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# The emergence of patronage and changing forms of rent-seeking in East Central Europe

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## ABSTRACT

The foreign direct investment (FDI)-led development path of the East-Central European (ECE) countries has been queried most recently. Using mainly the evidence of Hungary and Poland the paper analyses one of the potential reasons of this strategic turn: the struggle between political elites. One elite was bound to the strong presence of multinational business and the institutions of the 'competition state'. Their positions were challenged by another political elite that allied mainly with local bourgeoisie. One main arena of conflicts is the economy where political elites try to widen their influence in order to gain financial support. New forms of rent-seeking and corruption became possible after the V4 accession to the European Union (EU) when the flow of financial aid increased. Aid was channelled to partisan firms in public procurement tenders that made legal corruption possible. Political and social control over this practice declined with the demise of classic program parties' role in politics and the raise of populist 'business firm' political parties.

## KEYWORDS

East Central Europe; rent seeking; legal corruption; business capture; elites

## 1. Introduction

East-Central European countries, new member states of the European Union, underwent fundamental political, economic and social changes in their transition process from communism to democracy. Their economies were substantially restructured and modernised, market economic institutional frames were established, political democracy was introduced, civil society strengthened. All these changes made the transition process of the region politically irreversible and economically successful. Yet, since the turn of the millennium popularity of these new achievements declined in the society: euro-sceptic and anti-globalist arguments were emphasised in political rhetoric and policies in a number of countries (most notably in Hungary, Poland and Czechia). The process seemed to culminate when Hungarian Prime Minister Viktor Orbán declared that Hungary's main political ambition was to reconsider the country's liberal democratic development and replace it with illiberal democracy (Orbán, 2014)<sup>1</sup>. A term such as illiberal democracy can be interpreted as an antonym to liberal democracy in the simplistic formulation used in a political speech. The speech was about the rejection of liberal values and their replacement by 'something else', a not properly defined concept.

This paper focuses on defining and evaluating this ‘something else’ with special regard to the national economy of ECE countries. The main argument of the paper is that the collapse of traditional ideological parties and the advance of populist ‘business firm’ parties can be regarded a systemic element of ECE capitalist development. The lack of strong ideological underpinnings, low social appreciation of the democratic political institutions and competitive market economic institutions opened up opportunities for ‘business firm’ parties to acquire and monopolise political power. The latter aim is achieved through the systematic destruction of democratic institutions and organisations. Strong political positions are used for business capture, which can be exercised through regulatory tools. Including, the use of measures offering selective advantages and disadvantages. These policies as well as an increase in state ownership are usually labelled as steps of economic patriotism. However, as this paper argues they are rather measures aimed to dominate large parts of the economy by the government and the ruling party. Competition is frequently put off entirely on closely regulated markets to favour political clients. This is a system of patronage rather than economic patriotism. The paper sees the ultimate goal of patronage and business capture in political rent-seeking. However, the lack of competition and the repression of social control also increases the risk of corruption. There is ample empirical evidence in the case of Hungary that the level of corruption increased parallel with the decline of political and social control over government policies. This ambition is not restricted to Hungary. We can see similar systemic political development trends in Poland. Moreover, elements of Hungarian and Polish patterns have surfaced in other countries, including Czechia, Romania and Bulgaria. This points to a systemic East-Central European feature behind these observations.

The paper consists of three main parts. First, we explore the general socio-economic setting in the region and point out the reasons of departure from the general consensus regarding the socio-political trends of the 1990s’ transition. The departure was present in the changes affecting elements of the democratic political system and the liberal market economic frame. In the second part, we continue with the analysis of patronage and business capture in the region. We describe the steps of political monopoly creation, the factors that allowed the emergence of ‘illiberal democracy’ and the attempts of a strong populist governments to capture dominant positions in the economy. In the third part, the changing forms of rent-seeking and corruption are described. Although rent-seeking and corruption had been present throughout the entire ECE transition, this practice has gradually become systematised and directly used for strengthening the political monopoly of the ruling parties. Most recently, legal corruption is used to reap political rents from state-owned companies and partisan private firms. We conclude in the final part.

## **2. ECE’s FDI-led transition path and the reasons for departure from it**

Systemic change and transition in East Central Europe can be interpreted as a historic success story (Kornai, 2006). In the context of world history, this was the only total political transformation towards Western values that took place peacefully. Moreover, this was achieved at a rapid pace. It was formally completed with the successful accession of ECE countries to the European Union in 2004,<sup>2</sup> although numerous problems and hardships did arise during the process. Guidelines were designed, especially in the first 5–10 years, according to the general objectives of the (post-) Washington Consensus’ SLIP (stabilisation, liberalisation, institution building and privatisation); however, details of specific policies were not created in seamless

fashion. Cernat (2006) called the established political and market economic institutional mix 'cocktail capitalism', referring to the contradictions and the frequently missing coordination within the institutional system. Roland (2000) gives a comprehensive summary of the main transition tasks and policies, and analyses the results of different policy solutions. Despite the occasionally patchwork-like institutions and conceptually different policy solutions to various tasks stemming from the implementation of SLIP, considerable convergence evolved over time in the development patterns of ECE countries.

This convergence was described as an FDI-led development model (Szanyi, 2003), which is based on economic restructuring and modernisation reliant on foreign direct investments. Only in hindsight was the focal and long-term role of multinational businesses in the ECE's development evaluated. Results were rather mixed. The highly successful process of structural change increases in productivity and international competitiveness (measured, for example, by growing exports and a positive trade balance) ultimately slowed down. Further increases in multinational affiliates' local income generation has become increasingly difficult (Szalavetz, 2017).<sup>3</sup> The share of foreign-owned (mostly multinational) companies increased to over 50% in the majority of economic sectors in terms of production, investments and exports. Many observers regarded this high foreign share as excessive. Szentes (2005–2006) wrote about an unhealthy asymmetric interdependence. Nölke and Vliegenhart (2009) conceptualised problems of the FDI-led development on a more general level in their dependent market economy (DME) model. However, DME's critics called attention to the fact that multinational business' strong influence did not necessarily curtail ECE countries' governments. They could generate income to finance policies independent of the multinational-dominated parts of their economies (mainly through EU transfers). Thus, ECE governments could still act relatively independently from global business and use this room of manoeuvre for purposes such as establishing local entities competing against multinational companies (Szanyi, 2016b).

