TRANSPARENCY INTERNATIONAL
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Corruption, Economic Performance and the Rule of Law in Hungary

Results of the Corruption Perceptions Index in 2018

Report of the Transparency International Hungary Foundation

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Contents

1. Relationship of corruption and economic performance in Hungary 4

1.1. Most recent results of the Corruption Perceptions Index.. 4

1.2. Relationship between corruption and the Gross Domestic Product 7

2. Beyond the Rule of Law - the privatisation of public authority 12

3. Systemic corruption in practice 13

3.1. Sale of residency government bonds: government travel agency for the corrupt 13

3.2. Corrupt public money pump: tax exempt corporate donations for sports 15

4. Public procurement and European Union funds 17

5. The media and corruption – distorted media market... 21

6. Summary: corruption, dismantling of the Rule of Law and crony capitalism in Hungary... 24

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HUNGARY

1. Relationship of corruption and economic performance in Hungary

1.1. Most recent results of the Corruption Perceptions Index

Last year the secretariat of Transparency International in Berlin compiled for the 24th time the Corruption Perceptions Index (CPI[*]), ranking the countries of the world based on the corruption exposure of the public sector. In 2018 Hungary scored 46 on a scale of 0 (most corrupt country) to 100 (least corrupt country), and ended up 64th in the survey covering 180 countries. Relative to the previous year's index, Hungary was able to improve its resistance to corruption by only two places and a single point, as indicated by the assessment of businesspeople and experts. While Hungary is in the mid-range internationally, it is among the most corrupt Member States of the European Union: last year only Greece and Bulgaria ranked below Hungary in terms of corruption. With its score of 46 in 2018, Hungary brought up the rear both among the V4 and in the group of countries that joined the EU in the 2004 enlargement round.

The report of Transparency International Hungary (hereinafter: TI Hungary) below first evaluates the results of the 2018 Corruption Perceptions Index in a broader context, then focuses on the assessment of Hungary to determine the reasons why Hungary, even though improving slightly in regional comparison, still shows an extremely poor anti-corruption performance.

Looking at the global results one finds that corruption in Hungary, as indicated by the CPI summarizing thirteen different surveys, is on par with that of the African island state of São Tomé and Príncipe and the Pacific country of Vanuatu (46 points each). In the anti-corruption fight Hungary performs somewhat below Cuba, Malaysia and Romania but slightly better than Greece, Montenegro and Senegal. To be fair, we should note that the comparison of countries with extremely different social, economic and cultural backgrounds may be misleading because expectations concerning the actions a particular country should take against corruption may be significantly different. Consequently, it is more expedient to look at the anti-corruption measures of countries in a longer timeframe, and to compare jurisdictions with similar institutions and shared cultural backgrounds. The comparison of EU Member States appears to be appropriate in all respects.

Within the EU, Hungary has stabilised its position at the tail-end. Indeed, the CPI data of the past six years reveal that even within the group of the most corrupt Member States, Hungary's

[*] The Corruption Perceptions Index (CPI) is prepared by the Secretariat of Transparency International in Berlin based on 13 surveys and analyses performed by 12 organisations. The indicators underlying the CPI measure corruption in the public sector by surveying the opinion of experts and businessmen on the corruption infestation of the public institutional system, the economy and society. Corresponding data was available on 180 countries in 2018, and Hungary was assessed based on 10 different sub-factors. TI defines the scores of the sub-factors on a scale from 0 to 100, and the CPI score of each country is calculated by weighting the average of the scores. In the Corruption Perceptions Index 0 marks highly corrupt countries and 100 those least infested. The detailed description of the CPI is available at: www.transparency.org/research/cpi/overview. CPI is based on the summary of the following surveys and studies: African Development Bank Governance Ratings, Bertelsmann Foundation Sustainable Governance Indicators, Bertelsmann Foundation Transformation Index, Economist Intelligence Unit Country Risk Ratings, Freedom House Nations in Transit, Global Insight Country Risk Ratings, IMD World Competitiveness Yearbook, Political and Economic Risk Consultancy Asian Intelligence, Political Risk Services International Country Risk Guide, World Bank Country Policy and Institutional Assessment, World Economic Forum Executive Opinion Survey (EOS), World Justice Project Rule of Law Index, Varieties of Democracy (VDEM) Project. The CPI 2018 figures for Hungary were composed from ten surveys; for obvious reasons, they do not include the figures of the African Development Bank Governance Ratings and the Political and Economic Risk Consultancy Asian Intelligence. The year 2018 survey does not include the indicators of World Bank Country Policy and Institutional Assessment either. Between 1995 and 2000 the CPI looked at an average of 50-80 countries; in the 2001–2005 period an average of 100-130 countries were reviewed, while since 2006 some 160-180 countries have been covered by the CPI survey. The number of countries reviewed was 175 in 2014, 168 in 2015, 176 in 2016 and 180 in both 2017 and 2018. Since 1995, Hungary has been covered by the CPI review each year.

performance has been deteriorating steadily. In 2012 Hungary was the 19th most corrupt member of the EU-27; since then it has followed a steady downward course and by 2017 its position plummeted to 27th, that is, next to last, in the expanded EU of 28 states.[1] While in 2017 Hungary exceeded only Bulgaria within the EU, in the 2018 ranking, with its improvement of a single score, it overtook Greece, which had shown a significant decline. In other words, last year Hungary was still the 26th most corrupt of the 28 Member States (See Table 1).

Table 1: EU Member States in the year 2018 Corruption Perceptions Index

RANK		COUNTRY	SCORE
1.	–	Denmark	88
2.	–	Finland	85
2.	↑	Sweden	85
4.	–	Netherlands	82
5.	↓	Luxembourg	81
6.	↓	United Kingdom	80
6.	↓	Germany	80
8.	↑	Austria	76
9.	–	Belgium	75
10.	↑	Estonia	73
10.	↓	Ireland	73
12.	↑	France	72
13.	↑	Portugal	64
14.	–	Poland	60
14.	↓	Slovenia	60
16.	↑	Cyprus	59
16.	↑	Czech Republic	59
16.	–	Lithuania	59
19.	–	Latvia	58
19.	↑	Spain	58
21.	↓	Malta	54
22.	↑	Italy	52
23.	–	Slovakia	50
24.	↓	Croatia	48
25.	↓	Romania	47
26.	↑	Hungary	46
27.	↓	Greece	45
28.	↓	Bulgaria	42

Source: Calculations of TI Hungary based on the 2018 figures of the Corruption Perceptions Index. The arrows in the figure indicate the direction of change of the score of the country in the Corruption Perceptions Index relative to 2017.

The improved score and corresponding ranking of Hungary is laudable; nevertheless, we cannot help noting that despite the slight improvement, Hungary ranks the lowest in terms of corruption both among the countries of the 2004 round of enlargement and the V4 states.

In the Central and Eastern European region (which includes 11 countries), Hungary's position worsened significantly in the past decade. In the years following our EU accession, Hungary ranked third in the region after Estonia and Slovenia, whereas now we are in the next-to-last position at the 10th place (see Table 2).

[1] A Korrupció Érzékelési Index 2017-ben – Korrupció, jogállamiság és gazdasági teljesítmény Magyarországon, nemzetközi összehasonlításban [Corruption Perceptions Index 2017 - Corruption, the rule of law and economic output in Hungary in international comparison]. Available at: https://transparency.hu/wp-content/uploads/2018/12/CPI_2017_narrativ_final_final.pdf

