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THE EMERGENCE OF PATRONAGE STATE IN CENTRAL EUROPE

THE CASE OF FDI-RELATED POLICIES IN HUNGARY

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Abstract

Despite of profound development success of Central European economies of the past 25 years Hungarian and Polish governments have started openly query the applicability of various elements of the "competition state". They took measures to curtail the activity of multinational firms that have played important role in the successful modernization process of the region. The paper makes an attempt to explain the rationale of this policy using political economy approach. It defines economic policy changes as shifts in the power relations of national elites. It is highlighted that the selective advantage and punishment measures taken are labelled economic patriotism. Yet, economic patriotism is interpreted in this paper as the application of covert discrimination policies applied for the benefit of spatially defined interest groups. The discussed policies are targeted rather at closely defined companies. They are therefore not regarded as tools of economic patriotism but rather of state clientism, or a departure from competition state towards patronage state.

JEL classification indices: D72, H82, P16, P31

Keywords: multinational companies, economic patriotism, elites, patronage state

Introduction

Central European transition process has been earmarked by the strong penetration of multinational business, especially in the Visegrad (V4) countries[3]. The role of foreign capital in establishing state-of-the-art manufacturing industry and service sector was seen as systemic element with remarkable historical background for the region, mainly

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[3] Poland, Czech Republic, Slovakia and Hungary

on the territory of the former Austro-Hungarian Empire (Szanyi, 2003). Another rationale of the powerful presence of multinational business was the unfolding globalization process. Markets became global. Global competitiveness depended on the successful combination of traditional comparative (local) advantages and new, company-bound competitive advantages. These later ones could be most readily offered by investments of multinational firms. The combination of various competitiveness factors is reflected in the most commonly used FDI theory, the Eclectic Paradigm by John H. Dunning (1988, 2001). Nowadays technologies, large factory and batch sizes enable firms to build regional centers. Production facilities need not be repeatedly established in neighboring countries. First movers of the region, countries which opened up their economies early obtained significant advantages in FDI attraction. Today we may declare that multinational firms became stable and progressive elements of V4 economies.

It is therefore rather surprising that the strong presence of multinational business has become a political issue in V4 despite of rather successful FDI attraction records. Political debates on multinational business have intensified and (populist) conservative parties have called for action against their spreading influence. This is most visible in Hungary and Poland. The debates are usually heated by anti-globalist sentiments, strong criticism is articulated, benefits are neglected. In order to conceptualize this trend the phenomenon can be formulated as an expression of economic patriotism (Clift and Woll, 2012; Naczyk, 2014). This interpretation states that (populist) conservative political elite would like to modify the group of winners of the transformation process. However, international competitiveness still depends on the performance of multinational firms, moreover, international institutions continue to safeguard important achievements of liberalization in world trade and factor flows. The room for open protectionism is therefore still restricted: the application of new, covert forms has become more common. This practice is reflected in changing Hungarian and Polish state policies towards multinational business. These new policies also mean a departure from the concept of competition state and shift towards patronage state[4]. I argue in this paper

[4] The term competition state is taken from Drahokoupil (2008) and refers to liberal state policies allowing full penetration of global competition on domestic markets. The term patronage state is applied after Schoenman (2014), and refers to the importance of personal business-polity linkages in shaping

that the kind of economic patriotism which has been applied currently in Hungary and Poland runs against the risk of killing sources of dynamic economic efficiency by limiting not only global but also local competition.

In the remaining part of the paper I first introduce the concept of economic patriotism as a form of business-polity relationship, highlighting the role of business elites and their networks. In the second part of the paper I provide empirical evidence of changing FDI-related policies from Hungary to illustrate that these policies can be interpreted as a special form of economic patriotism. I introduce in this part also results of an empirical survey that was conducted among multinational firms that signed strategic partnership agreement with the Hungarian government. These long-term cooperation agreements were conducted with selected multinational firms working mainly in manufacturing industries. The impact of this bilateral cooperation network will be evaluated together with restrictive policies against other multinational firms. The final part concludes.

Economic patriotism and changing power relations of elites in CEE

Shifts in FDI-related policies in Hungary and some other CEE countries (especially the V4) can be discussed from the political economy viewpoint. I interpret these changes as modifications in the business-polity relationships. In this regard three main strands of literature are applied in this paper. The first draws on the evolution of elites during the transition process, the second analyses the role of networks in business-polity relationships. The third approach combines the former two in a broader context and discusses the emergence of economic patriotism and clashes with the two decade long reigning neo-liberal economic thought as a power shift in political and economic elites. In this paper I will use mainly the Hungarian example to illustrate tendencies that might have a more general Central European application. Yet, more research has to be done to work out details of similar processes in other countries[5].

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economic policies, a strong, general curtailment of competition on local markets with the dominance of polity over business through the usage of selective advantage measures (business capture).

[5] Some of this work has already been done and published in the literature that I will also use in this paper.

In order to investigate the shift of FDI-friendly economic policy towards a more low-key sometimes even hostile stance of the Hungarian government it is necessary to discuss briefly the starting point. In earlier papers I argued that the FDI-led economic development path that Hungary and other CEE countries took in their transition process had historic roots and was reinforced also by the urgent restructuring and modernization needs due to global competition. This later statement, however should not necessarily be taken as given (like an imperative of the globalization process) but can be conceptualized as a deliberate policy to capture economic and political power in CEE countries. I believe that in the case of Hungary FDI-led development was coded by the antecedents of the time of systemic transition starting in 1990. Such determining factors were the economic reforms of the planned economy, heavy debt burden that pushed privatization towards the sales method, severe undercapitalization of firms and the weak domestic bourgeoisie (Szanyi, 2003). Although transition background and policies differed in other CEE countries, development of V4 economies converged towards FDI-led development model regardless of the differences. The dependent market economy (DME) model of Nölke and Vliegenhard (2009) conceptualized and criticized this development path. Based on this background I feel inclined to look after various policies that first intended to help multinational business dominate V4 economies later tried to reduce this dominance.