Both the FDI-led development model and the DME model were attempts to detect strong similarities between ECE economies that could characterise a specific capitalist model of the region in the framework of the varieties of capitalism literature. Two important features of this capitalist model could then be the strong integration of these economies into multinational companies' global value chains (DME) and the vigorous direct state intervention in shaping economic processes that became more and more evident in the region during the 2000s and thereafter (state-orchestrated revision of the FDI-led model). The main topic of this study is this latter feature<sup>4</sup>, which stands in sharp contrast to the FDI-led model which dominated developments during the 1990s.

Increasing state intervention could be observed in many countries during and after 2008–2009 crisis. Typically, however, long-established market economies regarded this as a temporary necessity until macroeconomic stability was achieved or too big to fail banks and other companies were financially restructured. The state's increased direct involvement was not expected in the long-run. The situation in ECE countries was different: governments expanded their activity over certain sectors well before the crisis and have continued to do so<sup>5</sup>. But what was the reason of this change? Why was FDI-led development model dropped?

Naczyk (2014) explained this phenomenon as a change in the main priority of national governments, which shifted to pursue policies according to their perceived national interests. During the 1990s the main ambition was to consolidate the transition towards free market

capitalism, an ambition was heavily supported by the international advisor community's SLIP program. The program was accepted and applied because ECE societies had weak ideological underpinnings and could not develop competitive alternative visions with regard to the transition process. SLIP favoured multinational business penetration too. The process also unfolded in countries where foreign direct investment was less welcome (e.g. Czechia, Poland) in comparison to Hungary. Drahokupil (2008) stressed that the introduction of SLIP was supported and carried out by the local bureaucratic elite ('the comprador service sector'<sup>6</sup>). According to Naczyk (2014) the change in attitude towards FDI in the region during the 2000s was a logical change as economic patriotism's prominence rose. The irreversibility of the transition was not in danger any more during this period and especially after 2004 (2007) accessions to the European Union. Therefore, governments turned to economic patriotism's traditional focus: supporting local business vis-a-vis global enterprises. This introduced a new round of competition between the 'comprador service sector' and the de nouveau local business elites.

Kornai (2006) provides a broader overview of the social background of disappointment with the transition process in the 1990s. The first set of worries consisted of factors affecting personal income distribution. Transformational crisis and deep restructuring eliminated many jobs and created massive structural unemployment, which was in sharp contrast to the job security of the communist regimes. Inequality grew by 15–40% during the 1990s, total employment levels declined to 70–85% of the 1989 levels and unemployment grew from mostly zero to 8–20% (Kornai, 2006, pp. 229–231). The comfort of the citizens was further deteriorated by growing corruption and declining public security with crime rates tripling.

The other source of social disappointment could be traced to cognitive problems. High hopes at the beginning of the transition process did not manifest: transformational recession cut back living standards. Real convergence was slower than expected and even stalled during the 2000s, especially in the rural areas (with growing regional inequalities). A further important cognitive problem was the points of comparison for personal welfare, individual freedom, access to consumer goods, etc. Most ECE countries felt more or less comfortable, when comparing their living standards with Soviet counterparts, but – despite increasing levels of well-being – there was still a large gap with neighbouring traditional democracies like Austria or Germany. This shift in the baseline of comparison increased frustration in ECE societies. Last, but not least, memories of hardships in the overturn regimes faded very quickly.

We can complement Kornai's list of factors explaining disappointment with the liberal FDI-led growth path with further elements observed during and after 2008–2009 crisis. Trust in the neoliberal agenda of the great moderation period was shaken worldwide. The theoretical background of the FDI-led development model was further eroded during the crisis and until now, no new theoretical concept was put forward to replace it – the revival of neo-Keynesian and protectionist concepts can hardly be regarded as adequate answers to the challenges of globalisation. Economic patriotism and even nationalism spread in economic policy even affecting the United States of America. We are witnessing a worldwide cognitive problem, as the international and the general social consensus seems to have broken.

The spectacular growth in the 1950s and 1960s as well as the successful consolidation attempts in the 1970s and 1980s were based on internal social and international compromises. The neoliberal policy agenda's social consensus in ECE rested on the same fundamental pillars. The horrors of the Second World War created a basic understanding

that personal and national ambitions should be limited and more cooperation within society and among states should be applied. As a reward for giving up areas of personal and national sovereignty economic growth and prosperity provided conditions for continuous development of welfare services and an increase in living standards. The most obvious example of this is the development of the European integration process. However, declining international competitiveness of the European economic space and slow economic growth limited the necessary resources to further increase welfare. Memories of war faded and were replaced by new impressions of violence manifesting in inter alia terrorism, and new social problems created by massive waves of migration. Hence, the effect of both former threats and the rewards from welfare services declined. The crisis of traditional European political parties, which led the political competition for the 70 years after 1945 became obvious in 2017–8 parliamentary elections inter alia in France, Italy, Germany, the Netherlands and Austria.

Traditional political parties' decline in popularity was especially dramatic in the ECE region, where their positions began to erode even before 2007/2008 crisis. In his analysis of ECE party structures, Cohen (1999) differentiated between traditional program parties and 'business firm parties'. Program parties were supported by elites (e.g. socialists, Christian democrats, liberals, nationalists) who shared ideologically embedded values and programs. In contrast, Cohen introduced the idea of 'mass elite' to describe a political elite with the characteristics of the mass, i.e. the average voter responsible for forming 'business-firm' parties. This – militantly anti-communist – elite is primarily motivated by short-term self-interest, as opposed to ideological commitment (Cohen, 1999, p. 5–6).

In the post-crisis era, ECE's business-firm parties and their governments do not feel that they have to compromise national sovereignty, especially after they have become members of the EU club. Newly emergent populist parties in Europe were usually led by charismatic leaders. FIDESZ-Civic Party in Hungary is led by Viktor Orbán, the party of Law and Justice (PiS) in Poland is led by Jaroslaw Kaczynski, Action of Dissatisfied Citizens (ANO) in Czechia by Andrej Babis. They all became prime ministers. Their personal character was usually a mix of a ruthless fighter taking on globalisation and communism. Their program suggested the defence of national interests and the completion of the transition process. At first sight, these goals can be interpreted as a correction to FDI-led development and liberal competition state (Drahokupil, 2008), as well as their replacement with a new system that concentrates on strengthening the local bourgeoisie and national sovereignty against foreign influence.

