



The agency of reformers in new European financial centres: A historically informed financial geography

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Abstract

While institutional frameworks are the dominant approach to analysing the geography of finance, this article focuses on how individual policymakers influence the characteristics of financial institutions and set, or even alter, financial centre development. The historical narratives from Central and Eastern Europe (CEE) that this article presents reveal post-socialist reformers' contrasting philosophies and approaches, despite their shared goals of market liberalisation and European integration. These reforms (or lack thereof) differentiated the securities markets in Warsaw, Prague, and Budapest, especially with respect to financial intermediary mechanisms. Although the legacies of such reforms continue to shape an uneven landscape of financial centres in CEE, this article proposes reformer-centred narratives as an alternative to deterministic institutional thinking. The article argues that historical narratives that foreground the actions and ideas of key policymakers need to be included in the observation framework of financial centre development, in a similar way to how scholars analyse foreign policy by focusing on the heads of governments and ministers.

Keywords

Agency, policymakers, financial history, Central and Eastern Europe, financial centres

Introduction

Reading through the news on the *Financial Times* or *Bloomberg*, we can familiarise ourselves with 'who's who' in financial markets, from the heads of regulators to the CEOs of major corporations. Reports often refer to the personal attributes of these figures in order to form policy expectations and market forecasts, especially when major changes such as regulatory reforms are taking place. Geographically, individual policymakers, or reformers, are agents of cities who are influenced by their specific socio-economic environments (Amin and Thrift,

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2017). At the same time, differences in their personal philosophies and leadership styles can affect the course of action each institution or regulatory regime pursues. Despite the interest in such policymakers from financial media, economic and financial geography continues to observe methodological institutionalism (i.e., placing an epistemological emphasis on inter-institutional relations, such as services trade, office-connectivity, offshoring, and so on). The presence of certain institutions (such as headquarters, investment banks, or financial intermediaries) then explains and justifies the growth of the financial centre in question. This analytical trend contrasts with foreign policy analysis, where both the media and academia pay attention to heads of governments and foreign ministers when trying to understand or explain institutional behaviour.

With the exception of Balcerowicz and Klaus, financial policymakers in Central and Eastern Europe (CEE) have been neglected in the academic literature. Reforms of financial institutions in Poland, Czechoslovakia, and Hungary are typically presented in a result-oriented manner with comparative macroeconomic data. Beneath such analyses, the term 'transition economy' often implies that successful reforms towards a fully-fledged liberal economy involves a certain course of action that needs to be pursued, consisting of strong rule of law, well-defined property rights, and full price and trade liberalisation (Fischer et al., 1996; Lavigne, 1996; Balcerowicz, 2002; Dunford, 2005). These economies are assumed to be dependent on investments from the US or Western Europe (Pavlínek, 2004) and guided by the international liberal consensus. The developmental paths of financial centres in CEE would thus resemble each other through a Westernisation of financial institutions, with any variance among them simply being in terms of the speed and degree of institutional transition (Aghion and Blanchard, 1994). However, as the policy priorities, visions, and political capital of the reformers differ from one another, Warsaw, Prague, and Budapest have differentiated their development as regional financial centres – a departure from deterministic thinking. To what extent, then, did those reformers influence the shaping of the new financial centre landscape in CEE? How does such a historically informed financial geography differ from widely communicated macroeconomic analyses of the region?

This article approaches these questions with historical narratives arranged in a chronological and geographical manner. Quantitatively, it utilises the securities market data obtained from the Federation of European Securities Exchanges (FESE) and Eurostat to identify the time periods during which the courses of financial centre development in Warsaw, Prague, and Budapest were altered and differentiated from one another. Qualitatively, it refers to memoirs and articles written by prominent figures who were engaged in high-level policymaking during the transition (e.g., Petr Pithart, Stanisław Gomułka, Janusz Lewandowski) in order to provide insights into how individual policymakers initiated their reforms. Reports issued by other academics, consulting firms, and media outlets supplement the historical analysis as the access to official archives and interviewees is limited.¹

The resulting 'reformer-centred' historical narratives reject deterministic institutional thinking and suggest a need for the agency of policymakers to be included in the observation framework of financial centres. The establishment of a securities exchange alone, for example, does not make the financial centre in question flourish. What is emphasised here is how the reformers in CEE had different approaches to the securities exchanges, thus influencing the developmental paths for each capital city as a securities centre. At the early stage of the post-socialist transition, these reforms heavily characterised the financial-centres-in-the-making.

The next section summarises some of the key theoretical themes in financial history and historically informed financial geography, with an emphasis on the agency of policymakers. It then briefly visualises the landscape of financial centres in CEE through the narratives of

recent events as well as comparable quantitative data. The subsequent qualitative historical narratives highlight how financial transitions in each case were by no means deterministic, with reformers altering the developmental path of financial centres in significant ways. The concluding section identifies some topics for future research within the scope of this article.

Financial history and the agency of policymakers

From Wallerstein (1974) to Taylor (2004), financial history has found its place in the financial geography literature, especially where interurban connectivities are concerned. Detailed historical narratives on international trade were centred around the agglomeration of wealth and urbanisation (e.g., Kindleberger, 1984; Cassis, 2006), and the hierarchical relationship among the major cities. While the rise and fall of international financial centres, such as London, Frankfurt, and Hong Kong, continues to attract the interest of scholars (e.g., Cassis and Wójcik, 2018), this body of financial history literature has also become a part of the standard readings on the global network of cities (e.g., Friedmann, 1986; Amin and Thrift, 1992; Brenner, 1998; Castells, 2010). However, while historical narratives are fond of individuals and their anecdotes, individual policymakers do not attract a comparable level of scholarly attention to external events.

