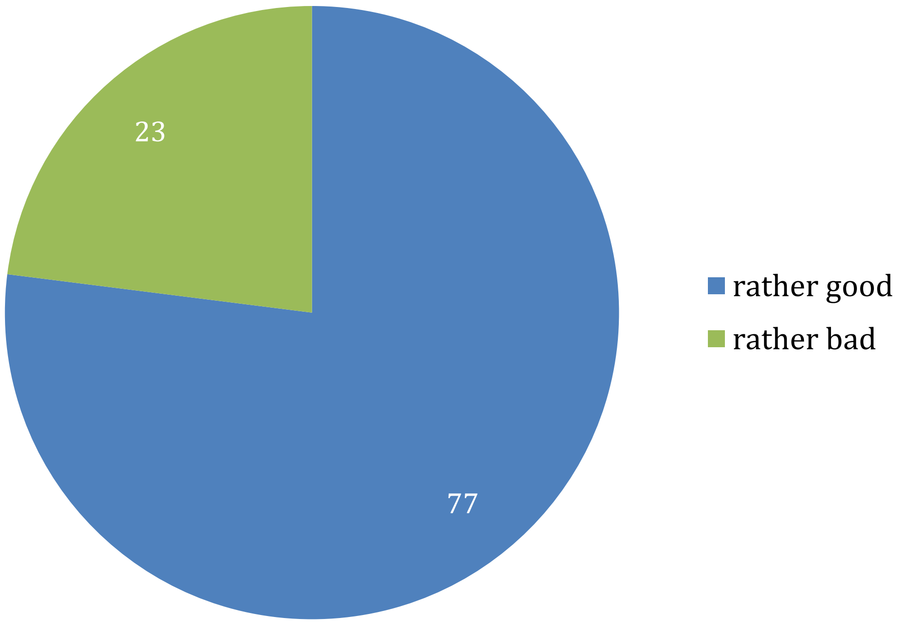


Source: valasztas.hu (2014)

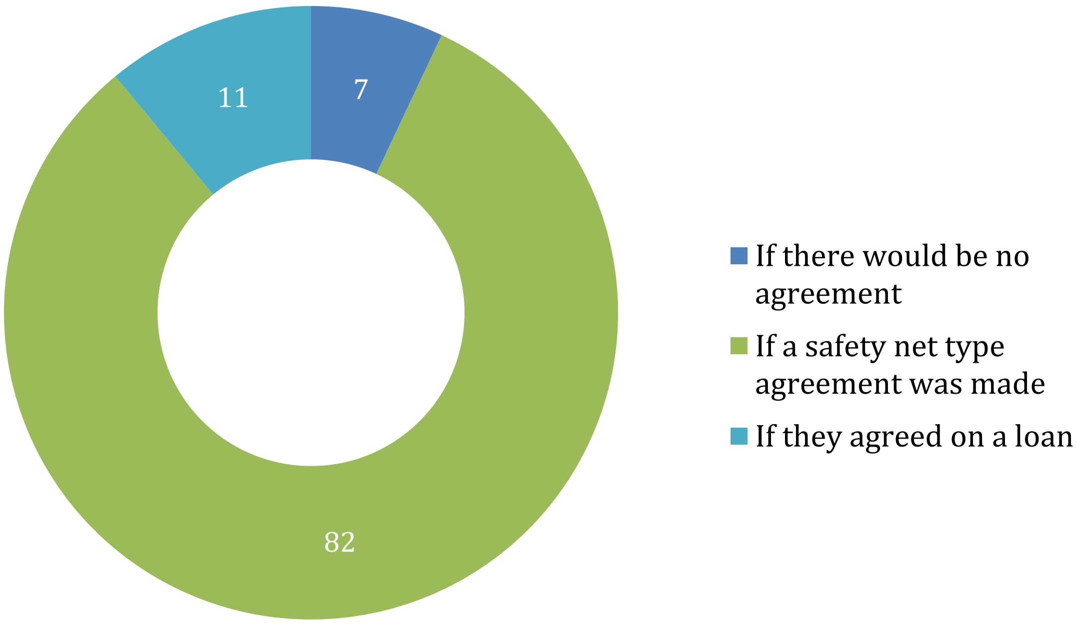
We can see from the results of the 2014 general elections that the incumbent coalition Fidesz-KDNP of 2011-2012 IMF negotiations has won the voting. They have managed to get another supermajority in Parliament.

However, in Dreher's research the outcome when a government would like to show competence by not concluding an IMF is applicable in a situation when it is election year. Neither 2011, when the IMF negotiations started about a potential agreement, nor 2012, when the incumbent Fidesz-KDNP government secured money from private investors, was an election year, only 2014. A potential solution for the election year approach by voters might be that Fidesz-KDNP regularly polled voters by national consultations and otherwise, as well. It was also the case in December 2011 regarding their preferencies about the IMF-talks. The results are shown in the following charts.

Figure 5. Public opinion on IMF talks.



According to you, is it rather good or bad for Hungary that the government and the IMF are having negotiations?



According to you, what would be the best outcome of negotiations? (valid respondents only, n=676)

Source: Nezopont Institute

On the left side voters were asked whether it is good or bad for Hungary that the government is having negotiations with the IMF. A huge proportion of respondents, 77%, said that it is fairly good for Hungary. On the right side, voters were polled and asked what the best outcome of these negotiations would be. Here, an even greater rate, 82%, has said that a safety net type agreement would be the best. Due to the nature of precautionary deals these would not mean a loss of sovereignty, because their existence only would bring the desired effect of calming down the markets. Fidesz-KDNP therefore was going for this, but the IMF was not willing to offer that as they were disagreements from which the independence of the central bank, the MNB was the most accentuated. The parties at the same time did not want to end the negotiations either.

In 2012 the negotiations stopped, however the Fidesz-KDNP came out from the developments as a competent government and managed to keep the support for the next elections, as well.

CONCLUSION

The connection between sovereignty and the economy appeared centuries ago and it has evolved through time and incorporated more elements into that relationship. Alliances of sovereign states have a reduced ability to make decisions freely in areas which are belonging to a common area. Contracts, like IMF-agreements have also a similar, sovereignty-limiting aspect due to conditionality aspects in many cases.

Dreher studied the connection between IMF-agreements and the re-election of debtor governments in 2004. His findings, that in case of economic shocks, reigning governments that show an image of incompetence to voters by making an IMF-deal and those who manage to secure the necessary funds from the markets are reflecting an image of competence, were right even later for the observed cases of Hungary which was already a member of an alliance affecting sovereignty, the European Union during both examined periods. The incumbent socialist-liberal MSZP-SZDSZ government after concluding an IMF-arrangement in 2008 lost the next elections in 2010. The possibility, covered by Bird and Rowlands (2001) to blame the preceding government to justify turning to the IMF, was not open for the governing socialists in 2008 Hungary as it was their second term in power. The next right-wing Fidesz-KDNP after securing funding from private markets during 2011-2012 won again in 2014 with another landslide victory. Therefore, financial sovereignty reflecting an image of competence by not restricting their leeway, pays off for governments as Fidesz-KDNP got re-elected by not giving in to sovereignty-limiting conditionality.

The competent image of a reigning government by not turning to the IMF but securing private money was in Dreher's model an election year outcome. Further research research might investigate voters-government communication and any potential influencing factors.

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