Elites

CEE transition process was designed by an interplay of local political forces and the international advising institutions the recommendations of which stemmed from neo-liberal concepts. The aim of shaping social processes mainly supporting the emergence of local bourgeoisie was an important aspect of the transition process. Liberal concepts of ownership change and the role of privatization emphasized the political impacts of the process. The reduction of state property was regarded as crucial element in institution building mainly because of its role in reducing chances of surviving paternalism between managers of state owned enterprises and politicians at various levels (Boycko et al, 1996; Rapaczynski, 1996). The liberal concept emphasized the liquidation of incumbent management’s power position in order to make transition process irreversible (Friedman and Rapaczynski, 1996). Concerning the practical implementation the general concept did not make strong recommendations e.g. in favor of foreign investors. Therefore, privatization practice varied among CEE countries. Yet, privatization was a key issue of the transition process in all transition countries.

Political economic approaches of the privatization process soon directed attention to the empirical fact that incumbent management's influence and economic power could not be eliminated (Stark, 1996; Stark and Bruszt, 1998). Nevertheless, fears of reversing transition process proved to be unfounded. Instead, new power networks evolved that included old and new players in the economy and in polity as well. New types of alliances were set up, new elites were created. While penetration of multinational business was very quick in transition economies' markets, local companies' and entrepreneurs' adjustment process lagged behind (Szanyi, 1996). Therefore, market power shifted very quickly away from local firms to foreign companies. Foreign penetration increased to unusually high levels.

This process of economic restructuring was also reflected in relationships between business and polity. Both foreign and domestic business organized itself into various interest groups. Drahokoupil (2008) analyzed the emergence and impact of the new elite around foreign-owned companies. He regarded this elite as the ultimate winners of the transition process in CEE, especially in the V4 countries (as compared with the position of the incumbent technocratic-managerial elite and the new entrepreneurs). He called this elite "foreign investors with their comprador intellectual allies", and claimed that "the domestic comprador forces rather than their foreign allies had … a major role in domestic politics" (p. 361). The rise of this sector was intertwined with the consolidation of the "competition state" the main aim of which was the insertion of the local economy into the structures of global capitalism. It is important to note, that the "domestic comprador elite" bound to foreign investors need not be a proprietor class[6].

[6] Drahokoupil (2008) characterizes the FDI-related elite, the „comprador service sector" and its recreation as follows: „I characterize the domestic actors linked to FDI as the comprador service sector… (It) comprises various groups providing service for foreign investors. It includes local branches of global consulting and legal advisory firms and their local competitors, companies providing other services to foreign investors and officials from FDI-related state bodies. This group is comprador as it is structurally dependent on transnational capital, whose interests it represents. Structurally, this sector is not a bourgeoisie, as it constitutes neither a propertied class nor a professional managerial class….(Its) links to foreign capital can be characterized mainly by the Weberian notions of 'market capacity' and 'income

Based on the "strategic-relational state theory" (Drahokoupil et al. 2008) argues that the social relations of production, institutions and ideas constitute "a (strategically selective) environment that provides advantages to some actors and certain strategies over others" (p. 363). If this environment is determined by one or another type of elite the advantages will be received by actors bound to the given ruling elite.

The dominance of one or another elite may or may not be politicized and bound to parties in power. In this regard we find observations for both solutions. Drahokoupil (2008) argued that the political support of the competition state went beyond party divisions in CEE. Thus, the connected "comprador elites" might work under the rule of various political parties. Post-crisis experience showed a more partisan approach towards foreign investors in some CEE economies, most importantly in Hungary and in Poland. Schoenman (2014) on the other hand made the type of business-polity connections conditional to political and economic uncertainty, and the strength and degree of organization of networks (lobbying platforms). According to him all three above mentioned elites may or may not act in non-partisan ways in relation with polity, depending on their level and strength of organization and the level of political uncertainty of the ruling parties. In this approach the dominance of a certain type of elite may be challenged when determinants change. Moreover, Schoenman (2014) found different patterns of business-polity cooperation in the various CEE countries. We come back to this issue later.

Local business has developed representative organizations, but also direct links between businesspeople and politicians persisted over time. Incumbent management of pre-transition state-owned enterprises as well as petty entrepreneurs formed local business. Some analysis of the Hungarian business elite showed that most influential entrepreneurs have had some kind of pre-transition career, either as party members and chief or second line managers of SOEs or petty entrepreneurs (Laki, 2002). It also turned out that local entrepreneurs could not keep pace with the dynamic development, superior technological and market competences and wealth of multinational

class'….the comprador service sector helps to translate the structural power of transnational capital into tactical forms of power within the states…The structural power of capital is derived from the dependency of the state and society at large on the investment decisions (p. 366-7) This type of dependency is fundamental to the DME model of Nölke and Vliegenhart (2009) too.

competitors (Laki and Szalai, 2013). Typically, influential Hungarian entrepreneurs participated in various service businesses (trade, logistics, hotels, business services, gambling, etc.), real estate development, construction and banking, much less in manufacturing. They maintained good personal relationships to politicians and frequently became also officers of various parties. Therefore, the representation of Hungarian business towards polity was much more based on personal linkages then on representative organizations.[7]

Be it a temporary or long lasting phenomenon, business-polity elites do whatever they can in order to stabilize their privileged positions. State and corporate functions of the elites are integrated through personal ties, institutional channels, material benefits and recruiting patterns. There is a frequent personnel exchange between business, polity (state, regional and local administration) and supporting institutions (consulting firms, developing agencies, law offices, etc.). Many persons hold several positions in various areas. Interactions between the state and business are usually institutionalized. Due to important agency problems the flows of material benefits between government and business are also frequent, giving way to rent seeking and corruption. Last but not least, personal careers usually combine positions in the various areas of business-polity interplay. The recruitment system gives preference for broader professional experience including both business and government positions. While Drahokoupil (2008) provided evidence on the establishment of FDI-based elites in various CEE countries, other authors described similar process featuring local business (Schoenman, 2014; Naczyk, 2014; Stark and Bruszt, 1998; McDermott, 2002).