To be more precise, on one hand, financial history as well as historically informed financial geography often utilise events external to the institutions in question (such as the end of the Cold War, the 2007/8 financial crisis) as the *turning points* of institutional development. On the other hand, they consider reforms initiated by individual policymakers (who are internal to the institutions in question) as *processes* of institutional development, with the results assumed to be revealed in a gradual manner. The boundary between analytical frameworks based on external events and those based on internal policymakers is certainly ambiguous. What is emphasised here is that the latter can explain *how* reformers altered and differentiated institutional developments, whereas the former can explain *why* such differentiation took place. By largely fixing external events to the end of the Cold War (and the post-socialist transition), this article is able to analyse the agency of reformers in depth, complementing those analyses based on external relations, macroeconomic environments, and institutional developments in the region (Aghion and Blanchard, 1994; Gelos and Sahay, 2000; Balcerowicz, 2002; King and Szelényi, 2005; Åslund, 2013).

As is implied above, the concept of financial centre ‘development’ is understood broadly in this study, because the article focuses on the agency of reformers and the process of financial centre differentiation, which includes ineffective or failed reform initiatives. Given the characteristics of the early-stage post-socialist transition at the time, these narratives are centred around securities markets, which inevitably distance the study from a larger body of financialisation and global network of cities literature, as the latter often deals with more complex and advanced financial services trade. Nevertheless, the core message of this article is a call for a historically informed financial geography with an emphasis on the agency of policymakers. The case study of CEE justifies such a call, particularly when we analyse medium-sized financial centres where a small group of elite actors has significant influence in shaping the developmental path of financial centres.²

On a regional level, institutions, even when they are ‘liberal’ (hence, flexible), are expected to evolve in a stable manner (Hall and Thelen, 2009) and remain ‘on-path’ (Kang, 2006), nourishing a path dependent way of thinking. In CEE, the liberalisation of markets can be understood as ‘path dependent’ for it was a single dominant policy doctrine in the region after the collapse of the socialist regimes. The dogmatic influence of international

organisations such as the World Bank, International Monetary Fund, and European Commission was clearly visible during the post-socialist transition and EU accession periods. At the same time, as the degree and methods of transition differ from country to country and reformer to reformer, the epistemological capacity of the path dependent theory is limited in analysing the evolution of financial centres in CEE (Kang, 2006; Mykhnenko, 2007b). Due to the so-called ‘open method of coordination’ of the EU, where Brussels allows each Member State to adjust its own national institutional arrangements, even the institutional convergence surrounding the EU accession of CEE seems to exhibit non-deterministic characteristics (Epstein, 2008; Hancké et al., 2009).

The following historical narratives therefore illustrate how national policymakers and elites differentiated these institutional developmental paths. In so doing, they show how the agency of these reformers is a powerful tool to help explain uneven financial centre development in the region. The 2004 accession countries (e.g., Poland, the Czech Republic, Hungary) are undoubtedly more similar to each other compared to those yet to complete the transition (e.g., Ukraine, Belarus). Yet such a macroeconomic comparison is insufficient to justify a deterministic analysis of financial centre development. Thus, this article follows the style of Cassis (2006) and Cassis and Wójcik (2018) by presenting a historically informed financial geography of CEE and resists the temptation to utilise the 2004 accession as the turning point towards homogeneous institutional developments across in the region.

An overview of stock markets in Warsaw, Prague, and Budapest

In September 2014, the Warsaw Stock Exchange (WSE) led by Paweł Tamborski withdrew from merger talks with the Vienna-led stock exchange consortium, Central and Eastern Europe Stock Exchange Group (CEESEG) (Iglewski, 2014). Warsaw had been the largest stock exchange in the region since 2008, with its total market capitalisation reaching EUR 154 billion at the time of the above announcement, against Vienna with 81 billion, Prague with 26 billion, and Budapest with 13 billion according to the FESE. A relatively large and stable economy in Poland led Goldman Sachs to open its Warsaw investment banking office in 2011, “consider[ing] Poland, and Warsaw in particular, to be an important financial hub for the whole region” (Waldoch, 2011). In the midst of stock exchange consolidation in Western Europe, the merger between the WSE and the CEESEG was considered a logical step to provide higher liquidity and attract more regional and global investors to CEE (Cieński, 2013). The September announcement, therefore, signalled Tamborski’s willingness to remain institutionally independent from its Western neighbours in spite of the foreseen economies of scale achieved through the merger.

Two contrasting views on this ‘independence’ from the West emerged from Prague and Budapest. Criticising former President Václav Klaus’s Euroscepticism, the then Czech Finance Minister Andrej Babiš commented in March 2014 that “the most natural ally [for the Czech Republic] is Germany and not Britain” (Santa, 2014). The Prague Stock Exchange has been a part of the CEESEG and its predecessor since 2008, symbolising financial integration with its immediate neighbours. A strong presence of Austrian and German banks in the Czech Republic accompanies this integration trend in the capital markets. In Budapest, where its stock exchange was owned by Vienna since 2004, Viktor Orbán’s national conservative government imposed regulatory burdens (or ‘levies’) on foreign-owned banks as he returned to power in 2010. Orbán eventually renationalised the stock exchange in December 2015, making both capitalisation via loans and equities more ‘Hungarian’. Although his policy seemed effective against the 2015 Swiss franc shock (Rao and Peto, 2015), the Hungarian

financial market is considered to be lacking in ‘shareholder value’ by, for example, the Austrian Raiffeisen Bank (Shields, 2015). Today, neither Budapest nor Prague seems to have benefited from either policy as far as total market capitalisation is concerned.

Figures 1 and 2 illustrate such claims visually. With market capitalisation reaching 30% of GDP, Prague became an active financial centre in the mid-1990s. Warsaw’s financial market, on the other hand, was almost non-existent up until 1995, but it had grown in size considerably by 2000. Financial markets in CEE in general have grown more than four times in terms of size between 2002 and 2007, reaching EUR 385 billion among Vienna, Warsaw, Prague, and Budapest. This period is characterised by large capitalisation, especially in Vienna, reaching nearly 60% of GDP. The effect of the recent financial crisis in Europe is visible in 2008 and 2011, although Warsaw seems to have recovered faster than the other financial centres.³ Between 2009 and 2018, the trends in Warsaw mirrored those in Vienna, as far as total market capitalisation is concerned.⁴ The development of financial markets in Budapest has been slow and total market capitalisation is still comparable to pre-EU accession levels.