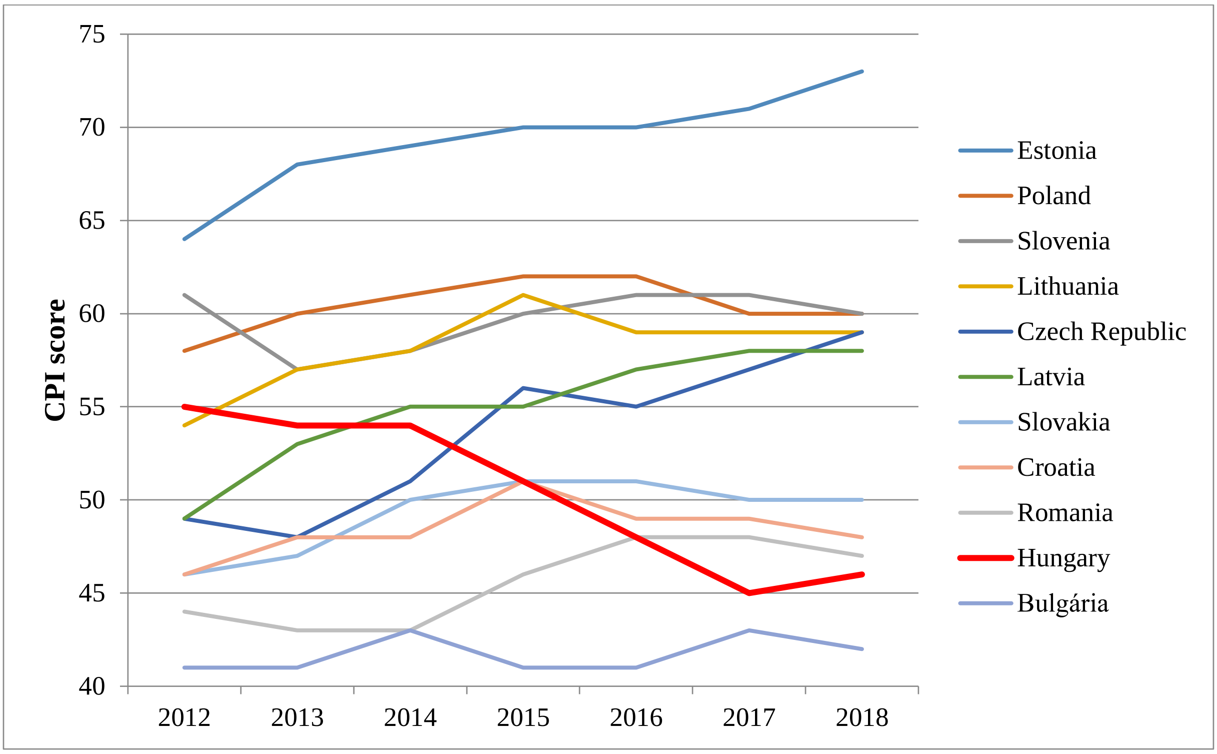
Table 2: Central and Eastern European countries in the 2018 Corruption Perceptions Index

Ranking within the region	Country	CPI 2018	CPI 2017	CPI 2016	CPI 2015	CPI 2014	CPI 2013	CPI 2012	Change in the score
1.	Estonia	64	68	69	70	70	71	73	**+9**
2.	Poland	58	60	61	62	62	60	60	**+2**
2.	Slovenia	61	57	58	60	61	61	60	**-1**
4.	Lithuania	54	57	58	61	59	59	59	**+5**
4.	Czech Republic	49	48	51	56	55	57	59	**+10**
6.	Latvia	49	53	55	55	57	58	58	**+9**
7.	Slovakia	46	47	50	51	51	50	50	**+4**
8.	Croatia	46	48	48	51	49	49	48	**+2**
9.	Romania	44	43	43	46	48	48	47	**+3**
10.	**Hungary**	**55**	**54**	**54**	**51**	**48**	**45**	**46**	**-9**
11.	Bulgaria	41	41	43	41	41	43	42	**+1**

Source: Calculations of TI Hungary based on the 2012–2018 figures of the Corruption Perceptions Index. The figure in the last column is the difference between the scores of the 2012 and 2018 Corruption Perceptions Index.

Between 2012 and 2018 Hungary's CPI score fell from 55 to 46, producing the largest drop in the perception of anti-corruption performance in the region in the past seven years. The Corruption Perceptions Index shows that in 2018 (just as in 2017), only Bulgaria was perceived as more corrupt than Hungary in the region. Hungary was the only Visegrád country with deteriorating corruption perception since 2012, while the Czech Republic, which started from a lower score, improved by 10 points during that period, and in 2018 it was ranked 38th, 26 places ahead of Hungary. Slovenia was the only other country in the region with declining perceptions of corruption in the period concerned, but the decline was by a single point, while Hungary scored 9 points lower in 2018 than six years before. The worsening regional position of Hungary is illustrated in Figure 1, showing the CPI scores of Central and Eastern European countries between 2012 and 2018.

Figure 1: CPI scores of Central and Eastern European countries between 2012 and 2018



Source: Calculations of TI Hungary based on the 2012–2018 figures of the Corruption Perceptions Index.

Even though Hungary is in the mid-range globally, and thus this range is the most relevant reference, it is worth looking at both the top and the tail-end when assessing the CPI results.[2] For several years now, the same countries have led CPI's global rankings – for instance, Scandinavian countries have always had top positions. In 2018 Denmark (88), New Zealand (87), Finland (85), Switzerland (85), Sweden (85) and Singapore (85) were front-runners. Apart from Singapore, which can be considered an "enlightened autocracy", democracy is well-developed in these countries, state institutions are impartial and inclusive, governments can be held accountable for their actions and public spending is transparent. This is why the fight against corruption is successful in these countries and this serves as the basis for their world leader position in terms of welfare. In 2018 North Korea (14), Yemen (14), South Sudan, (13), Syria (13) and Somalia (10) ranked at the bottom of the CPI list; these countries have performed poorly for many years. These countries are dictatorships or anarchies, and state institutions are unable to fulfil their role or do not even attempt to serve the public good. Corruption is extremely high, which is one of the reasons of flagrant indigence.

1.2. Relationship between corruption and the Gross Domestic Product

There are a number of international surveys, theoretical and empirical studies on the relationship between corruption and economic performance.[3] Corruption is the key sign of "bad governance", mostly going hand in hand with violations of the requirements of the Rule of Law.

[2] The figures in brackets after the countries listed indicate the CPI score of the country concerned in 2018. Higher scores signal lower levels of perceived corruption – the meaning of the score was explained in the introduction
[3] See for instance: De Vaal, Albert – Ebben, Wouter, „Institutions and the relation between corruption and economic growth." Review of Development Economics 15, no. 1 (2011): 108–123. https://doi.org/10.1111/j.1467-9361.2010.00596.x

Biased state institutions striving to fortify the power of the ruling elite tolerate or even encourage corruption rather than fight against it. This results in the ruling elite strengthening its power and society becoming even poorer, which violates the principle of equality before the law, erodes public confidence, leads to rent-seeking and harms the business environment. The worsening of the business climate may result in the decline of investments, which in turn undermines sustainable growth. This is how corruption is linked to the Gross Dational Product.[4]

The correlation between per capita GDP and levels of perceived corruption was strong in the European Union in 2018 as well (see Figure 2). As part of the less developed group of Eastern and Southern European countries, Hungary is among the Member States with severe corruption and low per capita GDP. This is true even though in the 2014–2017 period Hungary's gross national income has been growing continuously, rising from 105.5 billion EUR to 124 billion EUR in four years.[5] Based on the Q1-Q3 figures of the Hungarian Central Statistical Office, a GDP growth of close to 5 per cent is expected for the whole of 2018.[6]

Figure 2 also shows the performance of Hungary within the region. Of the Central and Eastern European countries, in the same league with us, the results of Slovakia exceed those of Hungary both in terms of per capita GDP and the effectiveness of the fight against corruption. Romania and Croatia are also ahead of us, with a slightly more modest GDP per capita but lower levels of corruption. Bulgaria is the only Member State that performs below Hungary in terms of both indicators.[7]

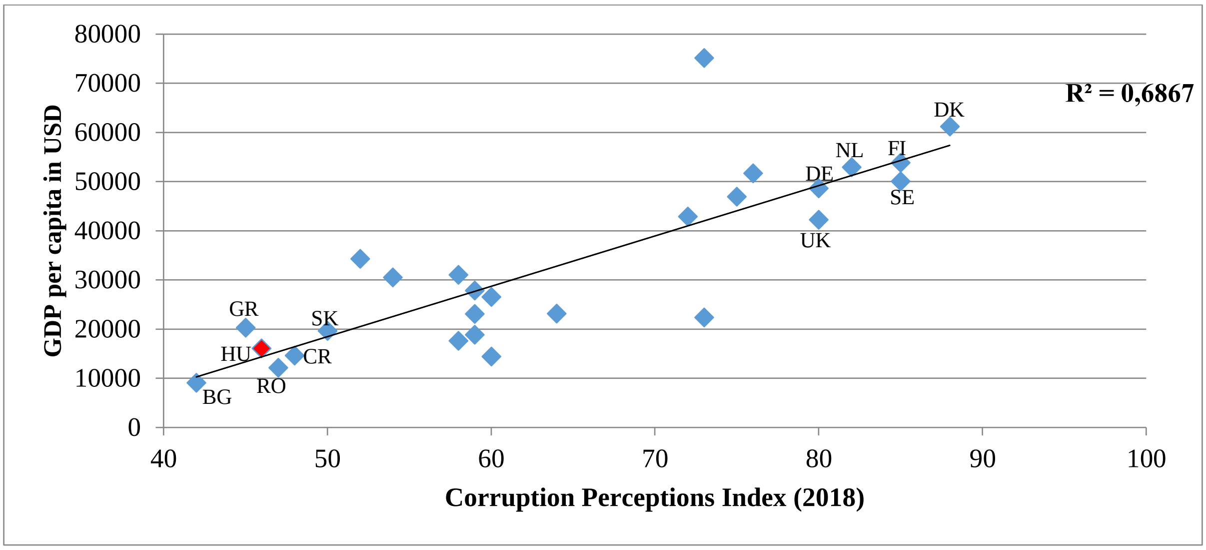
[4] As revealed in an OECD study of 2012, this relationship exists on the global scale as well, even though a number of Asian countries are exceptions, with impressive economic results coupled with high corruption exposure. Organization for Economic Cooperation and Development (2012): Issues Paper on Corruption and Economic Growth. Working Paper. 1–43. http://www.oecd.org/g20/topics/anti-corruption/Issue-Paper-Corruption-and-Economic-Growth.pdf