[7] The career of Mr Gábor Széles is a good example of this. Up till 1990 he was president of Műszertechnika Coop, a small firm producing electronic devices for the Hungarian market. His firm was one of the two lucky Hungarian companies who could form a winning coalition together with Svedish Ericsson for the tender producing electronic switching centers for the Hungarian wired telephone network in 1992 – that is before the apparence of the cellular services. Despite of the opportunity Műszertechnika could not establish itself as a significant player in electronics. Thus, Mr Széles tried lobbying for another less technology and innovation intensive activity and could participate in the privatization process of the large Hungarian bus producer Ikarus. He could also acquire the large Hungarian electronics firm VIDEOTON. Neither of these projects proved to be successful in the sense that the original industrial activity could not be maintained. Both companies serve today mainly as real estate development agencies and component producers. Széles used to be a high-ranked official of MDF the larger right-wing coalition member party of the first Hungarian government after 1990. Széles' is today also owner of a right-wing oriented media network.

Networks

Elites exercise influence through personal contacts and also using communication platforms of business networks. Depending on the main message of their study, authors describe particular sets of business networks. Drahokoupil (2008) highlighted the FDI-related networks and emphasized FDI-dependency. Naczyk (2014) interpreted the sharp turn in the orientation of government policies in Hungary and Poland from FDI-support towards local business preferences. He described therefore mainly local business networks and mechanisms of polity-local business interplay. TIH (2014) drew attention to the fact that after 2010 the then new Hungarian government closed the usual communication interfaces towards multinational business in its effort to thwart FDI dependence. Simultaneously, it allowed local business interest groups to exercise more influence on government decisions. I believe that networks and communication platforms are always important channels of business polity communication, however, participants may have different access to them over time. The intensity of platforms' usage may also depend on the political stance. If governments need more support for example due to their weaker political power relations they may rely more on networks and supporters.

As far as the concrete analysis of FDI-related networks is concerned, Drahokoupil (2008) provided an interesting comparison of the V4 countries. The networks are operated by different types of organizations. State agencies for the promotion of foreign investments, regional development agencies are most influential from the side of the state especially in Hungary and the Czech Republic, less so in Poland and Slovakia. In Slovakia the Ministry of Economy and the Governmental Assignee for Development of Automotive Industry (in the years 1997-2003) established themselves as centers of representation of FDI-bound elites. Where state institutions are less active business associations play major role. In Hungary the American Chamber of Commerce (AmCham), the Hungarian European Business Council (HEBC) the Joint Venture Association (JVA), the British Chamber of Commerce in Hungary and the German-Hungarian Chamber of Industry and Commerce are the most influential organizations. They are also backed by diplomats of foreign embassies establishing powerful lobby organizations. The membership of the associations is not closed, thus they also integrate firms with other national background including Hungarian companies. Major international consulting firms have strong presence in V4 countries too and act as hubs of the "comprador service sector". It is important to emphasize that even more senior positions in afore mentioned firms and organizations are frequently filled by local managers. A similar pattern of representation has been observed in Poland and Slovakia. In case of Hungary two main associations played a role in shaping institutionalized forms of local business-polity contacts. The Hungarian Chamber of Commerce and Industry is an association representing Hungarian small business. The National Association of Entrepreneurs and Employers represents Hungarian big business. Both organizations proved to support the actual governments, nevertheless, they both gained more in terms of influence with right-wing governments. This is due to traditionally bigger emphasis of these governments on local business support, which has always been openly declared and implemented in various policies during the transition process. Therefore, we may conclude that the two important business elites in Hungary always had partisan linkages to polity.

According to Naczyk (2014) Poland's local business representation proved to be partisan, and the various organizations shared the political spectrum. The liberal Civic Platform has had close links with PKPP Lewiatan, the country's largest employers' association. And although the Polish Chamber of Commerce (representing small business) has not developed strong political ties, on personal level its leaders had good contacts to the Civic Platform. The now ruling Polish party Law and Justice (PiS) had good contacts to the Sobieski Institute a think tank that organized the "Poland Great Project" an action plan to support Polish local business. Naczyk also provided anecdotal evidence that representative organizations did not only lobby for members' interests but intervened in political campaigns directly.

Schoenman (2014) compared Polish, Rumanian and Bulgarian experience with business-polity exchanges. He found that these were more institutionalized in Poland, than in the other two countries where even if formal representative organizations existed, they were overshadowed either by wealthy businesspeople (oligarchs) who used them to lobby for their own business interests, or by influential politicians. He also claimed that broad networks (with substantial membership) were less partisan and thus their lobbying power was larger in any political setting than personal contact-based lobbying. Business-polity networks that are based on the activity of broad representation can lobby for "broadly distributive" advantages in exchange for political support. Narrow networks where personal contacts play dominant role create "selective advantage" institutions and distribute benefits to targeted recipients who are among the supporters of the ruling political party.

