

Corruption, Economic Performance and the Rule of Law in Hungary

The results of the 2019 Corruption Perceptions Index

A report by Transparency International Hungary Foundation

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Executive Summary

Results of the Corruption Perceptions Index, 2019

The Secretariat of Transparency International in Berlin has prepared the Corruption Perceptions Index (CPI), ranking the countries by the public sector's exposure to corruption for the 25th time. **In 2019 Hungary received 44 points on a scale ranging from 0 (the most corrupt country) to 100 points (country least infected by corruption), placing it at joint 70th position, tied with Romania, among the 180 countries examined.** Compared to the previous survey in 2018, Hungary's resistance to corruption worsened by two points and six positions based on the assessment of the businessmen and experts interviewed in the surveys forming the basis of the Corruption Perceptions Index. While globally Hungary is considered moderately corrupt, within the European Union it is perceived as one of the most corrupt Member States. With 44 points achieved in 2019, Hungary finished in last position both among V4 countries, and among the Member States that joined the European Union in 2004; and is ranked as the second most corrupt country within the European Union, preceding only Bulgaria and Romania in joint first position.

According to the CPI, which is a composite index based on thirteen different surveys, Hungary's exposure to corruption is globally at the same level as South Africa and Suriname (44-44 points). From the point of view of the European Union it can be stated that Hungary stabilised its position among the poorest performers. Furthermore, comparing the CPI data of the past decade (2012-2019) it is evident that despite the minor improvement perceived in 2018, Hungary shows a constantly degrading performance even within the group of the European Union's corrupt Member States. 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. On the other hand, the report highlights that from 2018 to 2019 the CPI score has declined in the majority of countries in the Central and Eastern European region. Compared to last year, only the assessment of Estonia, Lithuania, and Bulgaria (still ranking at the last position with 43 points) improved in the region, by one point, respectively.

At the top of the global CPI ranking there hasn't been any significant change: in 2019 Denmark (87 points), New Zealand (87), Finland (86), Switzerland (85), Sweden (85), and Singapore (85) formed the frontline. Members of the G7 countries – apart from Italy (53) – can also be found in the first fifth of the global ranking. The interviewed experts assess the exposure to corruption of Germany (80), the United Kingdom (77), Canada (77), Japan (73), France (69) and the United States (69), also, relatively low. The United States with its 69 points ranks at the 23rd place of the global ranking, sinking to its lowest point in a decade. Even compared to the relatively weak performance showed in 2018, the US declined by two points and one position. In 2019, the bottom of the CPI ranking is made up of Yemen (15), Syria (13), South Sudan (12) and Somalia (9), countries which have performed consistently poorly for years.

Correlation between corruption and economic performance

TI Hungary's report highlights that within the European Union there is still a strong correlation between the economic development of a given country and the public sector's exposure to corruption. Comparing the CPI data of 2019 and the statistics related to the gross domestic product shows that Hungary is still among the Member States of the European Union which are seriously affected by corruption, while having a low GDP per capita. This statement is correct even though the GDP per capita in Hungary has continuously increased in the period between 2012 and 2018; growing from EUR 10,050 to EUR 13,690 within six years. The growth impetus characterising the second half of the decade of 2010 continues for the time being despite the spectre of deceleration in the global economy: Hungarian and international experts and organisations predict a growth of 4-5% for the whole previous year.

By examining the regional correlation between the gross national product and the exposure to corruption, it can be stated that among the Central and Eastern European countries, Slovakia's performance exceeds that of Hungary both in terms of GDP per capita and also regarding the efficacy of fighting corruption. Croatia, while possessing a more modest GDP per capita, but a slightly lower level of corruption, outperforms Hungary. Romania, also with a level of GDP per capita lower than Hungary's, shows a similar exposure to corruption. Among the EU Member States, Bulgaria is the only country that performs worse than Hungary on both indicators.