[5] Source: Eurostat (https://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tec00001&plugin=1)

[6] The volume of the Hungarian gross national product in Q1-Q3 2018 was 4.8 per cent below the corresponding figure of the previous year. See: https://www.ksh.hu/docs/hun/xftp/gyor/gdp/gdp1809.html

[7] The R^2 in Figure 2 shows the correlation between per capita GDP and the Corruption Perceptions Index score; its value of close to 0.7 indicates a fairly strong link between the two variables. R^2 shows the strength of the correlation between the two variables, in the range of 0 to +1. Even though there is no consensus among statisticians as to the exact level above which the determination coefficient is regarded as "high", a value close to 0.7 denotes strong correlation no matter which threshold is applied.

Figure 2: Relationship between corruption and per capita GDP in the EU



Source: Calculations of TI Hungary based on the data of Transparency International and IMF[8]. *Note:* The higher the score measured by the Corruption Perceptions Index, the lower the corruption exposure. Luxembourg has been omitted from the Member States for technical reasons.

1.3. Improving competitiveness, declining performance of state institutions

With the increase of per capita GDP, the competitiveness of Hungary appears to be stabilising. The competitiveness report of the World Economic Forum (WEF)[9] showed a continuous decline in the competitiveness of the Hungarian economy in the 2001–2016 period. In 2001 Hungary was the 28th most competitive economy globally, while in 2016 it held 69th place on the same list. The Global Competitiveness Report of the WEF examines the institutional pillar[10] to evaluate the functioning of the institutions of public authority, the transparency and accountability of the government and how the economic framework, including the Rule of Law, can promote the productivity of the economy. Hungary's position was particularly poor in the institutional pillar, plummeting from 26th place in 2001 to 114th place in 2016. It is recognised, however, that in 2017 Hungary's competitiveness showed a slight improvement, moving from 69th to 60th place, while the performance of public institutions rose to 101st on the list of 137 countries.

Because of the profound change in the methodology[11], the 2018 competitiveness survey of the World Economic Forum cannot be compared with the figures of previous years; however, it is

8 https://www.imf.org/external/pubs/ft/weo/2018/02/weodata/weorept.aspx?sy=2016&ey=2023&scsm=1&ssd=1&sort=country&ds=.&br=1&pr1.x=96&pr1.y=3&c=946%2C122%2C181%2C124%2C918%2C138%2C964%2C182%2C960%2C423%2C935%2C968%2C128%2C939%2C936%2C961%2C172%2C132%2C184%2C134%2C174%2C144%2C944%2C178%2C136%2C112%2C941&s=NGDPDPC&grp=0&a=

9 The Global Competitiveness Report and the Global Competitiveness Index calculated on its basis takes into account various indicators and the results of surveys, for instance the Executive Opinion Survey conducted among businessmen and experts. For the detailed results and methodology of the Global Competitiveness Report, see: http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf

10 The institutional pillar assesses the efficiency of the system of state institutions relying on 21 indicators. For a detailed description, see: http://www3.weforum.org/docs/GCR2017-2018/05FullReport/TheGlobalCompetitivenessReport2017%E2%80%932018.pdf

11 For the detailed description of the composition of the GCI 4.0 index see: http://reports.weforum.org/global-competitiveness-report-2018/chapter-3-benchmarking-competitiveness-in-the-fourth-industrial-revolution-introducing-the-global-competitiveness-index-4-0/

still valid to say that the competitiveness of Hungary continues to significantly lag behind the level measured at the turn of the century.[12] It is notable, however, that Hungary outperforms its own average score with regard to the indicators describing the short-term growth potential of the economy. For example, among the 140 countries covered, Hungary ranked 43rd in terms of macroeconomic stability, 28th in terms of infrastructure, 51st in terms of the adoption of infocommunication technologies and 39th in terms of innovation capabilities.

In contrast, investors and businessmen still considered the performance of Hungarian government institutions to be extremely poor in a number of areas (see Table 3). It is striking, for instance, that in terms of the adequacy of conflicts of interest regulations, Hungary ranked 121st among the 140 countries covered, and only 134th regarding the efficiency of legal remedies against government decisions. The respondents ranked Hungary at 108th place regarding property rights and at 103rd place regarding judicial independence.

Table 3: Critical points of the performance of the institutions in Hungary

Sub-factors of the institutional pillar of the competitiveness report	Ranking (/140)
Efficiency of legal framework in challenging regulations	134
Conflicts of interest regulation	121
Property rights	108
Judicial independence	103
Future orientation of government	96
Burden of government regulation	95
Efficiency of legal framework in settling disputes	89

Source: Institutional scores of the global competitiveness ranking of the World Economic Forum for 2018

The performance of Hungary's state institutions, way below the expected level, as well as the decline of the rule of law and the increased frequency of corruption are also observed in other surveys. Hungary's performance has been deteriorating steadily in the democracy index of Freedom House, and perceptions of corruption and the freedom of the press are also worsening (see Table 4). Bertelsmann Foundation's Sustainable Governance Index also indicates that even though economic policy has changed in a positive direction, the quality of democracy has deteriorated significantly.[13]

[12] Based on the new methodology, in 2018 Hungary archived 48th place among the 140 countries covered, the same as its ranking of 2017 recalculated with the new methodology (in 2017 Hungary was at 60th place among the 137 countries surveyed, which corresponded to 48th place calculated with the methodology applied in 2018). The 2017–2018 competitiveness report is available at: http://www3.weforum.org/docs/GCR2017-2018/05FullReport/TheGlobalCompetitivenessReport2017%E2%80%932018.pdf

[13] For the data of the Bertelsmann Foundation Sustainable Governance Index (SGI) including comparison with previous surveys, see: http://www.sgi-network.org/2018/. Among the relevant indicators of Hungary, the quality of democracy fell from 5.0 in 2014 to 3.5 in 2018 (on a scale of 1–10), and the scores for executive capacity and executive accountability also worsened.

Table 4: Hungary's scores on Freedom House's Democracy Index

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
National Democratic Governance	2.50	2.50	3.00	3.50	3.50	3.75	3.75	4.00	4.25	4.50
Electoral Process	1.75	1.75	1.75	2.25	2.25	2.25	2.75	2.75	3.00	3.25
Civil Society	1.75	1.75	2.00	2.00	2.25	2.25	2.50	2.50	2.75	3.00
Independent Media	2.50	2.75	3.25	3.50	3.50	3.50	3.75	3.75	4.25	4.50
Local Democratic Governance	2.50	2.50	2.50	2.50	2.75	2.75	3.00	3.00	3.00	3.00
Judicial Framework and Independence	1.75	2.00	2.25	2.75	2.50	2.50	2.75	3.00	3.00	3.00
Corruption	**3.25**	**3.50**	**3.50**	**3.50**	**3.50**	**3.75**	**3.75**	**4.00**	**4.50**	**4.75**
Democracy Score	**2.29**	**2.39**	**2.61**	**2.86**	**2.89**	**2.96**	**3.18**	**3.29**	**3.54**	**3.71**

Source: Freedom House "Nations in Transit 2018"[14] *Note:* Higher scores on the 1-7 scale indicate lower democratic performance.