Schoenman (2014) states that this dichotomy of business-polity network structure works differently under high or low levels of political uncertainty. When political uncertainty is high and polity needs the (material and moral) support of business a broad cooperation, kind of concertation characterizes business-polity relations. In case of high uncertainty and narrow networks influential oligarchs may capture the state (like pre-Putin era Russia or Bulgaria). Political uncertainty is usually high in transition economies, nevertheless, there may be periods of lower uncertainty (like in Hungary after 2010 or in Rumania during the 1990s). Under the low uncertainty environment broad business networks may engage in new corporatist cooperation with the state. However, if business is less organized polity may dominate the relationship and pick the winners of selective advantage measures. Schoenman calls this patronage, but the term business capture (see: Yakovlev, 2006) can be also applied for this setting.

We may conclude here that the organizational network of business-polity relation differs to a large degree among CEE countries. Meanwhile business representation has formal institutions in each of these countries, their membership, bargaining power, embeddedness varies. Multinational business' representation is usually strong and well organized – in those countries where FDI has been strong. Local business representation's characteristics are very different and are shaped by local political, economic and social development factors. They are definitely less effective than FDI-based elites' representation, and are usually less broad and often partisan. Besides them personal business-polity relationships may be also important, in some countries even determining, giving way to business- or state capture positions.

The emergence of economic patriotism

FDI-bound elites dominated the first two decades of transition in CEE even in countries of less significant FDI stock. The neoliberal concept was reinforced by the international advising community that favored well established multinational players against weak local companies, investors or interest groups. The classic concept of free competition and its general impact on overall well-being determined transition policies with correction in favor of local institutions and infrastructure development. Massive financial and knowledge transfer has flown to the CEE region that largely contributed to the modernization process of these countries. The CEE region especially the V4 countries became integrated part of the European economic space (the Single European Market). The level of integration can be regarded as extraordinarily high. Foreign penetration is dominant not only in market supplies, but also in local production. The share of foreign owned (mostly multinational) companies is over 50 % in the majority of economic sectors in terms of production, investments and exports. This high foreign share was regarded excessive by many observers. Szentes (2005/6) wrote about unhealthy asymmetric interdependence, Nölke and Vliegenhart (2009) developed the "Dependent Market Economy" concept in the framework of the Varieties of Capitalism literature. Yet, economic policies remained crucially influenced by neo-liberalism until the financial crisis of 2008.

The crisis delivered extraordinary shocks to most developed market economies that needed rapid crisis management steps of various kinds that did not fit into the neo-liberal concept framework but rather into a neo-Keynesian one. Many forms of increased state intervention were applied temporarily (nationalizations, cash transfers to bail out important firms), others remained in place for longer run (e.g. demand stimulation through increased public spending). However, even in the worse days of the crisis governments refrained from the application of "classic" protectionist policy tools like devaluation of currencies or export restrictions. This fact reflected the different level of todays' world economic integration compared with the times of the Great Depression, as well as the accumulated policy experience gathered since then. Thus, we may conclude that crisis management practice itself remained influenced in many areas by the neo-liberal concept. Many of the temporarily applied steps were withdrawn since then.

However, many governments in CEE countries have gone against the current and did not limit increased state economic intervention but rather continued and even increased it after crisis shocks eased. Most striking examples are Hungary and Poland. Hungary entered open conflicts with a series of policies that run against various EU regulations (mainly competition policy). Also Poland was reported to have undertaken steps that aimed strengthening statist policies in the field of state property management for example. And many of these steps were taken already by the Civic Platform dominated government after 2010 (Naczyk, 2014). The new right-wing populist PiS government just continued and expanded these policies. Mihályi (2015) highlighted that in certain delicate issues social-liberal Hungarian governments of the 2000's also pursued interventionist policies[8]. Thus, the departure from the neo-liberal suit started before the crisis also in Hungary. These facts allow me the conclusion that in some CEE countries politicians have started questioning the dominant neo-liberal policy agenda in general, and have increasingly favored interventionist policies. The tendency can be regarded as a kind of reaction to the far reaching application of neo-liberal policies that produced strong dependencies in economies that started from direct state control at the beginning of the transition process.

Increased state intervention is currently referred as "economic patriotism" (Clift and Woll, 2012; Naczyk, 2014). Clift and Woll (2012) make a clear distinction against classic "economic nationalism" the roots of which go back to Adam Smith and Friedrich List. The main difference lies in the limited toolkit of economic patriotism. This means, governments do not go back to outright protectionist measures but use covert tools to positively discriminate domestic players or they use liberalization measures selectively. The aim is reinventing control over open markets. The term itself was first used in 2005 by Dominique de Villepin then French prime minister who called the defense of local prerogatives in integrated markets 'economic patriotism' (Clift and Woll, 2012). They

[8] Most striking action was the introduction of „Lex MOL", an amedment 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 scarce mutual agreement of government and opposition.

also state that the conflict of pursuing the special political economic interests of citizenry under conditions of complex economic, legal and regulatory interdependence has started well before the 2008 financial crisis. Having no exclusive control over large parts of economic governance, facing deepening international trade and competition policy regulation governments “had to become creative with policy strategies”.