Rule of Law after a decade of Fidesz governance

TI Hungary's report states that in Hungary, as a result of a decade-long rule since 2010 of the current elite, the majority of the State institutions responsible for exercising control over the government are in defunct state. The erosion of Rule of Law has been continuous for a decade now, meaning that State institutions have an interest not (only) to promote public good, but to favour the governing party's actors, to keep them in power and to accumulate their wealth. The report examines the possibility of enforcing Rule of Law in three areas: 1. in justice; 2. in the procedure of the EU's Article 7; and 3. in municipalities.

In the area of **justice**, the report states that the prosecution under a one-man leadership, with a hierarchical and strictly centralised structure can easily fit in the System of National Cooperation. In certain corruption cases related to the governing elite the prosecution does its job, while by its inaction it ensures impunity to the persons involved in corruption scandals closest to power.

The courts proved their independence and their commitment to autonomy in numerous situations and cases, however, various signs suggest that the government has not given up on its attempts to weaken judicial impartiality.

The possible infringement of Rule of Law, human rights and the value of democracy was also noticed by the European Union, thus, following Poland, Hungary has become the second Member State against which the **procedure of Article 7** has been launched.

The report of TI Hungary also points out that although; in light of the 2019 municipal election results; **municipalities** appear as a possible scene to restore Rule of Law, they are significantly limited by their loss of competence and resources resulting from the government's centralisation efforts in the past ten years.

Public Procurements and the European Union Funds

The report of TI Hungary highlights that the Hungarian public procurement market still depends significantly on EU funds, and the use of the former is characterised by overbudgeting and the pressure of absorption, that is, the need to use funds as fast as possible at a maximum level. In the programming period 2014 – 2020 Hungary receives almost HUF 8.000 billion (EUR 25 billion) of support from the European Structural and Investment Funds. This amounts to 4% of the Hungarian annual GDP on average. Hungary ranks second among the Member States in terms of the amount of EU support per capita.

The pressure of absorption is apparent in the fact that in the actual programming period the government plans to use 110 – 115% of the EU funds allocated to Hungary so that, if certain projects are stopped by the auditors of European Commission, the invoices of another project could be submitted. An example is the so-called Elios case.

The report also refers to the fact that although the statistics published by the Public Procurement Authority show that the rate of the so-called single bid procedures dropped to 24% in the public procurement procedures above EU threshold, this does not coincide with the calculations of the European Commission, according to which this rate was 39 % in 2018. Based on information from the European Commission, this rate increased to 42% in 2019. It can thus be concluded that on the Hungarian public procurement market competition is fairly limited.

Nature of corruption in Hungary

According to the conclusions of the report, corruption has become extremely centralised in Hungary in the last decade. The essence of contemporary Hungarian State corruption is to re-distribute economic resources by various means, to create a new elite, and to reward and privilege actors close to the government. By legal means the State takes away or acquires certain groups' property, which is then redistributed to other groups. This is institutionalised in many cases. As a result of public fund drains, and by infringing upon the Rule of Law, taxpayers' money is transformed into private wealth. Corruption has become an integral part of the system, rather than a side effect.

Hungary, which from a political perspective is a hybrid system between democracy and dictatorship; can from an economic viewpoint be characterised as an instance of crony state capitalism. In certain segments of the economy, loyalty overwrites performance. Family members and cronies of political actors and those in power have much better chances to get contracts and positions. Finally, citizens and economic actors seeking the mercy of the State or the government are more interested in rent-seeking than showing (market) performance – claims the report of TI Hungary which presents the results of the Corruption Perceptions Index of 2019.

1. The latest results of the Corruption Perceptions Index

The Secretariat of Transparency International in Berlin has prepared for the 25th time its Corruption Perceptions Index (CPI^{*}), ranking countries by the public sector's exposure to corruption. In 2019, Hungary received 44 points on a scale ranging from 0 (the most corrupt country) to 100 (country least infected by corruption), placing it in joint 70th position with Romania among the 180 countries examined.