These indicators in aggregate outline a country where, even though the poorly performing institutions of the rule of law and democracy are unable to effectively curb corruption, because of the favourable macroeconomic indicators and other cyclical factors business actors have resigned themselves to the situation and have, as it were, "put a price" on corruption. As shown in Figure 2, this combination keeps the country on a course of low per capita GDP and high corruption exposure in the long term, undermining sustainable economic growth.

Business leaders assess the short-term economic outlook in Hungary to be favourable, and they also see progress in competitiveness, whereas they find the reliability of state institutions and the predictability of their operation to be disappointingly poor in global comparison. Probably the most important lesson to be drawn from the year 2018 Corruption Perceptions Index regarding Hungary is that short-term economic stability and improved competitiveness in themselves are unable to substantially improve the corruption ranking of the country due to the extremely poor performance of public institutions.

[14] https://freedomhouse.org/report/nations-transit/2018/hungary

2. Beyond the Rule of Law - the privatisation of public authority

As a result of the decade-long rule of the elite that has been in power since 2010, it is a fact that most institutions of the Rule of Law are now practically defunct. The government has almost completely eliminated the professional and organisational autonomy of state institutions which are independent of the executive, and, with very few exceptions, placed them under the direction of persons loyal to the cabinet. This occurred with regard to the Constitutional Court, the prosecution, the institutions to safeguard the freedom of information, the State Audit Office, the bodies of election administration, the media authority, the Hungarian Competition Authority, the institutions of public procurement, the central bank, the ombudsman's office as well as bodies subordinated to the government such as the police or the tax authority. As a result, the system of checks and balances has been disrupted. The new system of institutions replacing the arrangement designed to keep the balance of powers in the arena of public authority as envisaged at the time of the fall of communism is unable and in most cases not even inclined to keep the executive power in check.

The penetration of the public law arena, ongoing since 2010, has not only compromised the functioning of the rule of law but also entailed state capture. In Hungary state capture has taken a novel form: not the influential economic interest groups took control of the weak public authorities. The process in Hungary is best described as the privatisation of public authority, as the non-transparent cooperation of the holders of public authority and business circles with close ties to them ("oligarchs") has become the routine. Such capture of the state and the poor corruption resistance of the country are closely interrelated (in recent years TI Hungary has expressed this view in numerous studies[15]).

Due to the dismantling of the rule of law ongoing since 2010, in Hungary corruption is not the malfunction of the state but a method intentionally applied by the government. Corruption is a tool in the hands of the holders of public power; it allows for the distribution of goods as a function of loyalty rather than performance. In this system, corruption is no longer a benefit obtained by circumventing rules but the direct and main consequence of bad rules. In the scope of high-level abuses mostly linked to the holders of public authority, corruption occurs not against the rules but through them.

The government's gradual takeover of the public arena has not completely dismantled the system of checks and balances, though. This is because courts have preserved most of their professional autonomy. Unlike the public prosecution, which exhibits increasingly obvious signs of partisanship and bias, tendencies of partiality or favouring those in power are not present in the jurisprudence of courts, which have retained their independence from the executive. The real test of the rule of law for judges and jurisprudence will start in 2020, when the administrative courts are to commence their operation. At this point it is anyone's guess whether the new courts can and want to work at the high standard that characterises the present judicial system. We can only hope that just and professional decisions will be delivered after 2020 as well about access to information of public interest, which is one of the most important and effective instruments of the civil control of those in power.

[15] The most recent publication of TI Hungary on this subject is "*Javaslatok a korrupció visszaszorítására Magyarországon" [Recommendations to curb corruption in Hungary]*, available at: https://transparency.hu/wp-content/uploads/2018/01/Javaslatok-a-korrupci%C3%B3-visszaszor%C3%ADt%C3%A1s%C3%A1ra-Magyarorsz%C3%A1gon.pdf.

Countering systemic corruption requires a state organisation that promotes the separation of powers and the values of the rule of law. The success of this endeavour depends primarily on institution building; however, the attitude of the political elite matters just as much. The rule of law, democracy and market economy can prevail in the long term only if those in power govern the country with self-restraint, with due regard to written and unwritten rules, without curtailing or withdrawing acquired rights.

3. Systemic corruption in practice

Below we shall present the example of the Hungarian residency bond business and the corporate profit tax allowance, the so-called "TAO-funds" to illustrate how systemic corruption works in Hungary in practice.

3.1. Sale of residency government bonds: government travel agency for the corrupt [16]

The Orbán cabinet started the immigration programme targeting non-residents outside the EU in 2013. The residency government bond programme was open to those who invested in government bonds of a face value of 300 thousand euro[17] for a term of five years. In the programme closed on 30 June 2017, 6,583 bonds were subscribed and, together with family members 19,855 foreign nationals were awarded residence permits for Hungary,[18] allowing them free movement within the Schengen Zone. The government, which fights migration by amending the Fundamental law, among other things, settled some twenty thousand persons in Hungary and at the same time in the European Union.

One of the most severe discrepancies of the programme was that the residency government bonds could not be directly subscribed by foreigners intending to settle in Hungary. The bonds could be purchased only through intermediary organisations that had obtained a permit from the Economic Committee of the Parliament. With the exception of a single enterprise, all intermediary organisations were registered in secrecy jurisdictions offering off-shore services.[19] In practice, the residency government bonds were subscribed by the intermediaries, at the expense of non-resident individuals, who transferred the 300 thousand euro purchase price of the bond to the intermediary, which then proceeded to purchase the government bond in its own name. However, the intermediary paid only approx. 271 thousand euro to the Debt Management Agency (ÁKK). That is because the residency bonds were discount bonds, meaning that the five-year interest is deducted from the nominal value at the start, then the ÁKK pays the nominal value upon maturity. This favoured the intermediaries because they could pocket the profit from

[16] In the course of the writing of the sub-chapter we relied on the joint study of TI Hungary and the Fiscal Responsibility Institute Budapest (Corruption by design – the economic and financial impact of the government's Golden Visa bonds in Hungary - The role of residency government bonds in financing the Hungarian government 2013-2017, available at: https://transparency.hu/wp-content/uploads/2018/12/lmak_tanulmany_final_magyar_lektoralt.pdf)

[17] The nominal value of residency government bonds was 250 thousand euro until 31 December 2014.

[18] The source of the data disclosed is the response of the Immigration and Asylum Office to the request for data of public interest, No. 106-Ti-35375/1/2018.; the response is in possession of IT Hungary. The data was processed by: Tamás Wiedermann: 59 országból jött Magyarországra a húszezer letelepedési kötvényes (https://g7.hu/kozelet/20190116/59-orszagbol-jott-magyarorszagra-a-huszezer-letelepedesi-kotvenyes/).

[19] A total of eight such intermediary organisations were granted lincences for the subscription of bonds. Based on the data available on the website of the Debt Management Agency (http://www.akk.hu/hu/oldal/allampapir-forgalmazas#letelepedesi-magyar-allamkotvenyek), the following organisations are involved (with the country of registration after the name of the organisation): Hungary State Special Debt Fund (Cayman Islands) Discus Holding Limited (Malta), Innozone Holding Limited (Cyprus), Arton Capital Hungary Pénzügyi Tanácsadó Kft. (Hungary), VolDan Investments Limited (Liechtenstein), S&Z Program Limited (Liechtenstein), Euro-Asia Investment Management Pte. Limited (Singapore), Migrat Immigration Asia Limited (Cyprus).

the yield of the bond right away while when the bonds sold for 271 thousand euro are redeemed, Hungary pays 300 thousand euro for each.

The Hungarian government sold residency government bonds with a total nominal value of 1 billion 844 million euro; however, they received revenues of only 1 billion 666 million euro, some 178 million less, from the transaction. Through the sale of foreign exchange bonds of also five-year term but without residency entitlement, Hungary could have obtained the same amount of investment for 66 million euro, or at present value 21 billion forints, less. This arrangement would have allowed Hungary to raise external funds cheaper as well as without granting the right of settlement in Hungary and in the European Union.

Also, the intermediaries would not have pocketed 29 thousand euro after each package of residency government bond sold. The Hungarian government pays the 191 million euro luxury profit, in excess of 61 billion forints at the current exchange rate, from the funds of Hungarian taxpayers, while according to the Fundamental Law, public funds may not be entrusted to bodies with non-transparent ownership structures.