I 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 favor of particular social groups, firms or sectors understood by the decision-makers as insiders because of their territorial status. Economic patriotism entails a form of economic partiality: a desire to shape market outcomes to privilege the position of certain actors. Unlike economic *nation*alism, economic patriotism is agnostic about the precise nature of the unit claimed as *patrie*. It can also refer to supranational or sub-national economic citizenship.” An important feature of this approach is that it uses territorial references of political economic space in the definition rather than policy content. Thus, it can handle a wide range of state intervention including also liberal economic policies that are applied selectively (Helleiner and Pickel, 2005). The novelty of present day economic patriotism over old fashioned economic nationalism and mercantilism is that it is a response to the reconfiguration of economic governance and market interdependence. Governments had to become creative to assure traditional economic policy objectives with new means. They can today transfer their particular objectives from the national to the supranational level. For example the EU can reinforce liberalization within the EU for the sake of protection towards the outside. On national and sub-national level we can distinguish between the defense of existing local production advantages and the creation of these in the process of integrating markets.

Paradoxically, liberalization, deregulation may itself serve the creation of new types of discrimination (Levy, 2006). Deregulation involves not only removing restrictions but also active reregulation that can be designed to promote particular outcomes. The need for re-regulation provided politicians new means to continue influence over the economy to get territorially beneficial outcomes. As Clift and Woll (2012) state economic patriotism represents a shift from measures of classic protectionist barriers to trade to more indirect measures like discriminative product and process standards or state subsidies (as part of overall aid policy). Alternatively practice may also prefer selective liberalization in strategic sectors or the introduction of competition rules that prohibit standards common abroad and other restrictions. These forms of protectionism cannot be easily detected and their usage had spread parallel with mass-scale liberalization process (e.g. within WTO negotiations) already during the 1990s.

CEE relevance

As is seen from the above analysis, the roots of the practices that gave rise to the concept of economic patriotism are not new, moreover they characterize all market economies not just CEE countries. What is really new is the way of selling the idea more openly taking deliberate conflicts with safeguarding institutions of the neo-liberal concept. Occasionally, other governments also pursued policies that openly contradicted e.g. EU's liberal competition policy rules. Clift and Woll, (2012) interpreted these clashes as political messages to the electorate that lacked serious intention of realization. We can see similar attempts but on rather mass scale from the Hungarian and more recently from the Polish governments. They are aware of the impossibility of the implementation under the current EU framework regulations, nevertheless they would like to send political messages to both their electorate and Brussels. Yet, the amount of the new non-complient measures can seriously undermine the classic market economic institutions and erode the rule of law in these countries.

The other, more important purpose of economic patriotism is a real reconstruction of power relations. In this sense the practice of the Hungarian and Polish governments goes beyond the rationale described in the above definition of the term. The Hungarian evidence shows that selective advantage measures have been applied to favor particular agents. This is in contrast with the notion that economic patriotism uses broadly distributive measures in favor of territorially determined group of actors. The aim of such steps is not the general preference of citizenry but the promotion of selected clients: selected members of the local elite that were considered losers of power competition of the transition process. Thus, this policy practice supports only a predetermined part of the local bourgeoisie.

This aim is more likely to be achieved if the new (local business bound) elite has no strong organizations. Our previous analysis showed that local business associations in Hungary were rather weak, especially when compared with the lobby platforms of foreign investors. Moreover, their leadership has always been politically determined, thus these organizations could not strongly enforce interests of their members. Weak, politically influenced networks, strong personal linkages of influential business people with polity makes Hungarian business elite an easy prey of the state. The usage of selective advantage measures does not serve the elite's interest as a whole but only selected clients. This practice cannot be regarded an example of economic patriotism. The concept of economic patriotism is rather used as a politically good selling label for predator practices of the state.

The application of covert protectionism is sometimes justified with the historical (today not repeatable) success stories of the classic East-Asian developmental state. However, an important element of these was regulated competition on protected internal markets first and on global markets later. The system of patronage state kills market competition all together. Clients are protected on domestic markets from unfriendly foreign and domestic competition alike. Without competition however, 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 will be declining competitiveness, deteriorating product and service quality, decreasing income generation and overall impoverishment. The concept of economic patriotism (neither economic nationalism nor mercantilism) never ever negated the role of competition as driving force of market economies. The political practice of the patronage state in Hungary eliminates competition and cannot be regarded therefore as an example of economic patriotism.

Empirical evidence from Hungary

Hungary is a small open economy, which started the transition process from socialism to the market economy in 1989. The establishment of minority foreign ownership in form of joint ventures was legally allowed under communism already in

1972, and a USD 400 million large stock of investments had been accumulated until 1989. Moreover, regular contacts to world markets and to foreign firms allowed the accumulation of some network capital in the Hungarian economy that became an important lever of Hungary's internationalization process. More significant volumes of FDI started to arrive to the country after 1991 when privatization process was directed towards sales to foreign investors. When privatization process decelerated at the end of the 1990s large scale greenfield investments started to upheld yearly FDI inflow levels in the range of EUR 3-4 billion. Later on also the expansion of existing capacities gained momentum. This is shown by the increasing share of reinvested profits in the source structure of FDI stock increment (Antalóczy et al, 2011).

Traditionally, FDI statistics has been provided from the balance of payment figures of the countries. This source became rather problematic after the year 2000 but especially from around 2010. FDI flow figures became mixed up with capital flows of "special purpose entities", moreover temporary capital flows were also reflected. The problem has been recognized internationally (UNCTAD) and figures were cleaned also by the Hungarian National Bank. However, despite of the cleaning procedure international and also timely comparisons remained rather difficult and less reliable than earlier (Antalóczy and Sass, 2015).

Despite of this, Hungarian FDI statistics clearly demonstrate the outstanding role of foreign investments. During the years of the transition process most of the largest multinational companies established direct presence in Hungary in the form of an affiliated company. Foreign presence has been especially strong in the automotive and electronics industries of manufacturing, in retail trade, banking and financial services, telecommunication, media. These are typically the most globalized businesses. The establishment of Hungarian affiliates in them reflects the fact of successful integration of the Hungarian economy in global production networks. I regard this development as a key determinant of structural development, technological modernization, investment activity and economic growth in Hungary.