Compared to the previous survey in 2018, Hungary's resistance to corruption worsened by two points and six positions based on the assessment of the businesspeople and experts interviewed in the surveys that form the basis of the Corruption Perceptions Index. While globally Hungary is considered moderately corrupt, within the European Union it is perceived as one of the most corrupt Member States. Last year, Bulgaria was the only EU Member State to perform worse than Hungary in terms of perceived corruption. With 44 points achieved in 2019, Hungary finished in last position both among the V4 countries and among the Member States that joined the European Union in 2004; tied with Romania, it ranks as the second most corrupt country within the European Union, after Bulgaria.

The report of Transparency International Hungary (hereinafter: TI Hungary) below first discusses the 2019 results of the Corruption Perceptions Index in a wider context, then focuses on the assessment of Hungary, examining the underlying reasons behind – despite a small improvement in 2018 – the country's continuously deteriorating anti-corruption performance since 2012, which has led to plummeting 24 positions on the global ranking list over the past eight years.

Based on the CPI, which is compiled using 13 different surveys, in a global comparison corruption in Hungary is on the same level as in South Africa and the South American country of Suriname (44 points each). For the sake of objectivity, we should note that comparing countries with distinctly different social, economic and cultural backgrounds could be misleading, since expectations with regard to the individual countries' fight against

* The Corruption Perceptions Index (CPI) is calculated by the Secretariat of Transparency International in Berlin using 13 different surveys and analyses by 12 different institutions. The measurement tools underlying the CPI determine the level of perceived public sector corruption in the various countries based on the opinions of experts and businesspeople. In 2019, corresponding data was available from 180 countries, and Hungary was assessed based on 10 different sub-indices. Researchers at the Secretariat of Transparency International score the underlying indices to a standardised scale of 0 to 100, and calculate the CPI scores for the individual countries by using the average score of the sub-indices. In the Corruption Perceptions Index, 0 equals the highest level of perceived corruption and 100 equals the lowest level of perceived corruption. The detailed description of the CPI methodology is available at: www.transparency.org/research/cpi/overview. The CPI is based on the aggregation 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 (EOS), World Justice Project Rule of Law Index, Varieties of Democracy (VDEM) Project. The 2019 CPI figures for Hungary are based on ten different sources and, for obvious reasons, do not include data from the African Development Bank Governance Ratings and the Political and Economic Risk Consultancy Asian Intelligence. At the same time, the CPI evaluates Hungary based on all sub-indices that cover Europe. The 2019 report also does not include the indicators of the World Bank Country Policy and Institutional Assessment. Between 1995 and 2000, the CPI report looked at an average of 50-80 countries, which increased to 100-130 countries in 2001–2005, while the CPI survey has covered around 160-180 countries since 2006. The number of countries reviewed was 175 in 2014, 168 in 2015, 176 in 2016 and 180 in 2017, 2018 and 2019. Hungary has been included in the CPI report in every year since 1995.

corruption may differ significantly. Therefore, it is more appropriate to assess the anti-corruption performance of countries over a longer timeframe, and to compare countries that have similar institutions and common cultural characteristics. Comparing Member States of the European Union can be considered appropriate in every aspect.

Within the EU, it can be concluded that Hungary has stabilised its position among the countries at the bottom of the list. Moreover, looking at the CPI data for the past near-decade (from 2012 to 2019), it is clear that despite a small improvement in 2018 Hungary has shown continuously worsening performance even among the more corrupt EU countries. In 2012, Hungary was the 19th most corrupt country among the EU's then-27 members, but since then it has consistently slipped in the ranking, falling to the next to last, joint 26-27th place by 2017 in an EU that in the meantime had expanded to 28 members¹. In 2017 Hungary placed ahead of only Bulgaria within the EU, and although it improved its score by one point in the 2018 ranking², temporarily overtaking a significantly declining Greece, based on its 2019 score it once again was able to rank ahead of only Bulgaria.

Hungary ranked as the second most corrupt EU country in 2019 (see Table 1), and remains last both among the new members that joined the EU in 2004 and the V4 countries. Hungary's position has deteriorated significantly within the Central and Eastern Europe region: in seven years, it has slipped from the middle of the list to the penultimate, ninth position, tied with Romania (see Table 2).