TI Hungary, in cooperation with the political daily Magyar Nemzet and, after its close-down, with the G7.hu economic news website, initiated several proceedings to make the trade of residency government bonds transparent. Thanks to the success of requests for data of public interest and successful litigations, the Debt Management Agency disclosed the number of residency bonds sold by the various intermediary organisations while the Immigration and Asylum Office released information on the countries of origin of the close to 20 thousand foreigners who obtained the right of residency. Accordingly, it is now known that more than 80 per cent of the immigrants (15,754 persons) came from China, and 6 per cent (1,265 persons) from Russia. Other countries of origin include Iran (305 persons), Pakistan (241 persons) Iraq (222 persons), Vietnam (211 persons), Turkey (204 persons) and Syria (171 persons). Surprisingly, 92 US nationals and 13 Canadians also immigrated to Hungary through the residency bond scheme.[20]

In the procedure for the acquisition of residence permits, the relevant bodies have only 20 days to decide whether the person paying the price of the bond or his/her relative "is a threat to the national security or public safety of Hungary".[21] It is safe to say that in such a short timeframe the national security check could not have been conducted to adequate standards.[22] Therefore it appears reasonable to conclude that the security screening of the close to 20 thousand foreign nationals who obtained residency through subscription of the bond and the check of the source of funds invested by them were both insufficient to prevent the laundering of funds obtained from unknown sources by criminals or terrorists. Therefore, we may conclude that by marketing the residency government bond, the government gave rise to severe national security risks.

Based on the data obtained from the economic committee of Parliament following extensive litigation, TI Hungary concluded that the Parliament authorised the firms marketing the bonds in contravention of the applicable rules. Consequently, we filed charges for maladministration;

[20] The source of the data is the document referred to in footnote 18.
[21] Act II of 2007. Article 35/C. (2), in effect until 26 July 2018. In the case of an appeal, another ten days are available.
[22] Hungarian authorities rejected the request for residence only in the case of 20 bond subscribers and 44 family members, that is, only 0.3 per cent of all applicants were not granted a residency permit. In case of other foreigners, the Hungarian state is 22 times more stringent, as 6.4 per cent of the residence and settlement permit applications have been rejected. Source: https://g7.hu/kozelet/20190116/59-orszagbol-jott-magyarorszagra-a-huszezer-letelepedesi-kotvenyes/

however, the prosecution service rejected the motion on the grounds that no crime had been committed.[23]

3.2. Corrupt public money pump: tax exempt corporate donations for sports

The arrangement established in 2011 for the support of spectator team sports (ice hockey, handball, basketball, football and water polo and, since the summer of 2017, volleyball), known, albeit incorrectly, as TAO donation, diverts part of the profit before tax of companies to sports organisations instead of the state budget.

This is not sponsorship, therefore it encourages companies to support one of the spectator sports without asking for any consideration so that they can reduce their corporate income tax payments. That is, enterprises donate the TAO funds to the sports clubs from their profit before tax rather than from their net, taxed profits. Thus the TAO payments result in the significant erosion of tax revenues: between 2011 and 2017 the Hungarian budget raised corporate tax revenues of 3,233 billion forints in total,[24], while in the same period it assigned a total of 441 billion HUF of corporate income tax revenues to sports teams and associations, as revealed by the figures in the Act on final accounts. That is, between 2011 and 2017 more than 13.5 per cent of the corporate income tax payments ended up at various sports organisations rather than in the budget.[25]

TI Hungary objects to the TAO arrangement primarily because public funds end up at beneficiary sports originations in a non-transparent manner. For years the government concealed the identity of the firms that pay some of their tax to sports teams rather than to the Treasury.[26] Secrecy allowed companies to give way to political considerations when making TAO payment decisions. Companies appear to be aware that they are better off giving their TAO to sports teams with good political connections. This is the only explanation that the absolute winner of spectator sport donations, Youth Training in Felcsút Foundation, received TAO funds of some 17 billion forints in the past seven years. In other words, the soccer club operating in the village of Prime Minister Viktor Orbán itself pocketed close to 4 per cent of the TAO budget, whereas more than 1,000 teams compete for TAO funds within the soccer sector alone, not to mention the entities of the other five spectacle sports eligible for funding.

TI Hungary has always been convinced that the identity of donor companies and the amount of funds they give to the various sports clubs are data of public interest and should be in the public domain. We enforced our conviction in court: we filed court proceedings to gain access to the data of companies donating TAO funds from the government and spectator sport associations.[27] We won the lawsuit against the Ministry of Human Capacities and the Ministry for National Economy on 25 October 2017 at the Curia of Hungary, but the government started to release

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[23] Decision Np. I. Nyom.151/2018, in possession of TI Hungary.

[24] Source: Hungarian Statistical Office: the revenues and balance of the central budget (http://www.ksh.hu/docs/hun/xstadat/xstadat_eves/i_qse006d.html)

[25] 369 billion forints of corporate tax revenues were budgeted for 2018, while 80 billion forints were proposed for subsidies to spectacle sports. The actual figures can be established from the final accounts on the year 2018 to be published on 30 September 2019.

[26] In order to keep information confidential, Parliament, by adopting act C of 2016, declared that the details of spectacle sport funding constituted tax secrets.

[27] It should be noted that while Prime Minister Viktor Orbán, for "domestic use", stated that it was a "communist obsession" to regard TAO payments as public funds (see: https://24.hu/belfold/2014/04/22/orban-budapesten-is-lehetne-a-felcsuti-stadion/), the Hungarian government admitted to the European Commission that the spectacle sport support regime was financed from public money. The European Commission stated that the TAO donation regime constituted state aid. Report C(2011)7287 of the European Commission, Section 65 http://ec.europa.eu/competition/state_aid/cases/240466/240466_1271180_52_3.pdf.

the data ordered by the court with final effect only in the spring of 2018. TI Hungary received donation certificates of more than 56 thousand pages in the form of documents that cannot be edited or computer-searched; their processing and conversion into a publicly accessible database is still ongoing. We won the lawsuit against the national associations of spectator team sports on 30 May 2018 with the decision of the Curia. Most sports associations released the data at the end of 2018; however, the Hungarian Football Association would release the donation certificates of approximately 40 thousand pages in its possession only for a photocopying charge of 10 forints per page. The football sector received TAO payments of close to 230 billion forints.[28] In light of this, the petty-mindedness of the Hungarian Football Association is particularly perverse.

The fact reinforced by the Curia that the TAO donations are pubic funds means, beyond the publicity of data, that the TAO funds should have always been spent though public procurement procedures. Therefore, TI Hungary reminded the government of the infringement that the donations to spectator sports are not covered by the Act on public procurement, and thus the purchases made from TAO funds are not subject to public procurement rules. We asked the Prime Ministers' Office to amend the regulation as well as to investigate whether the public procurement procedure was circumvented illegally in the course of the use of TAO funds.[29] So far the government has failed to implement the changes suggested by TI Hungary.

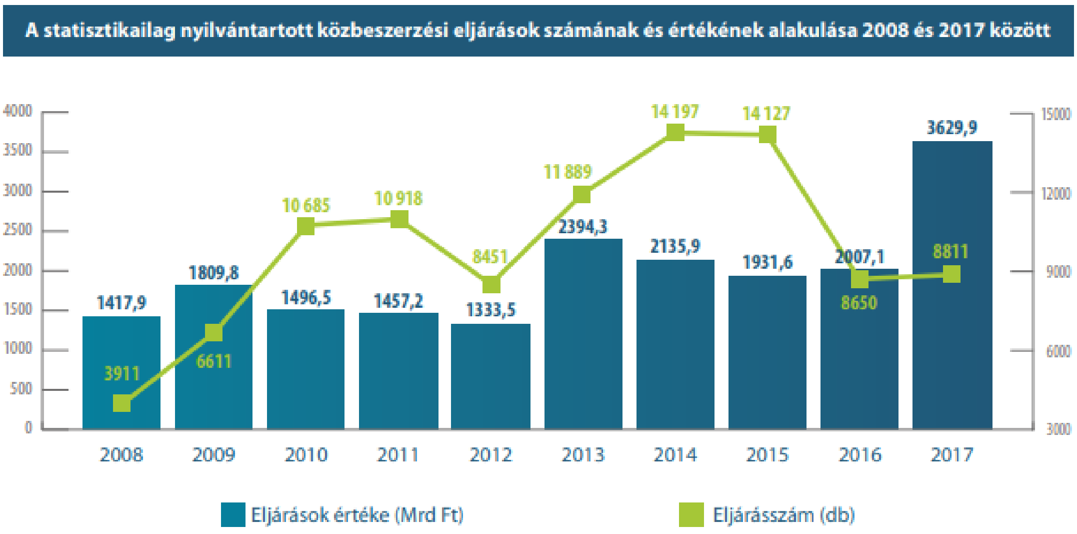
Finally, it should be noted that at the end of last year the government radically changed the rules of TAO donations, already amended numerous times (the rules governing TAO donations were changed on 170 occasions in the past eight years).[30] As of this year, the amount of funds to be donated to the various sports will be effectively decided by the government rather than the associations of spectator team sports. Furthermore, the government set a stricter limit for sports donations: this year and next year the state is willing to dispense with corporate income tax revenues of 100 billion forints in total.