Positive and negative impacts, criticisms of the FDI-led development model

The strong influence of multinational companies in the Hungarian economy can be illustrated by several figures. They have contributed much to national investments[9] creating a massive body of highly productive manufacturing and services base. The uneven spread of FDI is very much visible too. In certain hot spots like Komárom, Győr, Székesfehérvár, various parts of the larger Budapest agglomeration new industrial districts have been created or old ones renovated. Foreign companies produce 70 % of manufacturing production, 48 % of manufacturing employment. Their share in retail trade, banking and financial services, telecommunication is also exceptionally high. Since foreign firms especially those in manufacturing are partners in international value chains they by definition are export oriented. Over 80 % of total manufacturing export is delivered by the foreign owned sector. In other V4 countries foreign ownership participation is similarly important.

[9] The other main source of investment financing was EU transfers. Hungarian national sources' share was rather small.

Table 1. Share of foreign owned companies in sales, employment and gross investments in Hungary (selected economic branches, %)

	2008	**2012**
sales		
manufacturing	64,9	69,0
energy supply	74,4	67,5
trade	44,6	45,4
infocommunication	62,7	67,7
total non financial	50,1	53,3
financial	53,8	70,1
employment		
manufacturing	44,0	47,7
energy supply	51,5	51,9
trade	21,5	24,0
infocommunication	29,8	37,0
total non financial	23,8	26,1
financial	46,9	45,1
gross investments		
manufacturing	67,8	78,3
energy supply	61,6	65,0
trade	49,4	41,3
infocommunication	74,2	79,0
total non financial	49,6	55,3

Source: Central Statistical Office

We can evaluate the strong presence of multinational business in various ways. My standpoint regards the development trends of the whole transition period up till now. Compared with the starting point the current economic structure of Hungary is more developed with high share of high- and upper medium-tech manufacturing production and highly efficient services sector. I sincerely doubt this extraordinary change in economic structure would have been possible to be achieved without the strong investment activity of foreign firms. It is important to see, that global markets are dominated by firms who are present also in Hungary. Entry barriers of global markets are extraordinarily high, penetration is extremely difficult even for the most innovative small firms. True, there are some success stories of East-European born global companies, like Hungarian Graphisoft or Prezi as well as Estonian Skype. However, they all work on rather small market segments, and were sold to multinational big businesses when their further expansion to broader markets required large scale investments. Inserting V4 economies into the system of global value chains is hardly imaginable without the effective role of global players of the markets.

On the other hand, we can see clear drawbacks as well. The strong presence of multinational firms produced dual structure in V4 economies. Foreign firms have relatively few contacts to local companies along their main production activity. Local suppliers usually do not enter their value chain. The reasons of this are manifold. Firstly, existing technological cooperation links in the value chain are not likely be replaced by new entrants because of the high costs of entry. Secondly, local firms attained technological capabilities, financial and logistics capacities for cooperating with global business only gradually. At the moment of FDI penetration of the V4 economies local firms were not fit for cooperation (Antalóczy, et.al., 2011). Nevertheless, the scope of essential contribution by local firms to the global value chains started to increase after 2000. Due to the 2008/9 crisis and recession thereafter cost cutting considerations became even more important that moved multinational firms towards more intensive local sourcing. V4 countries launched support programs to enable local firms to cooperate with multinational companies (Kalotay, K. – Sass, M., 2012).

Another important widely discussed issue is the extent of positive externalities stemming from multinational firms (spillover effects). Most studies tried to measure the externalities using various measures of productivity, assuming that the aggregate impact of spillovers will increase productivity of local firms. The results have been mixed and not very convincing. A meta-analysis of the related literature stated that a larger part of the findings supported the idea of measurable productivity increase (Iwasaki and Tokunaga, 2014). There are methodological and also logical explanations of the lacking positive results (Szanyi, 2002b).

Other critics of the FDI-based development model drove attention to systemic problems that could be far more important than the low level of positive impacts. Nölke and Vliegenhart (2009) wrote an important paper in which they tried to conceptualize the CEE economic model (DME model). They picked out the role of foreign direct investments in shaping the structure of the establishing market economies of the V4 countries. They argued that the high share of multinational companies in the production and trade of these economies strongly influenced the development of some other economic and social sub-systems as well. Their impact on national innovation and education systems was negative, because their operation did not need high-end inputs from these systems. Furthermore strong bias was exercised on a variety of national policies, since multinational companies' tax reliefs deprived governments from financial tools, and also because their operation was largely independent from national policies.

But there has also been another, political criticism addressed to foreign investments and multinational companies' activities. Populist parties hoped to receive social support and votes in the elections with such criticisms. Terms like "luxury profits" of foreign firms, treatment of profit transfers as an attack against national property, predetermined expectations of tax revenues treated as justified claims of the state towards foreign firms earmarked the populist sentiments that were articulated in Hungarian and Polish mass media. Similar statements served as moral justification, political and social support for unfriendly changes in regulation and tax policy. This meant that political expectations of sharing a bigger part of the potential benefits of global economic integration were enforced by measures that reached beyond the usual action sphere of policies and market institutions.

Hostile actions in Hungary

While the main focus of the Hungarian government was set after 2010 on supporting domestic business ventures, the strongly imbedded Hungarian economy continued relying on the activity of multinational firms. The populist political attacks were targeted against selected branches and even companies. Critical arguments (when applied at all) lost their general character when they were translated into policy measures. The

Hungarian government defined a group of companies that were not treated friendly, meanwhile other companies and branches received further (mainly political) support[10].