Viktor Orbán's quoted statement about illiberal democracy reflects such a strong value statement. The ECE's transition was designed according to the values of the Western civilisation, liberal democracies, liberal market economies and the competition state. There are, however, other types of political and economic systems in the world that are constructed according to different values. Sometimes it is rather difficult to differentiate among various types of capitalist models (see debates of the VoC literature). We can identify 'Western' or liberal democracies, where there is political competition among political parties, free elections that decide control over governments and parties, market competition and there is also a second tier of social control: civil society. Moreover, legislative and executive branches of the state are separated, there is independent jurisdiction, free press and freedom of opinion. All these features establish a system of checks and balances that restricts monopolisation in polity and also in the economy. The

system is based on physical institutions, but also on soft social institutions (historic behavioural patterns and track records).

The quality of institutions is strongly influenced by past political, social and economic development patterns. In the case of ECE countries, this means that their societies' imprinted behavioural patterns (their convictions) are less supportive for liberal democratic values than classic democracies. ECE history shows continuous shuttling of the countries between the West (liberal democracy) and East (autocracy). Poland's Pilsudski regime and Hungary's Horthy regime were obviously autocratic regimes run by a charismatic leader, despite them having functional parliamentary and political party systems. Elements of appreciation towards these autocracies are even present today. The communist period is usually regarded as a dictatorship with no political and market competition, albeit the political and economic power was monopolised by a group of people, rather than a single charismatic leader (Gomulka, Kádár or Brezniew). In some ECE countries, especially in Czechoslovakia the democratic track record was longer and included the 1920s and 30s<sup>7</sup>. The current departure of Hungary and Poland from the concept of liberal democracy can be interpreted as returning from democracy to autocracy. We can even perceive concrete parallels with predecesing regimes 80 years earlier, such as Kossuth Square's – the square in front of the parliament building in Budapest – reconstruction according to its Horthy-era layout. One may say that the oscillation is a normal function of ECE societies; hence, there is nothing special or strange in the concept of illiberal democracy.

But there are at least two important problems with this. One is that today's world economy and politics are globalised. Countries, especially small ones cannot survive as closed economies any more. Small open economies must pursue policies that adjust to the imperatives of globalisation. The other important difference is political: the signing of the Maastricht Treaty and joining the European Union requires accepting Western liberal democracy and a liberal market economy. On the converse, the European Union is not prepared to manage members that negate the basic values of the great European compromise. It is not prepared, because designers of the integration process could not imagine that member countries will ever debate the fundamental premises of the Union. The EU is slow to take measures against member states which openly violate its rules and go against the integration treaty, both literally and figuratively. European values were attacked by both states becoming members of this club and from within the institutions themselves. One may suspect that the weak EU response also reflects strong business interests.

As far as the economy is concerned, during and after 2008–2009 crisis ECE countries' governments have gone against the current and did not limit increased state economic intervention, but rather continued and even increased it after crisis shocks eased. An important area of increased state intervention was public property management. Poland was reported to have undertaken steps aimed at strengthening statist policies in state property management. Some of these measures were already taken by the Civic Platform before the crisis (Naczyk, 2014). The current right-wing populist PiS government continued and expanded these policies. Hungary's populist government also introduced protectionist policies in favour of local businesses, that run counter to various EU regulations (mainly in the field of competition policy). Mihályi (2015) highlights that the socialist-liberal Hungarian governments of the 2000s had already pursued such interventionist policies<sup>8</sup>. Thus, the departure from the neoliberal suit started before the crisis both in

Hungary and Poland. The tendency can be regarded as a general political and societal reaction to the far reaching application of neoliberal policies. It revitalised the deeply embedded social appreciation of various forms of state paternalism that was depressed during the first decade of ECE's transition.

Increased state intervention in the economy is currently referred to as 'economic patriotism' (Clift & Woll, 2012; Naczyk, 2014). Clift and Woll (2012) clearly differentiate classic 'economic nationalism', the roots of which go back to Adam Smith and Friedrich List. For further analysis we can use the definition of economic patriotism given by Clift and Woll (2012, p. 308) as follows: 'We define economic patriotism as economic choices which seek to discriminate in favour of particular social groups, firms or sectors understood by the decision-makers as insiders because of their territorial status'. The concept of economic patriotism can include a wide range of state intervention including liberal economic policies that are applied selectively (Helleiner & Pickel, 2005). The novelty of present day economic patriotism over old-fashioned economic nationalism is that it is a response to the reconfiguration of economic governance and market interdependence. Governments became creative to assure traditional economic policy objectives with new means. In Europe, they can today transfer particular objectives from the national to the supranational level. Deregulation and liberalisation may itself serve the creation of new types of discrimination (Levy, 2006). Deregulation is not limited to removing restrictions, but also their replacement with active reregulation that can be designed to promote particular outcomes. Economic patriotism represents a shift from classic protectionist trade barriers to indirect measures, such as discriminative product and process standards or state subsidies (as part of overall aid policy).

As shown above, practices that gave rise to the concept of economic patriotism are not new. They characterise all market economies not just ECE countries. New is the way of openly selling the idea and thereby entering deliberate conflicts with international organisations. Some Western governments also pursued policies that openly contradicted the EU's liberal competition policy rules, for instance. These clashes could usually be interpreted as political messages to the electorate that lacked serious intention of realisation. ECE governments have taken similar actions, but on a much larger scale and with different intent. They are aware of the difficulties arising from such measures' implementation under the current EU framework; nevertheless, they aim to send political messages to both their electorate and Brussels. Moreover, certain unlawful steps are introduced to achieve an intended effect but are withdrawn before fully realised. The number of new non-compliance actions undermine classic market economic institutions and erode the rule of law in these countries.