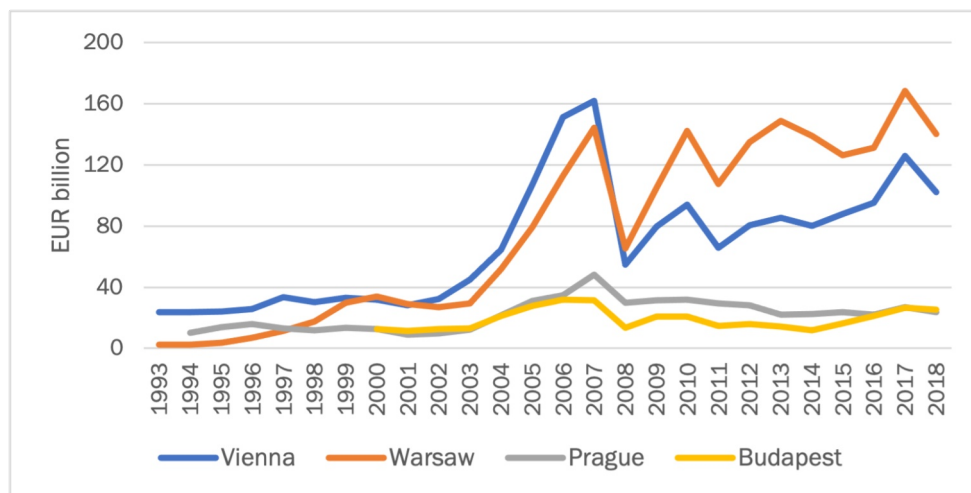


Figure 1. Total market capitalisation. Source: FESE, with WSE (1993-99) and PSE (1994-2000)

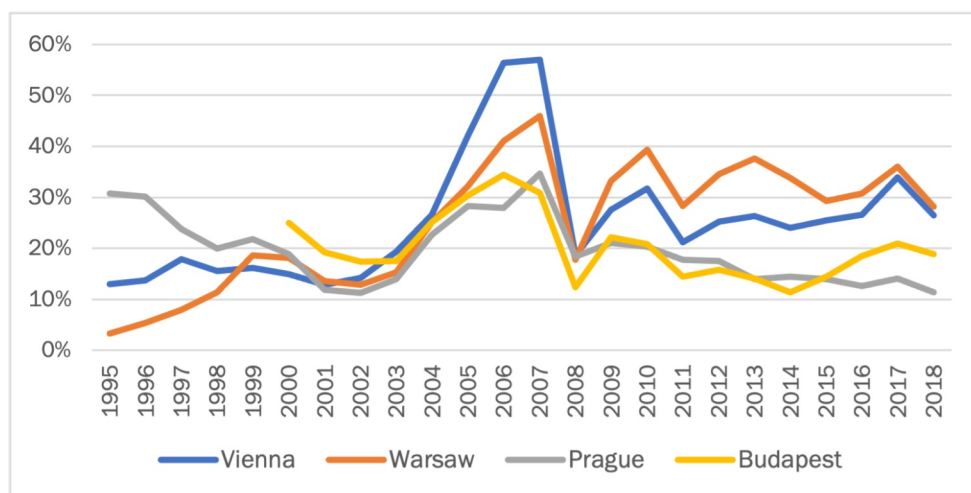


Figure 2. Total market capitalisation as a % of GDP. Source: Figure 1 and Eurostat (nama_10_gdp)

The number of listed companies in Warsaw has reached 336 (main market, of which 39 are foreign, as of July 2020), which is significantly higher than Vienna, Prague, and Budapest combined. In analysing multilateral trading facilities as markets for liquidity, Wójcik (2011) identifies investors as 'liquidity takers' and traders as 'liquidity makers'. A relatively large number of listed companies means that financial intermediaries are able to offer different types of portfolio management strategies. Liquidity makers are then able to receive positive externalities from other liquidity makers as they collectively increase both the supply of financial products as well as the options for risk diversification, both of which attract more liquidity takers into the market. In contrast, liquidity supply in Prague dries up due to the lack of IPOs and the absence of ordinary capital increase. Part of the vicious cycle, ironically, is the relatively strong banking sector in the Czech Republic, which allows firms to secure affordable direct bank loans rather than seek out investments through securities markets.

Certainly, comparing financial centres should go beyond the securities market, as the contemporary global financial market is more complex and its landscape is uneven (Wójcik, 2011). Capturing a wide range of financial centre activities, the Global Financial Centres Index, for example, ranks Prague higher than Warsaw from time to time. As discussed earlier, at the beginning of the post-socialist transition, securities markets were at the centre of financial sector reforms alongside the banking and insurance sectors. Furthermore, as the following sections illustrate, the different paths taken by financial centres are more evident in securities markets.

Against this background, the following sections narrate the histories of financial centre development in Warsaw, Prague, and Budapest, paying particular attention to their securities market reforms. Building on an earlier study by the OECD (Blommestein, 1998), they are organised around four themes: (1) voucher privatisation and the decline of Prague, (2) National Investment Funds and the rise of Warsaw, (3) gradual reform and the exit of Budapest, and (4) the consolidation of exchanges and the independence of Warsaw. While the first three themes focus more on the late 1990s and early 2000s, the last theme addresses post-EU accession development.

Voucher privatisation and the decline of Prague

While the 'voucher' privatisation programme in the Czech Republic is relatively well-known, the internal disagreement among the reformers – a key item in analysing the agency of policymakers – has not been well documented. Despite the swift legalisation of foreign investment in 1988, the challenge of acquiring liquid capital from domestic markets remained. The simultaneous banking and enterprise reform pressured the newly privatised commercial banks to assess loan applications without adequate information (Griffith-Jones, 1995). Informal market structures and social arrangements delayed many bankruptcy procedures, increasing the payment insolvency between enterprises. Neither the National Property Fund (Fond národního majetku) nor the Czech-Moravian Guarantee and Development Bank (Ceskomoravská záruční a rozvojová banka) had serious impact in providing sufficient liquid capital to the other smaller debtors (Hlaváček and Mejstřík, 1997; Zemplerová and Laštovička, 1997), until the Consolidation Bank (Konsolidační banka) began absorbing a large number of bad debts rolled-over from the socialist era.