Table 1: EU Member States in the 2019 Corruption Perceptions Index

RANKING		COUNTRY	SCORE	RANKING		COUNTRY	SCORE
1.	↓	<u>Denmark</u>	87	15.	▬	<u>Slovenia</u>	60
2.	↑	<u>Finland</u>	86	15.	↑	<u>Lithuania</u>	60
3.	▬	<u>Sweden</u>	85	17.	↑	<u>Cyprus</u>	58
4.	▬	<u>Netherlands</u>	82	17.	↓	<u>Poland</u>	58
5.	↓	<u>Luxembourg</u>	80	19.	↓	<u>Czech Republic</u>	56
5.	▬	<u>Germany</u>	80	19.	↓	<u>Latvia</u>	56
7.	↓	<u>United Kingdom</u>	77	21.	▬	<u>Malta</u>	54
7.	↑	<u>Austria</u>	77	22.	↑	<u>Italy</u>	53
9.	▬	<u>Belgium</u>	75	23.	▬	<u>Slovakia</u>	50
10.	↑	<u>Estonia</u>	74	24.	↑	<u>Greece</u>	48
10.	↑	<u>Ireland</u>	74	25.	↓	<u>Croatia</u>	47
12.	↓	<u>France</u>	69	26.	↓	Hungary	44
13.	↓	<u>Portugal</u>	62	26.	↓	<u>Romania</u>	44
13.	↑	<u>Spain</u>	62	28.	↑	<u>Bulgaria</u>	43

Source: TI Hungary calculations based on the data of the 2019 Corruption Perceptions Index. The arrows indicate the direction of change in the country's score compared to the 2018 Corruption Perceptions Index.

¹ The 2017 Corruption Perceptions Index – Corruption, the Rule of Law and Economic Performance in Hungary, in an International Comparison. Available (in Hungarian): https://transparency.hu/wp-content/uploads/2018/12/CPI_2017_narrativ_final_final.pdf.

² Corruption, Economic Performance and the Rule of Law in Hungary – Results of the Corruption Perceptions Index in 2018. Available: https://transparency.hu/wp-content/uploads/2019/01/CPI_2018_narrativ_en_20190208.pdf

Table 2: Central and Eastern European countries in the 2019 Corruption Perceptions Index

Ranking (2019)	COUNTRY	CPI 2012	CPI 2013	CPI 2014	CPI 2015	CPI 2016	CPI 2017	CPI 2018	CPI 2019	Change*
1.	Estonia	64	68	69	70	70	71	73	74	↑ 10
2.	Slovenia	61	57	58	60	61	61	60	60	↓ -1
2.	Lithuania	54	57	58	61	59	59	59	60	↑ 6
4.	Poland	58	60	61	62	62	60	60	58	▬ 0
5.	Czech Republic	49	48	51	56	55	57	59	56	↑ 7
5.	Latvia	49	53	55	55	57	58	58	56	↑ 7
7.	Slovakia	46	47	50	51	51	50	50	50	↑ 4
8.	Croatia	46	48	48	51	49	49	48	47	↑ 1
9.	Romania	44	43	43	46	48	48	47	44	▬ 0
9.	Hungary	55	54	54	51	48	45	46	44	↓ -11
11.	Bulgaria	41	41	43	41	41	43	42	43	↑ 2

Source: TI Hungary calculations based on data from the 2012-2019 Corruption Perceptions Index reports. The number in the last column indicates the difference in the CPI score of the given country in 2019 as compared to 2012.