[28] https://24.hu/belfold/2018/04/04/tao-felcsut-sporttamogatas/
[29] https://transparency.hu/wp-content/uploads/2018/11/transparency_int_mo_alapitvany_megkereses_tao_kozbesz_mellozese_20181105.pdf
[30] See Government Decree 318/2018 (XII. 27.)

4. Public procurement and European Union funds

Data for 2018 are not available yet, but it will be interesting to see whether the trend of 2017 continues. In 2017, 3,630 billion forints were spent though public procurement by state entities (among others, public authorities, state or local government owned companies, contracting authorities in the public services sector). This represents an increase of close to 1,700 billion forints, or more than 80 per cent, over 2016 (see Figure 3).

Figure 3: Number and value of public procurement procedures between 2008 and 2017



Source: Report of the Public Procurement Authority to Parliament, 2017

This sum is excessive relative to all prior public expenditure: in the past 10 years the value of procurement was highest in 2013, with a contracted value of some 2,400 billion forints. The value of public procurement amounted to only 8.2 per cent of GDP even in the peak year of 2013, while in 2017 it exceeded 10 per cent of GDP (see Figure 4).

Figure 4: Value of public procurement as a percentage of GDP between 2008 and 2017

Source: Report of the Public Procurement Authority to Parliament, 2017[31]

In this light it is particularly disconcerting that government orders increasingly concentrate in the hands of a few persons. Based on the value of public procurement contracts, the firms of the Mészáros family won 8.6 per cent of all procurements in 2017, while the enterprises of László Szíjj, at the top of the procurement ranking, had a share of 17.5 per cent in procurement contracts.[32] While in 2013 four pro-government entrepreneurs – István Garancsi, Lőrinc Mészáros, Lajos Simicska and István Tiborcz – won 11 per cent of all government contracts in aggregate, in 2017 two oligarchs, Lőrinc Mészáros and László Szíjj controlled more than one quarter of the procurement market. The absolute winner of procurement contracts in 2017 had not been in the top four in 2013.

Meanwhile, the statistics published by the Public Procurement Authority have shown the intensification of competition – in theory. For instance, the ratio of the so-called single-bidder procurement procedures declined to 16.6 per cent of all procurement contracts, whereas since 2009 only one company submitted a bid in 30 per cent of the procurement procedures each year and, in 2016, in 36 per cent of the public procurement procedures above the EU threshold there was only one single bid. Meanwhile, in the European Union single-bidder procurement procedures represent a mere 17 per cent of all procurements.[33] The number of public procurement procedures without prior public call – i.e., without competition – fell by 45 per cent relative to 2016.[34]

However, if the improving statistics are contrasted with the concentration of government contracts, we still find that competition in public procurement is extremely limited. Today even in regular, open public procurement procedures only those firms have any real chance to be selected that have been placed at an advantage in recent years, for instance by the tailoring of

[31] Report of the Public Procurement Authority to Parliament, 2017 (B/548), available at: http://www.parlament.hu/irom41/00548/00548.pdf
[32] Calculations of TI Hungary based on the calculations of atlatszo.hu and the statistics of the Public Procurement Authority.
[33] Country report of the European Commission on Hungary, 2017, p. 35 https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-hungary-en_1.pdf
[34] Report of the Public Procurement Authority to Parliament, 2017

calls, the unjustified use of procedures without public notice or of the national security procurement regime, etc. For instance, only the preferred enterprises can present the required references. Firms without effective competition are not under pressure to engage in development or employ innovative solutions, which is detrimental to the whole of the Hungarian economy in the long term.

As stated in the study of TI Hungary describing the year 2017 results of the Corruption Perceptions Index[35], partiality in the allocation of public contracts has significantly contributed to the fabulous enrichment of the oligarchs close to the government in recent years. While the wealth of Lőrinc Mészáros, once the mayor of Felcsút was “only” 35 billion forints in 2016, making him the 28th wealthiest Hungarian person according to Forbes[36], in 2017 his assets of 105.7 made him raise to 8th place on the list of the magazine[37], that is, in a single year he tripled his wealth. According to Forbes[38], in 2018 Lőrinc Mészáros was the wealthiest citizen in Hungary, while five years before had not featured among the richest. Public procurement documents show that firms of Lőrinc Mészáros and his relatives won tenders of 265 billion forints last year, 93 per cent of which was EU funding.[39]

On average, Hungary receives grants of more than a thousand billion forints from the EU budget; approximately half of Hungarian public procurement contracts are implemented with the co-financing of the European Union. In the 2014–2020 budget cycle Hungary has received close to eight thousand billion forints (25 billion euro) of grants, which corresponds to 3.4 per cent of Hungary’s GDP on average (in 2016 and 2017 this ratio was around 6-7 per cent of GDP). Hungary ranks second among the Member States in terms of financing per capita.

The use of EU funds in Hungary entails a number of systemic corruption risks. Not only are state institutions unable to prevent such risks, but in a number of cases the institutions themselves open the door for abuse. The survey of TI Hungary in 2015[40] found that the abundance of funds in itself created a corruption risk because all Hungarian governments since the country’s EU accession had the primary goal of the fastest and fullest draw-down (distribution) of the available funds. In view of the absorption pressures, the utility and necessity of the selected projects is of secondary importance, and the supervision of projects is not a priority because it would only hinder the use of funding.[41] As the objective is to spend the enormous amount of funds as soon as possible, projects funded by the EU are typically overbudgeted, that is, more than the necessary funding is approved. Overbudgeting and insufficient oversight significantly contribute to the overpricing of EU projects (the cited study of TI Hungary found that some 90 per cent of the projects may be overpriced, at the average rate of 25 per cent).

[35] See: Page 12 of the study referred to in Footnote 1
[36] https://forbes.hu/extra/33-leggazdagabb-magyar-2016/
[37] https://forbes.hu/extra/33-leggazdagabb-magyar-2017/
[38] https://forbes.hu/a-magazin/magyarorszag-50-leggazdagabb-embere-mar-nem-csanyi-az-elso/
[39] https://atlatszo.hu/2019/01/17/2018-ban-meszaros-lorinc-erdekeltsegei-nyertek-a-nemzeti-tokesosztaly-kozbeszerzesi-versenyet/
[40] Az uniós források korrupciós kockázata Magyarországon, Transparency International Hungary, October 2015 (https://transparency.hu/wp-content/uploads/2016/03/TI-Az-Uni%C3%B3s-forr%C3%A1sok-korrupci%C3%B3s-kock%C3%A1zata-Magyarorsz%C3%A1gon.pdf (hereinafter: Az uniós források korrupciós kockázata…)
[41] The sentences attributed to János Lázár can be interpreted as the acknowledgement of absorption pressure and rent-seeking: “We have been way too hasty. It was most important to spend the money, but this is not what we want in the forthcoming 7 years.” He added, “ there is money for everything except for what we want to do; not for preparation or execution but for the acquisition of funds or stealing the money, let me be clear”. In: Tibor Lengyel: Megnyílt a föld Lázár János lába alatt, in: http://www.origo.hu/itthon/20150617-megnyilt-fold-lazar-janos-eu-s-forras-jogalkotas-lobbi.html

The entities deciding about the beneficiaries of EU funds and controlling the use of funds and planning supported projects are subordinated to the same managing authority. That is, the above bodies are under the management of the same government entity (undersecretary or, ultimately, minister). Consequently, oversight institutions have disincentives to supervise the project because, on the one hand, it would slow down the use of funds and on the other hand, if deficiencies or irregularities were to be revealed, the government would incriminate itself that it had not been sufficiently circumspect in selecting the beneficiaries. The institutional guarantees of effective independence are strongly questionable on both the organisational and personal levels. As a typical example, the Directorate General for Auditing European Funds, an audit body independent of managing authorities, which is required under European Union rules, works within the Ministry of Finance and its staff consists of government officials.