Still, the then Czechoslovakian Finance Minister Václav Klaus was sceptical of large scale foreign takeovers. As a result, the Czech premier Petr Pithart gathered a team to prepare for a series of large-scale foreign-based privatisation negotiations 'against the will' of Klaus (Pithart, 1994 and 2011). The team included Deputy Prime Minister Franšek Vlasák, Minister of

Industry Jan Vrba (Pokorný, 2002; Pick, 1992), Minister of Labour and Social Affairs Milan Horálek, and Minister of State Property Management and Privatisation Tomáš Ježek (Ježek, 2006), which illustrated Pithart's intention to address a wide range of issues, including not only the financial stability of privatised enterprises, but also employment conditions and property rights. Under Pithart, Rakona Rakovnice was acquired by Procter and Gamble in 1991, Volkswagen obtained a 30% share of Škoda Mladá Boleslav in 1991, and Barum Otrokovice became a part of the Continental group in 1992. As soon as Klaus took over the federal premiership in 1992, large scale foreign-based privatisation subsided, until the Aero Vodochody takeover by Boeing in 1998 under Josef Tošovský. Although the National Property Fund estimated that around one third of state-owned enterprises in terms of volume was transferred through large privatisation, foreign participation in the first wave of voucher privatisation was around 2% by volume on average (Mejstřík, 1997: 61, 67). The voucher-dependent privatisation programme systematically encouraged dispersed ownership and preserved small and medium sized enterprises as the basis of securities markets in Prague.

Immediately, Prague faced two obstacles. First, the majority of voucher owners were regular citizens who had no previous experience or knowledge in business management. As Kraakman et al. (2009) illustrate, threats to sell equities is an effective corporate governance mechanism to solve principal-agent problems between investor-owners and managers. Thus, the voucher-dominated securities markets in Prague would have required a proper exchange mechanism from vouchers to tradable equities, transferring corporate supervision responsibilities from investors to financial intermediaries. Rapid introduction of voucher-based securities exchanges in Prague accelerated information asymmetry. As a result, manipulative investment funds, such as Harvard Capital Consulting, led by Viktor Kožený with the infamous slogan 'jistota desetinásobku' [certainly ten times more], began predatory purchases of equities, increasing market volatilities without strengthening fundamentals or corporate governance mechanisms.

The second obstacle Prague faced in the mid-1990s was slow trading at the Prague Stock Exchange, despite a large number of issues being listed on the main markets. By 1996, the number of listed companies at the PSE reached 1,792. A year later, the PSE had to de-list 1,301 companies due to their low level of trade. In the midst of Miloš Zeman's political challenge to Klaus, the Czech currency crisis and emergency expenditures for flood victims in Moravia during the summer of 1997 tightened Klaus' ability to salvage its securities market (Gelos and Sahay, 2000). The Czech crisis was followed by the Russian crisis in the summer of 1998, resulting in the general decline of the EC's economic activities vis-à-vis CEE. Stasis in Prague's IPO markets then dried up liquidity in the main market.

In terms of securities market infrastructure, the plurality of securities markets in Prague is rather confusing. As a natural consequence of voucher privatisation, RM-System exchange ('registrační místo' or 'place of registration') was established in 1993 by the Investment and Postal Bank (Investiční a poštovní banka) group. The RMS practically took over the nationwide system of voucher registration and used it as the basis for an electronic trading platform (Musílek, 1998). At the same time, the Prague Stock Exchange (PSE) was re-opened in 1993 by a consortium of local commercial banks. Investors seemed to have treated the RMS and PSE as complementary trading platforms, due to different trading frequency and registration requirements. Officially, commission is slightly higher for the RMS, but registered intermediaries at the PSE may charge additional fees for individual investors. The price quoted at the RMS often differed from the price at the PSE, despite some efforts made by the government to reduce price volatility (Mejstřík, 1997), and this gave some incentive to speculative and predatory trading practices.

As the markets matured, however, arbitrage trading between the RMS and PSE increased and the price differences diminished (Hanousek and Němeček, 2002). Through the amendments of the Securities Act, Commercial Code, and the Investment Funds Act, the Securities and Exchange Commission was established in 1998 (Musílek, 1998), increasing transparency and trust in the Czech financial market, which were severely damaged during the 1997 crisis. Ten years later, the RMS underwent a transformation from off-exchange to standard exchange, rebranding itself as RM-Systém Czech Stock Exchange in 2008. In 2010, the RMS's Securities Centre (Středisko cenných papírů) transferred its settlement duties to the Central Securities Depository (Centrální depozitář cenných papírů), a part of the PSE Group, linking the RMS and PSE activities. While the RMS continues to attract individual investors, the PSE became a part of the Vienna-led CEESEG in 2008, serving as the secondary exchange for regional institutional investors.

As noted earlier, the departure of Klaus from power in 1997/98 marked the revival of foreign-based privatisation.⁵ In its commentary, a global law firm White & Case touched upon the expected spill-over effects on corporate governance through the participation of experienced foreign strategic investors in Prague (Dlouhý, 2002). While the report inserted a cautionary note on potential political instability (e.g., minority cabinet), it listed several successful cases, including the sale of Česká spořitelna savings bank to Erste Bank and Agrobanka to GE Capital, both of which involved the German or Austrian capital and launched fundamental restructuring in the following years. After Czech accession to the EU, Prague began to welcome investors from other EU member states too. For example, Český Telecom was sold to Spanish Telefónica in 2005. The internal disagreement between Pithart and Klaus, as well as Klaus' later departure from power, in this way provide vital insight into the financial history of post-socialist Prague.