Another important purpose of economic patriotism in ECE is the reconfiguration of power relations. In this sense, the practice of the Hungarian and Polish governments goes beyond the rationale described above. The Hungarian case shows that selective measures have been applied to favour particular agents. This stands in contrast with the notion that economic patriotism uses distributive measures to favour territorially determined groups of actors. The aim of such steps is not the conveyance of a general backing for the broad citizenry, but the promotion of selected clients and members of the local loyal elite.

The application of covert protectionism is occasionally justified with the historical, albeit not repeatable in today's context, success stories of the classic East-Asian



developmental state. An important characteristic of this model was establishing regulated competition on a protected internal market first, and opening to the world market in the second phase. However, the patronage state kills market competition all together, because domestic clients are protected from foreign and domestic competition alike. Without competition, economic agents will solely rely on maintaining good relations with their patrons and do not enter the trying path of innovation and activity sophistication. The result is declining competitiveness, deteriorating product and service quality, decreasing income generation, as well as overall impoverishment. The concept of economic patriotism never negated competition's role as a driving force in market economies. The Hungarian example cannot be regarded as an example of economic patriotism, because the patronage state eliminated competition. Moreover, this practice can also be regarded as corrupt in case measures granted to businesses are then compensated.

'What they call corruption is practically the main policy of FIDESZ. I mean that the government set such goals like the establishment of local bourgeoisie, building of strong Hungary's pillars on the countryside or in industry ... This is a political viewpoint, truly a mystification of the word corruption' (András Láncki, president of Századvég Alapítvány – the home-grown think-tank of FIDESZ; Láncki, 2015). This statement clearly identifies the two contradicting views on current 'economic patriotism' in Hungary. Critiques do not necessarily agree that open or covert protectionism is useful for the society as a whole, but the kind of patronage that hampers competition under this label has nothing to do with national interest. It serves group, party or even personal interest. Several cases of ECE governments' actions run the risk of corruption. Before going into the empirical details, it is necessary to describe the ECE system of crony capitalism and patronage that opens up the way for corruption.

### **3. The creation of political monopoly, a system of patronage and new forms of paternalism in the economy**

The dominance of the polity over the economy – i.e. business capture – is made possible by the monopolisation of political power. In order to maintain political monopoly, governments which were led by 'business-firm' parties in ECE countries begun rolling back democratic political institutions. Kornai (2015) describes the process of dissolving democratic institutions in Hungary. The Hungarian case can be regarded as an archetype, since the distinguished majority of the governing party allowed the government to fundamentally change the legal system. The constitution was rewritten and passed by FIDESZ MPs' 'voting machine'<sup>9</sup> in the parliament. Less powerful majorities in other ECE countries (Poland, Romania) did not have the same opportunities to alter the legal system, according to their interests. In Hungary, the executive and legislative branches were essentially fused and became controlled by the governing party through changes in personnel. This applies to the constitutional court, the state audit office, the fiscal council, the competition office, the monetary council, the National Bank of Hungary, the ombudsman's office and the central statistical office. FIDESZ passed 88 bills up to a week after their introduction, during the party's four-year mandate between 2010 and 2014.

The new constitution was complemented by 32 so-called cardinal laws that can only be changed with two thirds of the votes in parliament (Kornai, 2015). The distinguished majority in parliament has allowed the governing party to change any law, whenever

required by its political or other (e.g. business) interests. Thus, people in power are now above the law. In several cases, laws were changed retroactively to justify unlawful, fraudulent actions of party members. All this seriously undermined the basic principles of the rule of law. Jurisdiction had also been put under party control: the Chief Prosecutor was chosen and appointed by the charismatic leader – Viktor Orban – and approved by the parliament’s voting machine. The prosecution service regularly rejects the investigations on fraudulent cases, where clients of governing party’s members are accused. Members of the Supreme Court were also selected and approved by the FIDESZ-controlled parliament. Members of the judicial colleges were also selected in a partisan manner: a new law reduced the age threshold of active judges from 70 to just 62, expelling the older less loyal generation from duty. Poland’s populist PiS government also introduced many of these measures recently.

The significant changes in the structure and personnel of the institutional system created centralised power structures, a pyramid-like vertical hierarchy with the charismatic leader (and few of his college-mates) at the top. Below him stand unconditionally loyal executors of the patron’s will. Every level of the power pyramid is then filled by people chosen for their loyalty to the regime. Only the charismatic leader at the very top does not depend on any superior and only the lowest level employees do not give orders to anyone. All others are incorporated into the hierarchy as both servant and master. They all aim to maintain their positions or move further up on the hierarchical ladder. They are not elected, but their positions depend on winning and maintaining the trust of their superior by uncritical obedience. This is the typical structure in all Hungarian public services. A robust system, because it builds on the fear of those that are most dependent on it.

Properly working democracies have a double control system. Besides the inbuilt checks and balances (legally incorporated control devices), civil society organisations also play an important role. But NGOs are regarded by the FIDESZ government as public enemies. FIDESZ-controlled mass media launched a massive campaign stigmatising them as enemy agencies of foreign powers. Masters of the hate rhetoric were not disturbed by the fact that many of the affected institutions were sponsored by Hungarian NATO- or EU-allies. No distinguishing nuances regarding their scope of activities were differentiated either: NGOs in the field of poverty reduction, education, preservation of the Hungarian cultural heritage were treated in the same manner as anti-corruption organisations. Any support that came through uncontrolled channels was suspicious. The stigmatisation of foreign-sponsored civil society organisations was reinforced through legal actions as well<sup>10</sup>.

Viktor Orbán’s almost unlimited political licence was used to the destruction of democratic institutions and massive brainwashing in Hungary, in order to cement his and his mates’ political leadership and establish autocracy in the country. This continued despite the loud, but rather inefficient protest of local opposition and the international community. Unfortunately, similar tendencies and practices emerged in other ECE countries as well, indicating that there might be a kind of common systemic similarity in the region (weak democratic institutions and historical precedents of autocracy). The process of destruction was less pervasive in Poland, mainly because of the Polish government’s limited power. Nevertheless, the PiS government openly declared that it would love to carbon copy the Hungarian antidemocratic development pattern (Budapest in Warsaw, Naczyk, 2014). Błaszczak (2017) provides a comprehensive listing of the antidemocratic measures taken by the Polish PiS government that show considerable similarity with the

Hungarian government's measures. The Polish constitutional court and the judicial system at large, the competition office as well as the Polish financial supervision authority were weakened when their scope of action was curbed and key positions were filled by cronies of the government. The Hungarian example was also copied through actions against the free media, the weakening of NGOs and in the centralisation of public services from local governments to nation-wide institutions (health, education, and utilities).