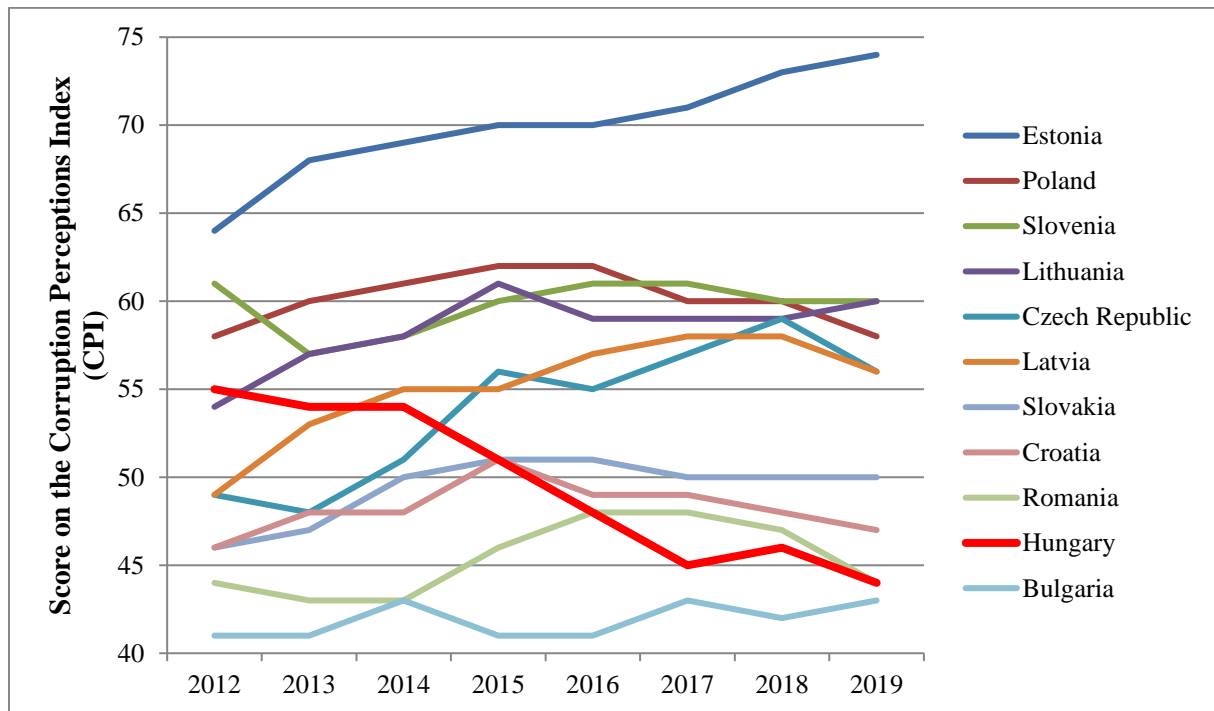
Hungary's CPI score decreased from 55 points to 44 points between 2012³ and 2019, making it the worst performer among the CEE members of the EU in terms of the perception of anti-corruption performance over the past eight years. Based on the Corruption Perceptions Index, 2019 is the third straight year in which only Bulgaria was perceived by experts to be more corrupt than Hungary among the countries of the region. Hungary is the only Visegrád country whose anti-corruption performance worsened compared to 2012, while the other countries showed unchanged or improving performance. Between 2012 and 2019, the CPI score of the Czech Republic increased by 7 points and that of Slovakia by 4 points, while Poland has held onto its stable, now 14-point, lead over Hungary since 2012. In the same period, Hungary's score fell by 11 points, which is an exceptionally poor performance not just in a regional, but in a global comparison as well.⁴ The progress of Hungary's relative position within the region can be seen in Figure 1, which shows the CPI scores of CEE countries in the period from 2012 to 2019. As seen in the figure below, the only other country besides Hungary whose score decreased in this period was Slovenia, with a loss of just 1 point.

³ The Corruption Perceptions Index's methodology was significantly revised in 2012, therefore the annual scores are only comparable from this year. Read more about the 2012 methodology update here:

https://www.transparency.org/files/content/pressrelease/2012_CPIUpdatedMethodology_EMBARGO_EN.pdf

⁴ The 11-point plunge in Hungary's CPI score between 2012 and 2019 is smaller only than the declines seen in the same period in the scores of Saint Lucia (-16 points), Liberia and Syria (-13 points each).