National Investment Funds and the rise of Warsaw

While both voucher privatisation in the Czech Republic and 'shock therapy' in Poland might be considered successes, the two transition programmes seemed to be incompatible with each other, not only because of the different 'starting point' in each economy, but also due to different visions of the stock market in relation to corporate governance. In 1989, the year when Tadeusz Mazowiecki assumed the premiership, nearly 30% of GDP already came from the private sector (including the co-operatives), which employed more than 44% of the total labour force. Yet, "Solidarity was above all a trade union and, as such, could not and did not have the return to full blooded capitalism as its principal objective" (Gomułka and Jasiński, 1994: 221). Solidarity supporters increasingly expressed their passion in property rights and employee-ownership as their perceived symbols of liberal democracy (Lewandowski and Szyszko, 1999: 45).

The expert team led by Balcerowicz, however, considered such an option as inefficient, and this was echoed by Stanisław Gomułka's privatisation proposals to organise investment banking activities (Gomułka and Kowalik, 2011). Thus, the initial privatisation proposals in 1990/91 resembled the IPO-based commercialisation in the UK along with the below-market-price asset leasing (Lewandowski and Szyszko, 1999). The employee-leased companies were later transformed into employee-buyouts after several years of leasing (Kozarzewski and Woodward, 2003), the time-gap being crucial in screening competitive and sustainable firms.

At the same time, the relative absence of a financial labour market in Poland resulted in a lack of intermediaries, and thus, the Government Plenipotentiary for Ownership Transformation, Krzysztof Lis, laid out a rather flexible general framework which allowed for

various methods and techniques of privatisation (Gomułka and Jasiński, 1994). The Lis proposal, later known as the Act on the Privatisation of State-owned Enterprises, was passed in 1990 despite some resistance from the employee ownership supporters. Lis then advocated mass-scale commercialisation and openly went against vouchers and investment funds, which were two main instruments in the Czech Republic. The proposal was again dismissed by the employee ownership supporters.

This privatisation discussion also coincided with the conflict between premier Mazowiecki and popular President Lech Wałęsa in late 1990. The victory over Mazowiecki in the presidential election led Wałęsa to select a successor premier, Jan Krzysztof Bielecki, who kept Balcerowicz as his Finance Minister. In this way, the privatisation project seemed to have continued smoothly, with Bielecki proposing various commercialisation schemes of state-owned enterprises accompanied by the establishment of the Warsaw Stock Exchange in 1991. Yet, the employee ownership supporters still preferred Czech-style voucher privatisation over IPO-based commercialisation, and their resistance resulted in the weakening of Bielecki's political foundation, leading to his resignation in less than one year in office.⁶ The following Jan Olszewski (half year), first Waldemar Pawlak (33 days), and Hanna Suchocka (15 months) governments were also short-lived and politically unstable, compared to Klaus in the Czech Republic, who stayed in power from July 1992 until January 1998. This continuous succession inevitably delayed the privatisation process, and especially those programmes with less popular methods. Tomasz Gruszecki, for example, drafted the proposal for mass privatisation in 1992, but fell along with the Olszewski government. Janusz Lewandowski, who contributed to the establishment of the WSE, succeeded Gruszecki, and some of the programmes were revived and continued. In 1993, Lewandowski finally was able to pass his mass privatisation proposal (Gomułka and Kowalik, 2011).

Lewandowski's proposal was to establish a number of National Investment Funds (NIFs), which were tightly regulated by statutes, but functioned as "venture capital/turn around agencies, holding companies, and closed-end funds" (Gomułka and Jasiński, 1994: 237). Some of the concerns addressed earlier were resolved. Employees received 15% of the shares in their enterprises when they participated in the mass privatisation scheme through the NIFs. The rest of the shares are divided among leading NIFs (33%), other NIFs (27%), and the State Treasury (25%). Ultimately, state-owned enterprises themselves (and to a large extent their employees too) could choose the method of privatisation (including whether or not to participate in a NIF-led privatisation) as prescribed in the Pact of Enterprises signed by government, trade union, and enterprise representatives in 1992. The Pact also mentions speedy privatisation or otherwise forced privatisation by the Ministry of Privatisation. As far as foreign takeover is concerned, a majority of board members in each NIF must be Polish citizens, who then select the fund managers. Furthermore, unlike in the case of the Czech privatisation funds, the Polish NIFs were joint-stock companies, and the remuneration of the fund managers was linked to the income of the fund, ameliorating the principal-agent problems in corporate governance (Simoneti et al., 1999; Hashi, 2000; Kraakman et al., 2009). In other words, the fund managers were actively involved in the restructuring of privatised enterprises, increasing their productivity, competitiveness, and stock values. The governance of the Funds itself was also controlled by market rhetoric; thereby, all citizens could receive a participation certificate for the NIFs, which gave them entitlement to receive dividend-like revenues. The certificates could be traded as they were (i.e., without voting rights) or exchanged into the de-materialised form of a NIF share with the usual voting rights at the Warsaw Stock Exchange through a licensed bank or broker.

The NIF-based mass privatisation programmes were first implemented in 1995, corresponding with the rise of market capitalisation in Warsaw. By the time total market capitalisation in Warsaw peaked in 1999, “512 larger and medium-sized SOEs [state-owned enterprises], representing around 10% of industrial sector sales, were formally transferred to the National Investment Funds Program” (Lewandowski and Szyszko, 1999: 45). Surely, large institutional investors such as pension funds, which were reformed in 1999, have decisive influence in capital markets when it comes to available liquid capital (Naczyk and Palier, 2014; Oręziak, 2014; also see Clark, 2000, 2003). However, the presence of institutional investors alone does not automatically increase securities trading. After all, investors take liquidity from the securities markets, while it is issuers and traders who provide liquidity in securities trading (as opposed to liquidity of capital). The NIFs therefore have provided liquidity in trading and contributed to the rise of Warsaw as a securities market centre in the late 1990s through their portfolio management and corporate governance activities. Furthermore, as Glaeser et al. (2001) noted, motivated Polish regulators installed a transparent high-standard financial regulatory regime in the early stage of transition, comparable to the OECD average and thereby strengthening investors’ trust in the market.