Destruction of the rule of law and public support of corruption is present in other ECE countries as well. In the case of Romania, for example, Tudorel Toader Minister of Justice suggested the firing of Laura Codruta-Kövesi, president of the Romanian Anti-corruption Prosecution (DNA) in February 2018. One of the main objections against her was DNA overstepping its role, when she initiated prosecution with regard to the passing a government decree in January 2017 that lifted prosecution control on corruption cases valued at less than RON 200.000 (EUR 50.000). In essence, this amendment of the penal code meant a quasi-legalisation of small-scale corruption. Other objections included her non-loyal behaviour and the accusation that her actions caused the defamation of Romania abroad. The Romanian president first rejected the minister's request, but a few months later Codruta-Kövesi was dismissed by the Romanian president.

Hungarian and Polish governments were also active in demolishing market economic institutions, most importantly the rule of law, which they replaced with a patronage system. An important field of action in this regard was state property management. Previous research has pointed out that privatisation logic's reversal aimed to achieve the transition process' opposite (Błaszczuk, 2017; Baltowski & Kozarzewski, 2017; Kornai, 2015; Szanyi, 2016a). In the 1990s, privatisation was not only reinforced to create responsibly acting market agents but to reduce the state sector to prevent the survival of paternalistic links between business and polity (Szanyi, 2016a). The reversal of privatisation's logic meant an ambition to increase the size of the state sector so the system of patronage could capture a larger part of it. We call this ambition business capture. In general, business capture has devastating effects on property right enforcement and the rule of law. As Rapaczynski (1996) emphasises that state property management practices and governments' track record concerning private property (especially forbearance from encroachments) plays an outstanding role in strengthening the soft social institution of property right enforcement (obeying the law). Expanding the state sector sends a bad message to the market, especially if it is achieved by curbing private property rights. This is exactly what has happened on mass scale in both Hungary and Poland (Błaszczuk, 2017; Baltowski & Kozarzewski, 2016, 2017; Kornai, 2015; Mihályi, 2015; Szanyi, 2016a, 2016c; Voszka, 2013).

The Hungarian government declared privatisation completed in 2008 (Hungarian Government, 2009), although substantial state ownership remained in place. Therefore, the statement could be also understood as an intention to give way for nationalisation. Indeed, this happened sporadically until 2010 and then on a larger scale under the rule of the FIDESZ government. The asset value of re-nationalised property was large, but still a magnitude smaller than assets privatised after 1990. Assessing a list of re-nationalisations (Mihályi, 2015, p. 17) shows that between 2010 and 2014, 209 companies were affected and the total value of the transactions was slightly over 1573 bn HUF (cca. 5 bn Euro). This amount included sales price paid to previous owners, increases of share capital and other commitments as well. The numbers and amounts seem to be very high especially, if we consider that Hungarian governments accumulated excessive public debt already prior to

2008–2009 crisis. However, as Mihályi (2015) explains, these transactions did not increase state gross debt, since they represented a change in the asset structure, a kind of securities swap for more liquid assets. The list of transactions shows that the overwhelming majority of the financial commitments stemmed from transactions in the energy and banking sectors (1366 bn HUF, or 4.5 bn Euro), with the large number of the affected companies boosted by numerous small saving banks (137 financial institutions altogether).

Various political aims explain re-nationalisation. The first large transaction was the nationalisation of the second pillar of the pension system at the turn of 2010/2011. The official narrative suggested that the pension savings were not secure and did not yield the expected returns in the hands of the private pension funds; therefore, they had to be redirected to the first, government-controlled, pillar. Account holders of private pension funds were instructed to withdraw their deposits and channel these savings to the state pension system. 2,8 million acted accordingly, with deposits moved adding up to approximately 3000 bn HUF (10 bn Euro) or the equivalent 10% of Hungarian GDP. The risk they face is losing their pension rights in the pay-as-you-go state pension system. Most observers believe that the 'voluntary' nationalisation of private pension funds was aimed at using the obtained assets for debt relief (which was partly accumulated by financing the social security system).

Several transactions and regulatory changes were taken under the umbrella of limiting utility costs. FIDESZ promised savings on utility costs as a major part of its campaign tool in both 2010 and 2014 election campaigns. The government prohibited price increases of public utilities. Later, prices were reduced by government agencies – eliminating profits from this sector. This was the first measure that directly affected the profitability of private businesses. New taxes were later introduced on financial transactions, mobile telephone calls, ATM cash withdrawals and advertisement revenues of the media, amongst others. All these actions undermined the profitability of affected companies. Owners soon felt encouraged to sell their loss-generating assets. The process is referred to as regulatory taking: company revenues dry up, because of unfavourable changes in market regulations or excessive taxes. Many privately held utility firms were thus sold to central or local public bodies, with some of them receiving generous compensations (for example, the German RWE).

In 2013, the government applied regulatory capture again, when the deposits of local financial cooperatives were targeted. First, the state increased the level of compulsory deposit levels. Since the small banks could not meet the new obligation overnight, the state itself provided them with the necessary capital and connected this transaction to the acquisition of a controlling share of ownership. Owners of the small banks were not asked beforehand but were provided an ultimatum if they were to reject the offer. In 2014, the Hungarian state acquired MKB Bank from its German owners. The German parent bank was unwilling to operate its subsidiary at losses and sold it to the only serious buyer: the Hungarian state. The losses were, however, caused by various negative changes in the business environment initiated by the Hungarian government (extra tax on banks' profits, tax on financial transactions and through the restitution of those indebted in Swiss-Francs). Later that year FHB Bank was purchased by the Hungarian Post, increasing national ownership to over 60% of bank assets.

The nationalised utility firms were in foreign ownership, and the regulatory takings against them heralded a third important consideration that seems to have explanatory

power: unfriendly relationships with selected foreign companies. The Hungarian governments repeatedly enacted market regulations and changed the tax system, curbing revenues of large multinational firms and thus creating more favourable conditions for domestic capital owners. Nevertheless, this sentiment was targeted towards certain types of companies: financial institutions, media firms, large retail chains and telecom companies. Governmental communication explained their negative treatment by suggesting that these firms did not contribute to the material (real economic) production platform of the Hungarian economy. This kind of populist confrontation with various sectors has not been used since the beginning of the transition process.