Figure 1: CPI scores of Central and Eastern European countries, 2012–2019



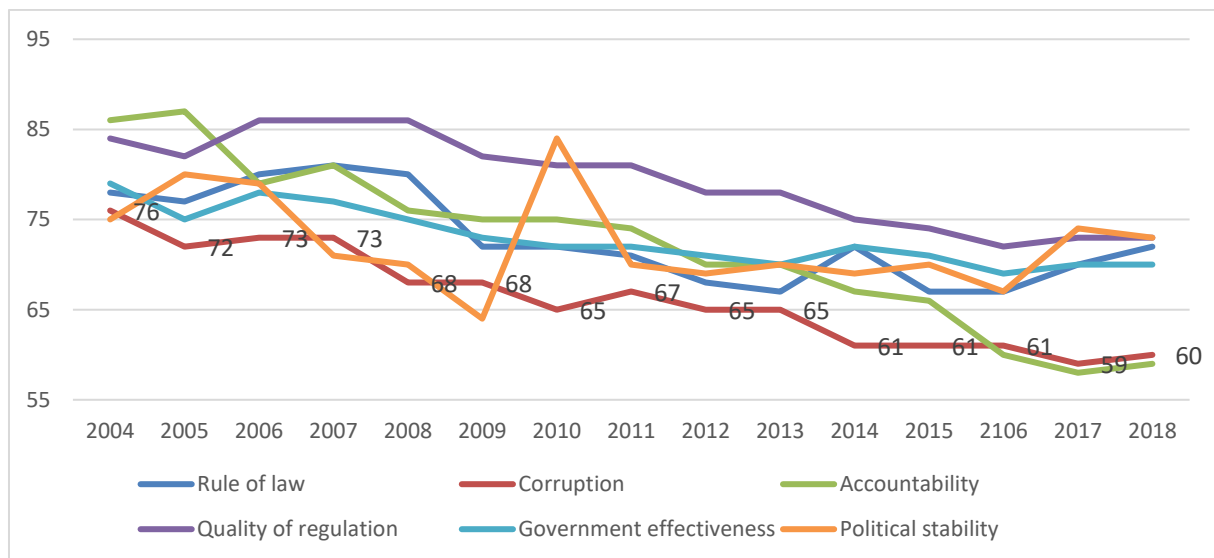
Source: TI Hungary calculations based on data from the 2012-2019 Corruption Perceptions Index reports.

It is worth noting that most countries in the Central and Eastern Europe region saw a decline in their CPI scores from 2018 to 2019. The only countries in the region to improve their scores – by one point each – were Estonia, Lithuania and Bulgaria, with the latter remaining in last place with 43 points.

In addition to the CPI, the World Bank’s Control of Corruption Indicator (CCI) also indicates a strong deterioration of perceived corruption in Hungary (see Figure 2). The results of the indicator⁵ – which uses a similar methodology to the CPI and is based on surveys of businesspeople and experts – point to the conclusion that the ability of the Hungarian state to combat corruption has shown a declining trend over the past decade and a half. The latest (2018) score of 60 points for Hungary is a particularly poor result within the narrower region, as Poland scored 75, the Czech Republic 69 and Slovakia 66 points in terms of the ability to control corruption (the higher the score, the more efficient the state is in guarding against corruption).

⁵ See data and methodology here: <http://info.worldbank.org/governance/wgi/>. Earlier calculations have shown a high correlation between the CPI and the CCI each year. See for example: Susan Rose-Ackermann – Bonnie Palifka (2016): *Corruption and Governance*, Cambridge University Press. p. 16, which puts the correlation coefficient consistently above 0.9.

Figure 2: Governance indicators for Hungary⁶



Note: The CCI (Control of Corruption) is one of the six indicators used by the WGI

Source: World Bank, Worldwide Governance Indicators (WGI)

Although undoubtedly a regional comparison is the most adequate when evaluating Hungary's position, putting it in context with the countries at the top and bottom of the list, as well as the performance of the G7 group of the world's largest developed economies, cannot be disregarded either when assessing the results of the CPI.