The audit of the use of EU funds is primarily the competence of Member States; this function must be performed by the appropriate national authorities – in particular the managing authorities, and ultimately the prosecutor's office. The control bodies of the European Commission (the auditors and the European Anti-Fraud Office – OLAF) are unable to check tens of thousands of projects in detail. By way of illustration: in the 28 Member States OLAF launches approximately 300 investigations a year, including Hungarian projects in the magnitude of tens. For instance, in 2017 OLAF closed ten investigations involving Hungary; seven of them found irregularities. In contrast, in the previous budget period of 2007–2013 more than 60,000 projects financed partly or wholly by the European Union were implemented in Hungary alone. The Hungarian prosecution has the worst rate of indictment: in the 2010–2017 period the prosecution sought indictment in eight cases based on the 37 notifications received from OLAF for suspected fraud, but five indictments occurred after 2016.

The manner of use of EU funds in Hungary and in general the nature of Hungarian public procurement, in particular procurements tailored to a specific bidder and the outstanding role of application writers is exemplified by the several-year-long streak of Elios Innovatív Zrt., a firm affiliated to István Tiborcz, the Prime Minister's son-in-law, lasting until 2015. Between 2009 and 2014 the public procurement procedures for street lighting funded by the European Union contained eligibility requirements that could be met satisfied by no other company. In addition, in all the procedures investigated the contracting local governments were assisted by consulting firms (in practice these consultants designed the eligibility criteria tailored to Elios Zrt.) which were affiliated through ownership links with the winning tenderer, Elios Zrt. This is a clear violation of the conflict of interest rules set out in the Act on public procurement.[42] In addition, there are grounds to believe that the projects were overpriced, collusion with competitors occurred (Tungsram-Schréder, formerly another tenderer, later participated in the implementation of the projects as a supplier to Elios Zrt.) and documents were falsified (with regard to rate of return of the lightbulbs). According to press reports, OLAF proposed to the European Commission the recovery of 13 billion forints.[43]

At the same time, the Elios Zrt. case is an excellent example of the operation of the police and the prosecution service. Police started investigation in 2015, when charges were filed based on the articles of investigative journalists. At that time, the proceedings were closed after a few

[42] Act CXLIII of 2015 on Public Procurement (Kbt.), Section 25(2)
[43] The case was covered by Direkt36 and 24.hu in a series of articles each:
https://www.direkt36.hu/2015/03/11/tiborcz-istvan-es-az-elios-innovativ-zrt-sikerei-ledes-kozvilagitasi-kozbeszerzeseken/ (2018.02.19.)
https://24.hu/belfold/2018/02/07/igy-csalt-orban-vejenek-cege-megszereztuk-az-olaf-jelenteset/ (2018.02.19.)

months and charges dropped on the grounds that no crime had been committed. After OLAF officially notified the Hungarian prosecution in January 2018 and revealed organised fraud schemes in its report, the police reopened the investigation in July 2018. However, in less than four months the police announced that charges were dropped (again) in the absence of any crime.[44]

Beneficiaries spend the overwhelming majority of EU funds through public procurement procedures; this is one of the most risky stages of the use of EU funds in terms of corruption hazard. In addition to government bodies and other budgetary entities and state-owned enterprises, private companies are also required to conduct procurement procedures if they use EU funding.[45] By altering public procurement rules, the government made it easier to dispense with procurement when spending EU funds – for instance, the government may grant case-by-case exemption from the public procurement requirement. TI Hungary voiced its objection.[46]

At the end of 2018, several sections of Act CXLIII of 2015 on public procurement were amended, unfortunately to aggravate the risk of corruption in procurement procedures; the changes are likely to be in violation of EU law in more than one respect. The amendment *inter alia* lifted the requirement that churches must also implement public procurement processes when using public funds.[47]

Furthermore, there is severe corruption risk in the fact that the threshold for public procurement requirement for purchases using grants has been raised from 40 million forints to 300 million forints for construction projects; TI Hungary has also protested against that measure.[48]

5. The media and corruption – distorted media market

The Achilles heel of the current media market in Hungary, closely related to the cronyism and systemic corruption, is the distortion of market conditions and the rendering of fair and regulated competition close to impossible. Purchases of media outlets by business groups closely connected with the ruling party, oligarchs and even government officials present the gravest danger to the freedom of the press. This process is forging ahead, more and more media “falling” and becoming servants to the government each year. More and more people “consume” pro-government media, often not of their own free will. In recent years the ownership structure of the media sector has changed radically: by now, with the exception of the Bertelsmann group, owner of RTL Klub, the largest commercial television channel, all foreign investors have sold their holdings in Hungary in the quality segment of the media market. The remaining foreign investors have either left Hungary or provide assistance to the penetration of this market by the governing party. That is, the former assumption that foreign owners provide some sort of protection against the centralisation attempts of Hungarian politicians has long been disproved.

Before 2010, the media market, similarly to the bipolar political system, was characterised by a quasi-oligopolistic structure. By now it has become increasingly monopolistic. In the past three years we have seen the acceleration of the process whereby media critical of the

[44] https://index.hu/gazdasag/2018/11/06/elios_nyomozast_vege/ (based on an MTI release)
[45] The detailed rules are set out in Section 5(2)–(3) of the Public Procurement Act.
[46] https://transparency.hu/hirek/tobb-sebbol-verzik-a-kozbeszerzesi-torveny-modositasa/
[47] According to the established jurisprudence of the European Court of Justice (see for instance Case No. C-74/16), with the exception of purely religious activities, the operations of churches are also considered to be economic activities and therefore are also covered by the EU rules concerning public procurement, competition, state aid and other laws.
[48] https://transparency.hu/wp-content/uploads/2018/11/T3374_Kbt-foglal%C3%A1s_TI-HU-%C3%A1ll%C3%A1sfoglal%C3%A1s.pdf

government are closed down or acquired by businessmen or oligarchs with close links to the government. Mérték Médiaelemző Műhely (Mertek Media Monitor - MMM) summarised the penetration of pro-government media up to 2017.[49]

<u>The most notable events are listed below:</u>

i. termination of the daily Népszabadság;
ii. the acquisition by Lőrinc Mészáros of Mediaworks, publisher of regionalpapers;
iii. acquisition of the weekly Figyelő by the family company of Mária Schmidt, a billionaire with close ties to the government and holder of an official function;
iv. establishment of Lokál, a free daily, which obtained a monopoly position in the segment after Metropol went out of business;
v. launch of Ripost, a pro-government tabloid daily;
vi. on the radio market, Class FM, the only nationally broadcasting commercial radio that was independent of the government ceased its operation; the largest players on the radio market are all in pro-government ownership;
vii. Origo.hu, the internet portal with the broadest reach, has been acquired by oligarchs with ties to the government.

<u>The “black list” of 2018 is to be added to the above:</u>

ix. Magyar Nemzet, a daily paper looking back to 80 years of history, which had had a centrist-centre-right, opposition stance since the “G-day” in January 2015, was closed down after the parliamentary elections;
x. Hír TV, which worked as an independent channel after the G-day, reverted to being a government mouthpiece in the summer of 2018;
xi. the left-wing Vasárnapi Hírek and Szabad Föld also closed down at the end of 2018;
xii. the centre-right Heti Válasz also folded, even though it later resumed its operation as Válaszonline.hu but only on an online platform, supported through crowdfunding.