The rather grave list of nationalisations and anti-market measures taken by the Hungarian government can be continued with similar cases in other ECE countries. The Polish government's aim to increase the size of the state sector and curtail the activity of multinational businesses was very similar. Moreover, actions such as confiscating the second private pillar of the pension system, introduction of sector-specific extra taxes affecting mainly multinational companies, regulatory capture in the case of public utility service providers were copied (Błaszczuk, 2017; Baltowski & Kozarzewski, 2017). Baltowski and Kozarzewski (2016) also state that minority shareholding resulted in effective state control in a fairly large number of Polish firms, alongside those where the majority was acquired. According to their estimations, in addition to state-owned enterprises (SOEs), state-controlled firms increased state influence by a further 50%. Moreover, state control is significantly higher in big business, making state positions even more influential (Baltowski & Kozarzewski, 2016, p. 416).

#### **4. Business capture and changing forms of rent-seeking**

Material rents stemming from political power positions occur in all political systems. The extent of the rents, as well as channels of rent-seeking depend on the efficiency of political and social control and democratic institutions. Their role in a modern political democracy is to curtail prevailing private (or closed group) interests over societies. Strong control institutions are important because they limit the opportunities of rent-seeking; political competition increases its political risks. However, this does not entail the elimination of drivers. The transition process in East Central Europe could be interpreted as a competition for the redistribution of economic power. Privatisation meant the redistribution of existing assets, a process designed and executed by state institutions. It was the first main area of competition for personal wealth-generation through state agencies in transition economies.

In this setting of 'competition state' the 'comprador elite's' material wellbeing and enrichment was based on the existence and strong influence of multinational companies. Salaried positions on firms', their advisory background institutions' as well as in banks' boards and in their management were provided. Business and administrative positions were filled and there were regular exchanges of personnel between administrative and business positions (Drahokupil, 2008). The main beneficiaries of this setup were the segments of the elite which supported multinational business to gain influence in ECE countries. Mainly ideologically liberal parties took this role, but other larger parties that did not refrain from liberal policies also became involved. The other main grouping of parties – the conservative-nationalist and Christian-democratic parties – preferred

strengthening the national bourgeoisie and typically did not enter the 'comprador elite'. 'Business firm' parties of ECE usually supported the nationalist agenda.

There is some empirical evidence indicating that politicians and clients in various countries took the positions on corporate boards and advisory committees. Of course, it is much easier to take controlling positions in state-owned companies. It can be regarded as general practice to change not only the supervision but the complete management of SOEs after changes in government. Skuhrovec (2014), for example, reported peaks of personnel change in Czech SOE supervisory boards after election years. This practice on the one hand eliminates the conflicts between management and politicians but also provides an opportunity to milk the SOE through various channels. An SOE is fit for this purpose regardless of its potential efficiency. The social cost of this practice is not just foregone profits, but continuous cash flow is injected from various state institutions (i.e. the state budget) that are transferred from the SOE to private uses. SOEs may finance various social and cultural events, deliver red carpet treatment to politicians, donate to charity organisations or support various activities of the government and politicians. SOEs are also used for the rewarding politicians' clients, by financing expert fees, amongst others.

Main areas of rent-seeking thus shifted from property acquisition and tunnelling, or entering the interest sphere of multinational business popular in the 1990s' privatisation to controlling and running enterprises. As it was shown in the previous section, the privatisation logic was reversed during the 2000s. Slowing privatisation in Poland and nationalisations in Hungary aimed to maintain and expand the influence of the party-controlled state, while ensuring rent-seeking from SOEs.

In this period, state ownership served the enrichment of elites that previously did not join the 'comprador elite group'. Of course, the decline of available state assets to be privatised also contributed to this. Assets that remained in state hands by the late-2000s were mostly notorious loss-making companies (like mines in Poland) that were not worth insider ownership. Another part, was large service providers that could not be easily transferred to rent-seeking private hands but were very much suitable SOEs for mass scale milking.

Stark and Vedres (2012) provide an interesting and detailed empirical study intended to elaborate party-dominated companies' external networks in Hungary. In earlier papers, Stark called attention to the possibility of previous SOEs' incumbent managements' survival and the transfer of their economic power into new business forms through informal networks (Stark, 1996; Stark & Bruszt, 1998). This concept was changed in the light of new empirical findings: the dominant networks of the 2000s do not pose a political threat of systemic reversal. The new networks, even if they are controlled by former SOE's managers or communist party members, work in a manner where they are embedded into the then new economic environment. The spread of partisan firms alongside SOEs is a new development, stemming from politicians and their clients directly controlling significant parts of private business. This sector is also used for rent-seeking.

The survey of Stark and Vedres (2012) was conducted with data including 1696 large and medium-sized companies in Hungary for the period between 1987 and 2001. Party members and clients took controlling positions in less than 10% of firms at the eve of systemic transformation (1989), but this number steadily grew to almost 20% by 2001. In terms of capitalisation, the share of politicised firms grew from less than 10% in 1989 to

over 40% in 2001. The authors differentiated between the political influence of the then competing main coalitions (right and left) and found that after elections, winning parties' influence accelerated and losers' declined. However, the magnitude of the fluctuation declined over time, becoming less dependent on government changes. In my interpretation, this meant a marked shift from control over SOEs, towards privately owned companies – the management of which remained largely immune from political changes. However, this phenomenon needs further analysis.

During the first decade of transition in post-communist ECE economies, democratic and market institutions evolved, business systems and political systems were largely separated, albeit they influenced each other. Firms competed for capital, labour, suppliers and customers, parties competed with each other in democratic electoral system for political power in order to fulfil their programs. The main assumption of this view (the 'legacy concept' elaborated by Eyal, Szelényi, & Townsley, 1998; Stark, 1996; Stark & Bruszt, 1998) was that increasing sophistication of the two institutional systems will lead to declining business-polity interaction that was regarded a main risk of the systemic change, a potential route from 'plan to clan' instead of 'plan to market' (Stark, 1991). The clan-concept returned in the analyses of the transition during the 2000s, but in a completely different setting (Sallai & Schnyder, 2015; Stark & Vedres, 2012). Business-polity relationships intensified and featured new characteristics: increasing political and material rent-seeking, polarised character, large-scale personal entanglement, coevolution of political and economic structures. I call this new type of relationship party business capture rather than a clan economy. The business capture concept better reflects the dominance of political parties over significant parts of the economy (Yakovlev, 2006).