The ownership of the NIFs began to consolidate towards the end of 2000 under BRE (Bank Rozwoju Eksportu), PKO (Polska Kasa Opieki), and PZU (Powszechny Zakład Ubezpieczeń) (Błaszczuk et al., 2003), but banking sector reform was delayed by the presence of politically well-connected specialised banks.⁷ These shareholders were interested in the synergy effect rather than the value of NIF shares, and thus, Błaszczuk et al. (2003) argue that the corporate governance structure of the NIFs became more complicated, involving not only the privatisation of NIFs but that of shareholders too. The NIFs were also slow to identify new investors for smaller companies, resulting in relatively low performance. The macroeconomic slowdown became evident in 2000, and until EU accession was finalised in 2004, the Polish financial market remained rather bank-centred (Mykhnenko, 2007a) as opposed to securities-market-centred, despite the NIF-led expansion of the securities market from the supply-side point of view.

As Kokoszcyński (1999) highlights, the WSE was assumed to be the only stock exchange in the country, unlike in Prague. Under the leadership of Wiesław Rożucki, who holds a PhD in Economic Geography, the WSE actively engaged foreign investors with a regional mindset to participate in the Polish market, alongside the Polish Agency for Foreign Investment (today, Polska Agencja Inwestycji i Handlu under Polski Fundusz Rozwoju) and the Ministries. Foreign investment banks replied to the call by opening their offices in Warsaw after EU accession. Curiously, total market capitalisation did not necessarily correlate with GDP growth, but rather with FDI inflow (Akbar et al., 2006). It seems that Warsaw began to function as the regional platform for liquidity, linking domestic issuers with foreign or regional investors. Still, the initial conflict between policymakers and the employee-ownership supporters, leading to the eventual establishment of NIFs, characterises the timing and type of reforms pursued in Poland (and Warsaw).

Gradual reform and the exit of Budapest

Although Hungary can be considered as one of the model cases for a smooth political transition, the success of its financial reforms is debatable. Hungary introduced a two-tiered banking system in 1987, earlier than other CEE countries, while costly recapitalisation programmes pressured public finances up until 1995. As Gál (2010b) explains, Budapest thrived as a regional banking and financial centre in the nineteenth and twentieth centuries,

largely benefiting from its geographical location and connections to the Russian, Ottoman, and Austrian Empires. Today, OTP (Országos Takarékpénztár, National Savings Bank) and MKB (Magyar Külkereskedelmi Bank, Hungarian Foreign Trade Bank) enjoy the economies of scale stemming from their branch networks in the Balkans. However, as Gál argues (2010a), these regional banking networks are not enough to make Budapest an 'international' financial centre, as securities markets host a wide range of financial institutions. The rise of Orbán's nationalist government and his campaign against foreign-owned banks characterise the challenge facing Budapest today. On one hand, capital inflow from these foreign-owned banks has stabilised the Hungarian economy and accelerated the country's post-socialist economic transition and development. On the other hand, the recent financial crisis has shown the potential for reverse capital outflow, especially when a foreign company's domicile economy (e.g., Germany or Austria) is in trouble (Buckley, 2014). In this way, the high volatility of capital flows in Budapest signals a certain degree of financial exploitation by other financial centres in the region, namely Vienna, Munich, and Frankfurt.

Even prior to its political transition, Hungary already began to build a concept of property rights and a hint of capitalist rhetoric through limited trading activities. The so-called 'spontaneous' privatisations led by state-owned enterprises provided valuable experience in handling the process, if not the momentum needed to create a fully-fledged capital economy (Ábel, 1999). While Poland and Czechoslovakia went through rather harmful rapid price stabilisation programmes, the gradual Hungarian transition model exhibited some degree of stability. The Hungarian approach to many urgent issues in the so-called 'Bokros package', such as deficit reduction, was radical enough (albeit still gradualist) to provide effective solutions. Nevertheless, some earlier critics argue that "[strategic mid-to-long-term] economic policy was left without firm [political] leadership" (Stark and Bruszt, 1998, quoted in Åslund, 2013: 28). The successive rise of various coalition governments in the 1990s led to speculative trading in the foreign exchange and sovereign bond markets, delaying the development of the corporate securities market.

The privatisation method predominantly used in Hungary was sale to foreign investors. In the Czech Republic and Poland, vouchers and NIF certificates were expected to be traded at the securities exchanges (known as 'secondary privatisation'). As direct sales to outside owners do not involve such certificates, the securities market was not considered as a realm of privatisation in the Hungarian model. The Budapest Stock Exchange existed since 1987, although domestically registered investors began trading in 1989 and the IPO market became active only after the introduction of the Securities Act in March 1990. The price index illustrates that the general price of shares in Budapest fluctuated throughout the decade. This was partly due to the government's various 'experimental' policies, such as the 1992/93 automatic bankruptcy procedure (Bonin and Shaffer, 2002), which was accompanied by the mishandling of debt-for-equity swap cases in the hands of domestic fund managers. Thus, general macroeconomic performance functioned as the major indicator for companies' collective well-being in Budapest, as opposed to individual financial statements by firms. As a result, total market capitalisation correlates with GDP growth, rather than with FDI inflow, as was the case in Poland (Akbar et al., 2006; Alfaro et al., 2004).