Banks and financial institutions were repeatedly accused of unfair practices towards customers. They were also thought to realize above average profits. Foreign presence in the Hungarian banking sector was unusually high (80 %) that also annoyed the government. Actions were taken to change all this. The Hungarian was one of the first governments to introduce sector-specific extra taxes (on turnover and on transactions). Besides this banks had to bear much of the costs of the compensations of private debtors with (non-performing) foreign exchange debt. These changes in the regulation and new taxes brought banks into red when they still had problems with recapitalization after the 2007/8 financial crisis. Owners of private pension funds were accused with the low level of returns by the government. Pension claims were then "secured" by the government when the second pillar of the pension system, that is claims of private pension accounts coming from the compulsory insurance system were taken and rechanneled to the pay-as-you-go firs pillar state pension system. Most affected financial institutions were foreign-owned in both cases.

In 2014 the Hungarian state acquired MKB[11] Bank from the German owners. The German parent bank was unwilling to run the Hungarian daughter at loss and sold 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, and by the process of restituting the private foreign-exchange debtors. The achievement of 50 % of national ownership presence in the banking sector was heralded soon after. Later that year FHB Bank was purchased by the Hungarian Post increasing national ownership to over 60 % of bank assets.

Retail trade chains and other trading companies, firms in the telecommunication and energy sector as well as media were also harassed by disadvantageous selective regulations, most importantly sector specific taxes and fees in Hungary. In order to save

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[10] Documents of various government officials' media communication on the ideological differentiation between „good, productive" and „bad, speculative" business are analized by Mihályi (2015) and T. I. H. (2014).

[11] Magyar Külkereskedelmi Bank Rt: Hungarian Foreign Trade Bank Co., its previous owner was the Hungarian affiliate of Bayerische Landesbank until 2014.

local business from the effect of the new taxes specific selection rules were applied. In case of the tax on broadcasting advertisement for example, high level turnover threshold was fixed so that the tax affected only one major foreign owned medium[12]. A larger number of transactions and regulatory changes over a longer period of time was undertaken under the umbrella of limiting utility costs. The promise of savings on utility costs was a major campaign tool of the 2010 and 2014 election campaigns. The government prohibited price increases of the public utilities already in 2010. Later on prices were set by government agencies at significantly lower levels than before thus eliminating profits from this sector. This was a measure that directly affected the profitability of private business. Limiting utility costs through price decrease resulted in companies going into red. Owners soon felt encouraged to sell their loss-making assets. This process is regulatory taking: company revenues dry up because of unfavorable changes in market regulations or excessive taxes. Many of the utility firms were thus sold to central or local public bodies. Some of them received quite generous compensations (for example German RWE)[13].

Selected advantage measures – the strategic partnership program

In order to make a formal difference between favored and punished firms Hungarian government signed strategic agreements with a number of foreign companies. The process started in the summer of 2012 when macroeconomic situation of Hungary worsened. GDP fell, investments by major business ventures were postponed. The sluggish business conduct of large firms could not be counterbalanced by supported SME activity. The Hungarian government decided to encourage the activity of selected multinational firms with the declaration of partnership. Up till September 2015 60 such strategic agreements were signed, out of which 54 partners were foreign-owned company. The partners concentrated in three major manufacturing branches: electronics, automotive- and pharmaceutical industries. According to the Transparency

[12] Government communication explained the measure with suspected tax evasion of the company. Yet, it was never explained if there was something illegal in RTL's taxation, then why was this not repared by the responsible state institution the tax office?

[13] It is of course another question if today's sales revenues are sufficiently high for the necessary investments? Observers state that public utility companies are still in extremely bad financial conditions do not invest any more, which may threaten the quality of their services.

International's calculations the contracts signed by mid-2014 covered firms presenting 18 % of manufacturing employment and 40 % of manufacturing exports, a significant share of Hungary's manufacturing base (TIH, 2014).

Agreements were initiated mainly but not exclusively by the government. There is a set of conditions that applies for big multinational business (5 years track record in Hungary, significant contribution to GDP production and exports, investments exceeding HUF 5 billion, contribution to employment – at least 1000 own employment, intention to increase job creation for skilled workers, participation in education -, at least 10 % local supplier input in production). The content of the agreements was rather uniform. Usually the intention of cooperation was declared in job creation, training and education, R&D, local supplier network development. No concrete measures of cooperation were included. Our previous analysis of FDI attraction policies pointed out that these areas used to be the main foci after 2004. Thus, the Hungarian government did nothing more in the strategic partnership agreements then reassured selected foreign firms about the possibility of the type of cooperation and support, which had been normatively expanded to all business players before 2010.

Survey results

T.I.H. (2014) analyzed the usage of selective policies from the viewpoint of lobbying. The main conclusion of the analysis was that policies of the Hungarian government increased uncertainty not only in the regulatory environment but also in the communication channels between business and polity. Though previous regulation on lobbying and control of corruption was also far from perfect, institutions with normative effect were curtailed or lifted (e.g. the law on lobbying), and arbitrariness of decision making increased. Instead of using official channels practice of lobbying became informal. Business representatives used special occasions like soccer games, social events to meet influential politicians. Representatives of "bad" as well as "good" business equally used the informal channels.

TIH's survey of the practice with the partnership agreements looked back on a period of less than two years in 2014. Therefore, most interviewees expressed their hopes that the new tool will serve a more efficient lobbying and communication with the Hungarian government. Some stated that signing the agreement was a symbolic gesture from the side of big business as well: companies expressed their good will despite of the unfriendly policies of the government. In that early period interviewees expressed their satisfaction with the fact that based on the strategic partnership agreement they could directly contact medium- or high level government officials, which was not possible between 2010 and 2012.