Despite the political consensus in the 1990s of developing democratic institutions based on competing political parties and a market economy based on free competition (the 'competition state') the coevolution process of the two systems soon directed the attention of both business and polity to potential alliances. The concept of sharply separated fields of business and polity was undercut in the two spheres. Business needed insider knowledge and government support in its competition to grow its markets (e.g. in public procurements). Meanwhile, polity needed funds for party financing, election campaigns and rewarding political allies and clients. The coevolution process meant a development of occasional transactions towards long-term alliances. While the economic and political fields remained institutionally separated, firms and parties became organisationally entangled.

In Hungary, during the first period of the transition, the relationship was dominated mostly by business (Sallai & Schnyder, 2015). This was the heyday of the 'comprador elite', with a strong role also played by multinational business. Stark and Vedres (2012) also show that struggle over dominance of SOEs became a less significant way of combining political and economic power by the end of the 1990s. Besides multinational firms' influence, partisan private firms started to capture the lion's share of politicised business in Hungary during the 2000s. After 2010, the Hungarian government started to increase government control over multinational business as well. In an attempt to split the strong representation of foreign firms and undermine their political influence, the Hungarian government introduced selective advantage and disadvantage measures (Szanyi, 2016b). In many cases, measures introduced intended to support allied Hungarian partisan firms' market positions against foreign-owned competitors (e.g. in retail trade and banking). But

selected multinational firms were also treated as 'friendly business'. The 'strategic partnership program' of the Hungarian government re-established the lobbying platforms of selected foreign firms. In exchange, the government requested support for politically important programs.

Business-polity relationships of the 2000s have been increasingly dominated by partisan business in Hungary. The emergence of partisanship led to business' increasing politicisation: political parties captured business and the conversion of state power into economic power. The economy – like the political arena – became increasingly polarised. Cooperation patterns among partisan firms followed political alliances in the system of business capture: firms of political allies conduct business with each other, but not with firms of the opposition (Stark & Vedres, 2012).

Wedel (2001) distinguished between two qualitatively different stages of business capture in Central and Eastern Europe. The return of state capitalism in this part of the world was linked to a more profound transformation of the state and the underlying party-driven elite structure than in cases of other regions and periods (e.g. models of the developmental state in South-East Asia or authoritarian regimes in emerging states). In the first stage, informal groups take over certain functions or collaborate with state authorities, but the group is not synonymous with authorities. This relationship can also be classified as state capture: state authorities work under the influence of business interest groups. Wedel's second stage 'clan state' is one where certain clans (interest groups) are so closely identified with particular state authorities or institutional segments of the state that 'the respective agendas of the government and the clan become indistinguishable' (p. 11.). The 'clan state' is controlled in most obvious cases by a charismatic leader and their subordinated political allies grouped in political parties (typically in business firm parties). The concept of 'clan state' corroborates with Schoenman's concept of the patronage state (Schoenman, 2014). Both concepts describe various aspects of business capture.

The 'clan state' as a form of business capture can be the product of the business-polity coevolution process, beginning with largely independent actors working on meeting mutual interests. If polity dominates the relation, political interest is expressed through personal and largely informal pressure. The political support that once independent firms wished to obtain may transform into a golden cage. 'Firms have to be "locked into" this golden cage of political ties to survive, but these ties allow the state at the same time a close control over firms' (Sallay & Schnyder, 2015, p. 5.). This process was also described through Russia's example by Yakovlev (2006). But state (party) control over firms can also be developed intentionally: many of the partisan firms were established to serve various rent-seeking purposes. New forms of rent-seeking require loyal partisan firms.

When privatisation and other forms of state asset appropriation were exhausted, new forms of elite enrichment were discovered. These forms were bound to existing and functioning business entities; that is, rents stem from operational as opposed to capital transactions. Since the number of SOEs could hardly be expanded (despite of nationalisations in Hungary), party-controlled private business took the lead in obtaining rents. New forms of rents were bound to ongoing business activity: much of them could be realised in legally undisputable ways through means of 'legal corruption' (Kaufmann & Vicente, 2011). Legal corruption is based on a broader definition of corruption, which includes transactions that may not be illegal. This includes public actors' transactions which serve private interests at the expense of the public interest.



Public procurement through partisan firms became a form of rent-seeking after the ECE's accession to the European Union. Up until then, structural policies used mostly fiscal measures, providing supported industries and companies tax holidays on both state and local levels. The most well-known example of this tool kit was investment promotion policy (Antalóczy, Sass, & Szanyi, 2011). Tax measures can alter competitive positions on markets, but they are rather 'governments' tools'. They redistribute future incomes, which in most cases would not exist otherwise. Redistribution of existing incomes – that is financial support schemes – spread on a mass scale only after 2004 when ECE state policies were streamlined with the *acquis* of the EU. The preference of financial support meant an opportunity to redistribute real money. Simultaneously, EU structural funds were opened for the new member states greatly widening potential financial sources.

Party-controlled firms, for example, could be filled with public procurement orders if tender conditions were formulated in specific ways. Limiting competition or even the complete elimination of it in public procurement tenders is a frequently used tool of legal corruption in Hungary (Fazekas, King, & Tóth, 2013). There is ample evidence of market share in the case of companies participating in public procurement tenders (op. cit. 76.o.). This reflects the changing preferences of the political leadership for particular clients' firms (for details see: Sallai & Schnyder, 2015). The analysis of EU sponsored projects in Hungary showed that 33,8% of contracts signed between 2009 and 2012 received only one bid (no competition). Furthermore, 17,7% of contracts were modified after being granted, offering a mode to extract rents (Fazekas et al., 2013, p. 78.).