In addition to price volatility, the securities market in Budapest faced further structural setbacks. As in Prague, the relatively stable banking sector in Hungary led many firms to seek capital through loans rather than through IPOs or ordinary capital increases. A strong presence of FDI and foreign-ownership also encouraged cross-border capitalisation activities, including the listing at foreign exchanges. Thus, despite the fact that a higher ratio of total market capitalisation to GDP was maintained in Budapest compared to Warsaw and Prague prior to

EU accession, investment flow channelled through the exchange remained low. Furthermore, Bank for International Settlement data shows that Hungary was particularly exposed to capital inflow reversal risks during the pre-crisis period (Mihaljek, 2010). While the average price of equity recovered to its pre-crisis level by mid-2010 in both Budapest and Warsaw (as opposed to Prague), what differentiated Budapest from Warsaw was the lack of recovery in sovereign Eurobond and foreign exchange markets in the former.⁸

Budapest as it stands seems to have exited from the race to become the international financial centre in CEE, at least when it comes to the securities market. Nonetheless, Szabadföldi's survey (2002) reveals strong international business presence (regional headquarters, R&D, accounting, IT, HR) in Budapest, including Philips, GE (General Electric), and KPMG. While the survey highlights the ease with which Budapest connects to other financial centres in the region, it also reports a lack of leadership in Budapest. Although the so-called Széchenyi Plan of 2001 aimed to compete with Warsaw and Prague to become the regional business (and financial) centre, the New Széchenyi Plan in 2011 shifted the focus to acquiring EU funding for infrastructural development. Surely, these plans have identified the comparative advantages of Budapest vis-à-vis its Western neighbours. Nevertheless, they are short in providing a vision for the identity of Budapest as a regional financial centre, differentiating itself from Warsaw and Prague.

Consolidation of exchanges in CEE and the independence of Warsaw

As Prague and Budapest lacked momentum to expand their securities markets, Vienna began to consolidate its hold over the regional financial landscape. The Vienna Stock Exchange acquired Budapest in 2004, and Prague and Ljubljana in 2008, to form the CEESEG. With Bratislava becoming a *de facto* financial suburb of Vienna due to geographical proximity, Warsaw remains as the only sizeable securities exchange in the region that avoids consolidation. In the Czech Republic, foreign owned enterprises seek their capital from parent companies, and domestically owned smaller businesses have little chance to accumulate enough capital in the Prague securities market. Thus, the latter better negotiates with local banks (Myant, 2007). Listing on the PSE is used as a publicity stunt as any activities related to the PSE attracts media attention (Thompson, 2012). For this reason, the WSE attempted to acquire the PSE, but lost against Vienna.

Active marketing of the Exchange began in 2006, when Ludwik Sobolewski took over the WSE presidency. He first refined the price index (WIG) with various sub-indices, which are now considered some of the most 'efficient' in CEE (Křišťoufek, 2010), and increased the range of financial products offered in Warsaw. The establishment of *NewConnect* for smaller enterprises in 2007 increased Warsaw's liquidity, with its volatility impacting on the main markets only in a limited manner. In 2009, the WSE launched the *Catalyst* bond and debt securities market, complementing the treasury bills and bond markets under the *BondSpot* exchange (formerly Centralna Tabela Ofert, CeTO), currently owned also by the WSE.⁹ On the demand side, Sobolewski actively invited international financial firms to become members of the WSE and conducted a successful IPO of the WSE itself in 2010 (Sobczyk and Kruk, 2010). Even though total privatisation of the Exchange has yet to occur, the IPO raised both capital for further expansion and awareness of Warsaw as a major financial centre in the region.

In the meantime, the Markets in Financial Instruments Directive (MiFID) was transposed into Poland in 2009, with a delay of almost two years. While the MiFID differentiated a regulated market from a multilateral trading facility (MTF), the transposed Polish regulation distinguished between an exchange market (*rynek giełdowy*) and an over-the-counter market

(rynek pozagiełdowy), with the latter implied to have no physical trading space. By doing so, the WSE was able to run MTF *NewConnect* under the regulatory umbrella of an 'exchange market'. As opposed to *BondSpot*, which was categorised as an OTC market, *Catalyst* under the WSE can be treated as a part of regulated market activities with OTC characteristics. Whether such a regulatory development is the result of lobbying by Sobolewski or the Polish regulator's willingness to be pragmatic is difficult to say. Nevertheless, active transformation of the regulated market to include MTF activities through mergers and acquisitions seems to be a dominant strategy for the WSE. In August 2013 the WSE announced, with a 30% share purchase, its participation in a pan-European MTF *Aquis* (operated by BATS Chi-X Europe) (Cave, 2013). While the newly introduced MiFID II is yet to determine the prospects and potentials of *Aquis*, Warsaw's intention to link itself with London became visible. Moreover, the WSE also obtained the Polish Power Exchange (Towarowa giełda energii) in 2013, challenging nearby energy commodity markets, such as Power Exchange Central Europe in Prague (a part of CEESEG) and the European Energy Exchange in Leipzig (EEX, a part of the Frankfurt-based consortium). The Global Financial Centre Index published in September 2015 illustrated financial actors' interests on Warsaw, pushing the city to the 38th position, but it later dropped to 64th in September 2019.

Meanwhile, Prague envisioned hosting hedge funds and asset management companies, which are required to be domiciled within the terrain of the EU (Laca and Chamonikolas, 2013). However, Prague found it difficult to achieve this goal as the legal and technical infrastructures are yet to be installed. The deflation of the Czech crown in 2013 resulted in increasing inflation, further delaying the process. If Prague succeeds in hosting hedge funds and asset management companies, then it is possible for Prague to differentiate itself from Warsaw, potentially complementing each other in terms of regional financial market development. Yet, 7 years after these initiatives, little has materialised. Whether Prague is serious or not will be seen in its implementation of EU regulations such as MiFID II, as well as its further refinement of key infrastructure in the near future.

Conclusion

Historical narratives from CEE cast doubt on deterministic institutional analyses of financial centres. The development of the securities market in Prague during the 1990s was shaped by the contrasting ideals of influential domestic reformers, such as Pithart's aspiration for large-scale foreign-based privatisation and Klaus' passion for voucher privatisation. In Budapest, privatisation was mostly based on sales to foreign-based companies, who were more likely to request capital from their parent companies than through securities exchanges. Even though the conservative policies of Orbán were praised by some financial actors in the months following the Swiss franc shock, his nationalist approach still discourages the internationalisation of Budapest as a financial centre. Meanwhile, Balcerowicz in Warsaw insisted on avoiding voucher-based privatisation due to foreseen inefficiencies in corporate governance. The establishment of the National Investment Funds by Lewandowski then functioned as the primary means of developing domestic financial intermediaries. It was a gradual process further slowed down by poor macroeconomic growth prior to EU accession. However, the high standard of financial regulations in Poland, accompanied by the active development strategies pursued by the WSE under Sobolewski, accelerated the development of Warsaw as an international securities market centre.