In Autumn 2015 a series of interviews with CEOs of strategic partner companies was conducted[14] by the Institute of World Economics. The aim of the survey was to collect firsthand information about the importance and practical application of the partnership agreements. Out of the then 54 foreign partners 12 were approached. All of them worked in manufacturing industries and nine had the necessary qualifications for the program, one was negotiating. Since TIH (2014) conducted another empirical survey in 2014 I also had an opportunity to check for timely development of the linkages (though answers were anonymous in both surveys, hence no panel comparisons could be made). Most interviewees expressed their hopes that the new tool will serve a more efficient communication with the Hungarian government. Yet, they were not expecting quick results from negotiations. Some of them were most skeptical stating that the PR value of the campaign was most important, and they even did not hope to receive any kind of concrete benefits. Others reported some kind of success or at least hoped to have positive impacts on success in public procurement tenders in future. Several mentioning was made on lobbying for easing some disadvantageous regulation. For example, firms felt strange the government-level expectation of having sizeable corporate social responsibility activity (sponsorship of sport clubs, financing sports infrastructure development).

Most firms seemed to have been engaged in the cooperation activities suggested by the partnership agreement anyway, and could not report on substantial extra government support on these areas either. In sum, we could confirm the major findings of T.I.H. (2014) one year later too. Most multinational affiliates used the strategic agreements as communication channel, a platform for lobbying. But the success of their

[14] The full transcript of the interviews was published in Szanyi (2016b)

lobbying efforts did not depend on the conditions or content of the agreement. In fact they mostly wanted to achieve results in areas that were not covered by the strategic partnership agreements.

Conclusion and interpretation of the research results

What does the dual treatment of domestic and foreign owned companies, and changes in the communication channels to business agents mean for the business model of Hungary? In another paper I argued that arbitrary involvement of the state in the ownership patterns of the Hungarian economy would bring important systemic risks (Szanyi, 2016). Basic market economic institutions like the security of private property regime and the rule of law can be seriously undermined if the government does not apply the laws consequently for his own transactions. The dual treatment of local and international business seems to be less dangerous practice. It is rather a different concept of regulation which is in conflict with competition policy principles. Yet, the ways how losers and winners are picked may also matter. The decline of normative regulation and preference of selective measures will deliver the wrong message to economic agents that their success will more depend on the development of their network capital than own business activity. Also, a danger of increasing corruption is bound to the process. This all may strengthen negative tendencies of the evolution of crony capitalism.

In my understanding crony capitalism means a legally uncontrolled (badly controlled) interaction between polity and business that works against the principles of free enterprising and fair competition. Policy makers and influential business people cooperate to create preferential treatment for “friendly business” in exchange for material support of parties, politicians, election campaigns. This type of cooperation is not unknown in developed economies, though a more developed institutional background and strong civil society control may limit the harmful impacts of cronyism on market economic institutions. If financial support of political parties is transparent and lobbying for industry (company) interests is institutionalized, than crony capitalism is under social control. It does not mean of course, that the markets are free of marginal interest enforcement. In case cronyism is not transparent and not controlled it may lead to very high social losses and even illegal transactions. A major difference between most of the established market economies and most of the transition economies lies in the level of institutional and social control of polity-business interactions. Loose control in transition economies deteriorates investment and business climate which is expressed in rather low level of rankings in competitiveness reports and high cost of financing.

State favoritism in Hungary ranging from public procurement to market regulation seriously contradicted normative regulation and violated the principle of equal treatment and EU competition law. For example, only in the first half of 2015 three major processes were launched in Brussels against the Hungarian government. Levy on retail trade supervision and tax on tobacco products were suspended, and grants for road construction were ceased to be transferred to Hungary due to ongoing competition policy procedures. In the first two cases tax policy measures were designed in such ways as to favor a selected number of politically linked agents. The public procurement cases were investigated because of unusually high prices, but road construction was regarded by observers also one of the main areas of patronage.

Selective advantages have been provided to clients and simultaneously, competitors of clients were frequently punished by unfavorable regulation. This is most clearly visible in the example of punishing representatives of multinational business by selective disadvantages (extra taxes, exclusive regulation), meanwhile other members of the same community were rewarded and included in the close circle of strategic partners of the Hungarian government. The simultaneous steps in the opposite directions can be interpreted as a deliberate policy aimed at splitting the established business networks (that of foreign companies/multinational business). Using Schoenman's typology, this is a move towards narrow networks and the patronage state (business capture), since political uncertainty is perceived very low by the government relying on 2/3 majority support in the Parliament.

These cases illustrate the departure from the "competition state" (Drahokoupil, 2008). The concept of illiberal state declines the free market system and democratic institutions. The above cases as well as the whole departure process from the Western values has been conceptualized in Hungary and is therefore regarded by the Hungarian government as a sovereign decision to establish a new economic system. Populist followers of the Hungarian agenda can be found also in Poland. PiS party openly declared his appreciation of the concept declaring that hopefully once there will be Budapest in Warsaw. But the essence of the opinion of Polish observers is that the concept of economic patriotism has already been introduced in Poland as well.

When compared the fundamentals of the FDI-led development model and the current policy changes in Hungary (with an eye on potential changes in Poland) my assumption is that FDI-lose economic development cannot be run without an important decline of international competitiveness. I am not even sure if the replacement or substitution of multinational business is technically possible at all even on the long run. But if yes, I do not think that such a change could be carried out without a significant drop in economic activity, income generation and living standards. Therefore, such an undertaking is also politically hardly feasible. Thus, I evaluate increasing cronyism not as fatal danger but rather as a factor that deteriorates economic performance due to less effort on improving business activity.

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