Further empirical evidence of partisan firms' increasing activity in public tenders was collected by Tóth and Hajdu (2018). Their database consists of 126 330 contracts for the years between 2010 and 2016. The presence of potential corruption was indicated by several independent measures. The first of them was the number of contracts involving a single bidder. The share of such contracts fluctuated between 20% and 40%, with the highest values occurring in the election years (2010 and 2014). The index of a relative price drop (achieved price reduction via competitive bidding) was marginally low in at least half of all cases and showed a significant drop from 2010 onwards. This data did not only reflect an ever-decreasing efficiency of tenders but also indicates growing corruption: winners regularly provided bids, the prices of which only slightly differed from the estimated contract value. This is interpreted by the authors as insider knowledge of tender conditions.

Tóth and Hajdu (2018) paid special attention to the activity of four groups of firms that were related to/owned by the family members of the Hungarian prime minister or their trustees. The four interest groups won 510 contracts (0,4% of the total) worth of HUF 2,5 bn (5,1%). The authors' model showed that corruption was higher than the already high average in the case of this interest group. Intensity of competition in tenders was lower and the relative price drop was negligible. The negatively perceived impacts of business capture were strongest in the business related to the highest political levels.

## 5. Conclusions

This paper stresses that the current deviation from democratic political system and competitive market economy in ECE has several indigenous and historic reasons. In this sense, it can be regarded as a rather common feature of the ECE model of capitalism. The continuous shuttling between Western democratic values and autocracy has always been

a central political problem of the region. The transition process introduced a Western-style liberal path during the 1990s, mainly because there was a fundamental social and political consensus in the region that saw the guarantee of making the political transition irreversible in this policy. During the 2000s this belief lost influence, moreover, there was a general discreditation of the neoliberal paradigm due to 2008–2009 world economic crisis. Democratic institutions and the liberal market economy's appeal declined in ECE countries after the Great Recession.

In the political sphere, business-firm populist parties' political support increased. The "mass elite" behind them does not share ideological values but has developed rather eclectic conceptions of political and social development. Their main interest (like other political parties') is to prolong their political and economic influence for as long as possible. But by doing so they change the democratic institutional system of checks and balances, while trying to dominate all social and political spheres: legislation, the executive branch, jurisdiction, mass media and the economy. This paper analysed the modes of economic dominance.

Economic dominance is based on party business capture, but it is closely linked to dominant positions in polity as well. Policies are pursued and regulations are altered to free partisan business from unnecessary competition. This activity is frequently explained on the grounds of economic patriotism and the classic model of the (East-Asian) developmental state. I argue that blocking competition entirely and applying selective measures to political clients cannot be misunderstood as economic patriotism. This is rather the establishment of patronage state instead of a competition state. The main aim of business capture is rent-seeking.

ECE's autocratic regimes and party business capture lead to an economic (and perhaps a political) dead end. In the globalised world, the lack of competitiveness quickly erodes incomes that will manifest sooner or later in declining living standards, an inefficient economy and a horrible dictum of increasing dependence on global markets. Today, ECE autocratic regimes' economic performance is not bad, thanks to the widespread activity of highly competitive multinational business and the massive EU transfers that keep these economies running. In the case of Poland, a rather sizeable independent national bourgeoisie also helps stimulates the economy.

By the time of writing of this manuscript, Hungary – the archetype country of illiberal democracy – was preparing for new parliamentary elections. The stake of the elections was the further creation of a patronage system in the illiberal democracy as well as the further concentration of political and economic power in the hands of the patron and his allies. Political and social control over the monopolisation of power has been drastically weakened during the past 8 years. The FIDESZ-KDNP alliance won 2018 elections with a two third majority again, conveying illiberal democracy's stable position in Hungary. The election results showed similarities with the Brexit referendum in Britain and the last US presidential elections: main supporters of the authoritarian regime and its populist, paternalistic election promises, were those with below average welfare conditions and low levels of education: the losers of globalisation.

## Notes

1. The term was introduced to political science with pejorative connotation by Fareed Zakaria: 'Democratically elected regimes ... are routinely ignoring constitutional limits on their power

- and depriving their citizens of basic rights and freedoms ... we see the rise of a disturbing phenomenon in international life – illiberal democracy’ (Zakaria, 1997, p. 22).
2. Estonia, Latvia, Lithuania, Poland, Slovakia, Czechia, Hungary and Slovenia, in 2007 Romania and Bulgaria.
  3. Szalavetz introduced the term ‘low value capture trap’ of the ECE countries. This meant that ECE region occupied the least knowledge-intensive sections of global value chains that created below average income levels. Unfortunately, the spread of local activities alongside the value chain added new activities with equally depressed new value-generating potential, hence the term ‘low value capture trap’.
  4. Previous attempts to identify features of ECE capitalism tried to subordinate and categorize these countries according to the various existing types of capitalist systems (based on Hall and Soskice’s seminal work, and their followers) and paid less attention to figuring out region-specific features (e.g. Bohle & Greskovits, 2007, 2012; Farkas, 2011, 2016; Lane, 2005). Inclusion of the role of the state was reduced mainly to the quality of governance and securing macro-economic stability: factors of competitive business environment (e.g. Bohle & Greskovits, 2007).
  5. A comprehensive volume with many country case studies on direct state intervention is forthcoming: Szanyi (2019).
  6. The term ‘comprador service sector’ or ‘comprador elite’ refers to local managers, experts, representatives of international organisations, politicians working for or supporting multinational business in ECE host countries (see: Drahokupil, 2008).
  7. Despite this, Cisar (2017) reported that trust and appreciation of democratic institutions in Czechia has been also low allowing the populist ANO to win the support of especially the young generation voters on 2013 elections. Similarly to Poland and Hungary, traditional parties also lost much of their popularity due to serious corruption scandals.
  8. A most striking action was the introduction of ‘Lex MOL’, an amendment of the commercial code that changed corporate governance regulation in order to help the Hungarian oil company repel the takeover ambitions of the Austrian competitor ÖMW. The legal changes were passed in a rare mutual agreement of government and opposition.
  9. MPs univocally co-vote following the instructions of the fraction leader.
  10. For further details on how Viktor Orbán has destroyed democratic institutions and established his system of patronage in Hungary see: Kingsley (2018) or Kornai (2015).

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