What happened in November 2018 must be noted in particular: at that time a concentration unprecedented in the European Union was created by combining the finances of some 450 pro-government media, including Hír TV, Echo TV, Origo.hu, Magyar Idők, Bors, Nemzeti Sport, Lokál, Figyelő, Ripost and a number of radio stations in a single conglomerate, the Central European Press and Media Foundation (CEPMF). Claiming interests of national strategy, the government has removed the Foundation from the scope of competition supervision and scrutiny.[50]

Since the transition period the government has never interfered so brutally in the operation of the media, once called the fourth estate. The main problem with pro-government media is not that it represents a biased view but that it disregards the professional rules of journalism. The shallowness of the overwhelming majority of pro-government media (state-owned and formally privately owned alike) is more harmful for Hungarian publicity than their partisan attitude. Pro-government outlets, propaganda publications are characterised by “mouthpiece journalism” and direct and virulent censorship. Unlike the name would indicate, public service media today is the playing field of government propaganda, and thus cannot be regarded as a source of relevant

[49] Nyilvánosság helyett propaganda. Lágy cenzúra a magyar médiában [Soft Censorship in Hungary in 2016: When Propaganda Rules Public Discourse]. (ed. Polyák, Gábor) Mérték Médiaelemző Műhely (MMM), 2017 (http://mertek.eu/wp-content/uploads/2017/05/MertekFuzetek11-2.pdf)
[50] See Government Decree 229/2018 (XII. 5.)

news. On the other hand, state-owned media receives a generous allowance from the budget: in 2018, 81 billion forints were granted, to be raised to 83 billion forints in 2019.[51]

Furthermore, the media industry is the proverbial veterinary's horse showing every ailment possible, illustrating the ways to distort market conditions. The allocation of public advertisements show beyond doubt how loyalty and servility trump achievement. Pro-government papers with low, often microscopic readership receive the vast majority of state-financed advertising. These advertisements serve no valid commercial purpose, they are merely a vehicle to fund the medium concerned from taxpayer's money. According to Kantar Média, the 2017 figures show that there is only one pro-opposition medium with state advertisements in excess of 50 million forints, others were only granted a few million. Meanwhile, pro-government printed publications with a circulation of a few thousand and online media obtained close to 1 billion forints from state-financed advertisements.[52]

The list of the main beneficiaries of state (corporate and institutional) advertising expenditures also shows how distorted the media industry is.[53] At the top of the list there is TV2, acquired first by Andy Vajna, then by Lőrinc Mészáros; JC Decaux, a billboard company with French-multinational background but a pro-government attitude; and Origo Adhouse owned by government-friendly businessmen. State-owned companies paid several times, occasionally ten times the market rate for advertisements in pro-government media.[54]

The allocation of state advertising is not the only problem. The state often diverts the advertisements of private companies as well, albeit with more sophisticated methods, appealing to the sense of perceived threat (real or imaginary), and the pressure to toe the line. The pre-2010 distinction that parties exert political pressure on the media while business pressures come from market participants has effectively become irrelevant. Advertisements are often allocated based on political considerations, which override commercial rationale, that is, in their advertising decisions companies are not necessarily governed by circulation or reach figures; instead, they want to express their loyalty to those in power.

Market-like conditions survive to some extent in the internet segment, but even this is true only with some reservations. On the one hand, elements of soft censorship (real or perceived requirement for alignment, political-commercial pressure through state or private advertising spending) are also present in this sector. On the other hand, technological giants (Google, Facebook) syphon off enormous amounts from the market without any substantive expenditure (of course this is not a Hungary-specific phenomenon or a political issue), which causes severe hardship for most media, rendering it ever more difficult to produce quality content.

Respect for the facts, critical but objective and unbiased journalism is alien to the spirit of the age, and not only in Hungary. These days media are often regarded across the globe as vehicles for manipulation or the creation of an alternative reality rather than as tools for disseminating information and presenting different views. The penetration of social media further increases the segregation along ideological lines, where most people want to read views that reinforce

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[51] http://mertek.eu/2018/12/20/az-allami-media-finanszirozasa-tiltott-allami-tamogatas/; https://168ora.hu/itthon/a-80-milliardbol-mukodo-kozmedia-eddig-227-millio-forintot-egetett-el-arra-hogy-megtudja-hatekonyan-kolti-e-a-kozpenzt-156247

[52] https://g7.hu/allam/20180612/teljesen-irracionalisan-kolt-el-milliardokat-az-allam-a-sajtoban/

[53] Nyilvánosság helyett propaganda. Lágy cenzúra a magyar médiában. (ed. Polyák, Gábor) Mérték Médiaelemző Műhely (MMM), 2017, p. 22 (http://mertek.eu/wp-content/uploads/2017/05/MertekFuzetek11-2.pdf)

[54] https://g7.hu/allam/20180903/tizszeres-aron-is-hirdetnek-az-allami-cegek-a-barati-mediaban/

their own positions ("bubble effect") and are averse to making their own judgement based on the facts.

Finally, briefly about regulations. In light of the above, the one-sided media regulation introduced by the second Orbán cabinet, the adoption of the new Media Act[55] is not the primary threat to the freedom of the press in Hungary. The negative effect of the regulation is more indirect, manifested in what the media authority (National Media and Infocommunications Authority, NMHH) and the Media Council operating under its auspices fail to do. Just to give a few examples: it is the NMHH that laid the ground for all the 18 regional dailies being owned by persons close to the government. On the radio market, only state stations broadcast across the whole country. The Media Council prevented the partial merger of Central Média, which operates 24.hu, and RTL Klub, while it had no objection to the creation of the CEPMF. All this indicates that the Hungarian media authority is not motivated by the desire to promote the diversity of media content and market competition; instead, it unconditionally serves the government objective to create hegemony in the media.

Also, the Media Council lent support to the often inciting campaigns against George Soros and did not challenge the excessive propaganda spending of the government before the parliamentary election. As a different type of deficiency, the Hungary media authority takes no action whatsoever against the dissemination of fake news.[56]

6. Summary: corruption, dismantling of the Rule of Law and crony capitalism in Hungary

In recent years TI Hungary has pointed out repeatedly that Hungary is moving in the wrong direction in terms of corruption.[57] We also emphasized on multiple occasions that problems did not start in 2010; elements of poor governance cropped up already in the first decade of the 2000s. We noted in 2008, under a left-wing government, that corruption had been institutionalized in Hungary.[58] True, at that time we considered corruption to be a byproduct and dysfunction of the system rather than its core feature. This has gradually changed since 2010, and by now corruption has become a fundamental part of the system.

The incidents discussed in this paper regarding residency government bonds, grants to spectator team sports, public procurement and the use of EU funds are manifestations of corruption that indicate that the holders of political power are willing to openly promote the interests of those close to them – cronies, relatives, oligarchs – at the expense of the public as a whole. The new "national bourgeoisie" that is dear to those in power increase their wealth mostly from public funds. The source of the wealth of the new elite is the distorted mechanism of the allocation of state resources mostly, though not exclusively, through biased procurement decisions.

The politicians of Fidesz have stood up for the need to create a "national bourgeoisie and middle class" on numerous occasions, attempting to support with ideological arguments the redistribution of wealth by the use of public power, codified time and time again. This reasoning, however, is flawed in several respects. First, because oligarchs that enrich from

[55] Act CLXXXV of 2010.
[56] See Bátorfy, Attila: A kormányért újságíróként rajongani alapvető jog, a kormányt hatóságként támogatni szabadságellenes (http://index.hu/velemeny/2017/10/31/kormanypropaganda_sajtoszabadsag_nmhh/).
[57] See the communication referred to in footnote 15.
[58] Transparency International Hungary (2008): Korrupciós kockázatok az üzleti szektorban. Nemzeti Integritás Tanulmány. https://transparency.hu/adatok-a-korrupciorol/nemzeti-integritas-tanulmany/nis-2008-uzleti-szektor/

public funds serve no public interest; instead, they distort competition. Second, because according to the literature on economic development, predictability, legal certainty and the security of property are preconditions for long-term sustainable growth. Third, because the oligarchs that gain wealth from public funds typically create no value added; all they do is live off the wealth thus gained.

Economic success and social advancement are a function of a perverse mixture of loyalty and competence, with the former becoming increasingly important. Citizens and businesses seeking the favours of the state or government often have a vested interest in rent-seeking rather than in performing well in the market.

Based on the above we can conclude that in Hungary a top-down version of systemic corruption has become dominant, where wrongdoing is on certain occasions legalized. This determines the political system and impacts the functioning of the economy. The foundations of the rule of law in Hungary have been shaken. The institutions meant to curb the power of the government, that is, the so-called democratic checks and balances have been effectively dismantled. Government institutions have been taken hostage by interest groups of politicians and oligarchs ("state capture"). Cronyism has emerged, where performance has become relative in a number of sectors of the economy. Those in power may now distribute the national wealth, like feudal lords, to loyal oligarchs without any effective resistance. Meanwhile, the governing elite uses state power to incite hatred against critical civil organizations and to adopt laws to render their operation impossible instead of combating corruption and abuse of power.

The improvement of Hungary's short-term economic outlook and progress in the field of competitiveness are still unable to substantively improve the country's anti-corruption performance. This is mostly due to the poor performance of state institutions: investors in Hungary consider the reliability of state institutions and the predictability of their operation to be at a low standard in international comparison.

Changes in regulation can be expected to resuscitate the rule of law in Hungary, now practically defunct, only to a limited extent. The enforcement of the rules depends just as much on the attitude of the ruling elite, their commitment to democracy as well as the ability of civil society and the media to exert sufficient pressure on, and exercise control over, the ruling elite.