A theoretical framework that emphasises 'path dependence' would struggle to explain these divergent pathways. The narratives presented in this article demonstrate that a handful

of reformers had considerable influence on the establishment and modification of key securities market institutions, which in turn shaped the characteristics of the given financial centre. This suggests that reformers were able to exert a significant influence over the developmental trajectories of financial centres in CEE, and that a focus on the agency of policymakers may be useful for explaining the process of financial centre development and differentiation more broadly. As the narratives presented above are centred around securities markets, developments in other parts of the financial sector (e.g., investment banking, mergers and acquisition, service outsourcing) have not been addressed. By incorporating these areas into future studies, a historically informed financial geography of CEE could speak to the relational aspects of financial centre development (e.g., hierarchical interurban relations, regional urban systems, the international division of labour) and complement the ongoing work in these fields.

There is also a need for more observations in order to validate the claim that policymaker agency is a determining factor in financial centre development, as this study limits its scope to reforms initiated during the post-socialist transition. One of the major unanswered questions is how non-policymaking elites (e.g., CEOs of major retail banks) influence financial centre development. As the securities markets in CEE grew in size, these professional elites may have differentiated their firms' activities in any given financial centre. For example, in Warsaw, the state-owned insurance giant PZU's decision to purchase Pekao Bank (then owned by Italy's UniCredit) was likely to be driven by the then CEO Andrzej Klesyk's vision for consolidating the banking sector in Poland. Whether a particular individual has policymaking or foreign experiences, and whether a particular firm is owned by foreign firms or not may influence the path of financial centre development. Future studies of elite agency should include these kinds of actors.

Another 'missing piece' of the puzzle is the self-consciousness of elite actors. For example, the internal disagreement between Pithart and Klaus is enough to justify the inclusion of these reformers into the observation framework of financial centre development. However, it is still unclear how they envisioned Prague as a financial centre, how they observed the interurban relations and urban system of the Czech Republic, and how they foresaw the spatiotemporal distribution of financial activities among financial centres in Europe. To give a comparison, in foreign policy analysis, policymakers' beliefs and general rules are systematically subsumed into a 'doctrine'. During the tenure of the policymaker in question, we assume that policymakers consciously make their decisions based on the given doctrine and that the successors may continue, modify, or reject the doctrine, making the historical analysis more periodised. In order to take full advantage of agency-oriented analysis, studies on financial centre development may need to identify these doctrines and periodise the history of the given financial centre based on doctrines rather than external events.

Finally, the agency of financial centres themselves has to be scrutinised. Once we establish the influence and intentions of elites in shaping financial centre development, we must next think how the financial centre in question can influence the global network of cities. To be clear, while the reformer-centred analyses in this article reject deterministic institutional thinking, they are nonetheless compatible with macroeconomic and institutional analyses, as reformers are the agents of institutions. As these reformers are characterised as the agents of financial centres, financial centres in turn may be characterised as the agents in global network of cities. The circle of thinking is complete when we analyse how elites observe the global network of cities. Therefore, the agency of reformers is the first step towards a deeper understanding of the relational geography of financial centres.

Notes

1. For example, some interviewees avoid commenting on details due to their current positions. Others have changed their professions and their views on the legacy of reforms are not necessarily up to date. The author also acknowledges that his lack of knowledge in the Hungarian language may have resulted in an uneven treatment of primary materials between the countries studied in this article. The article should therefore be read as a regional historical narrative, rather than a comparative historical study.
2. To a certain extent, the topic of agency touches on debates surrounding assemblage theory and critical urban theory (Brenner et al., 2011; McFarlane, 2011; Storper and Scott, 2016). This article, however, deals with reformers that were already institutionally empowered to influence the development of cities. The process by which those elites climbed to such positions is relevant to this debate, but it is beyond the scope of this study.
3. The 2008 crisis was first observed in the equity markets, then the sovereign Eurobond market, foreign exchange markets, and credit insurance markets (Mihaljek, 2010). The sequence of events partly explains why the fall of GDP was delayed until 2009, while the financial markets already began to recover by October 2009.
4. During this period, total market capitalisation in Warsaw is between 1.5 and 2 times larger than the gross capital formation in Poland, while they are roughly the same in Vienna. Calculated by the author from the same dataset as Figures 1 and 2.
5. Although Klaus assumed the Presidency in 2003, Beneš and Karlas (2010) find that the 2009 Czech Presidency of the European Union illustrated some degree of policy convergence between Prague and other EU capitals and institutions.
6. Externally, Moscow was pressuring Warsaw through the revival of the Comecon, and Balcerowicz was ready to compromise for the sake of economic stability. Bielecki resisted, and the confrontation was softened as the Soviet Union finally collapsed (Davies, 2001).
7. For example, Bielecki “even question[ed] the definition of BGŻ [Bank Gospodarki Żywnościowej] as a ‘bank’” (Mitchell, 2003: 28) due to its structure as well as lobbying capacity. BGŻ specialised in the agricultural sector and owned the network of rural cooperative banks.
8. The Budapest Commodity Exchange has been active in currency derivatives, which are generally assumed to function as a market response to unreliable monetary policy in Hungary. The Hungarian derivatives market has illustrated some degree of stable development over the past two decades (Chi and Young, 2006).
9. However, Kouwenberg and Mentink (2006) argue that euro-denominated government bond markets in Poland and Hungary correlate with those in Germany and the UK, diminishing the portfolio diversification effects. Harrison and Moore (2010) also find a similar result.

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