For years, mostly the same countries have led the annual CPI global rankings, with the Scandinavian countries for example always placing in prominent positions. In 2019, the countries at the top of the list were Denmark (87 points), New Zealand (87), Finland (86), Switzerland (85), Sweden (85) and Singapore (85)⁷. Apart from the "enlightened autocracy" of Singapore, these countries are developed democracies with impartial state institutions and a transparent and accountable executive, where public spending is also transparent. Therefore, the fight against corruption is mostly successful in these countries, providing the foundation for their world-leading levels of prosperity. Naturally, corruption is also present in the countries leading the Corruption Perceptions Index, sometimes even in serious forms, but it can generally be expected that these transgressions will not go unpunished. That is because these governments consider corruption to be an abuse that needs to be sanctioned, and not something that is inherent to the exercise of power.

Members of the G7 group of countries, which represent a dominant, ca. one-third share⁸ of the global gross domestic product, also placed in the top one-fifth of the global ranking, with the exception of Italy (53). The professionals surveyed rated the exposure to corruption in Germany (80), the United Kingdom (77), Canada (77), Japan (73), France (69) and the United

⁶ In addition to corruption, Figure 2 shows five other governance indicators included in the World Bank's database – including the rule of law and accountability –, which overall demonstrates a significant worsening in the quality of governance in Hungary over the past 15 years. These results are in line with the trends outlined by the CPI.

⁷ The values in parentheses after the name of the country are their 2019 CPI scores. Higher scores indicate lower levels of perceived corruption.

⁸ <https://ec.europa.eu/eurostat/documents/7330775/7339485/G7InFigures-May2015/0578de75-f33c-4e45-92cb-a6ba30bd8fbc>

States (69) relatively low. It should be noted, however, that even though the United States placed 23rd on the list with a score of 69 points, this represents the leading world power's lowest score in about a decade, dropping another two points and one position compared to its already relatively weak performance in 2018.

Bringing up the rear of the CPI list in 2019 are Yemen (15), Syria (13), South Sudan (12) and Somalia (9), which have all performed poorly for many years. In these states, dictatorships or anarchy rule, and state institutions are unable or unwilling to serve in the interest of the public good. Corruption is rampant, which is at once the cause and the consequence of the high rate of poverty.

2. Correlation between corruption and economic performance

2.1. Correlation between corruption and GDP per capita

There is extensive international research, including many theoretical and empirical studies, on the correlation between corruption and economic performance.⁹ Corruption is the most important cause and consequence of “bad governance,” and usually goes hand in hand with violations of the principles of the rule of law. If biased state institutions, acting mainly in the interest of preserving the power of the governing elite, do not fight, but instead tolerate or even promote corruption, it leads to social and economic loss. In this case, members of the ruling – crony – elite will increase their power and wealth, while part of society will become poorer. If the well-being of citizens depends upon the favour of the state or government, this leads to rent-seeking and can have a negative effect on economic efficiency, productivity and the business environment, which in turn may undermine sustainable growth.¹⁰

In the European Union, in 2019 as well there was still a strong correlation between economic development – measured as gross domestic product (GDP) per capita – and the public sector's exposure to corruption, as expressed by TI's Corruption Perceptions Index¹¹ (See Figure 3). As a member of the less-developed group of countries in Eastern and Southern Europe, Hungary is among the Member States of the European Union that are seriously affected by corruption, while having a relatively low GDP per capita.

This statement is correct even though the GDP per capita in Hungary has continuously increased in the period between 2012 and 2018, growing from EUR 10,050 to EUR 13,690 within six years¹² (increasing from EUR 174 billion to EUR 214 billion in overall purchasing-power parity). The rate of growth characterising the second half of the 2010s remains stable for the time being despite the spectre of deceleration in the global economy: Hungarian and

⁹ See e.g.: Organisation 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>.

¹⁰ This correlation, as the OECD study quoted in the previous footnote shows, is present on a global level as well, though several countries – especially in Asia – can be considered exceptions: in these countries, impressive economic performance is often coupled with high exposure to corruption.

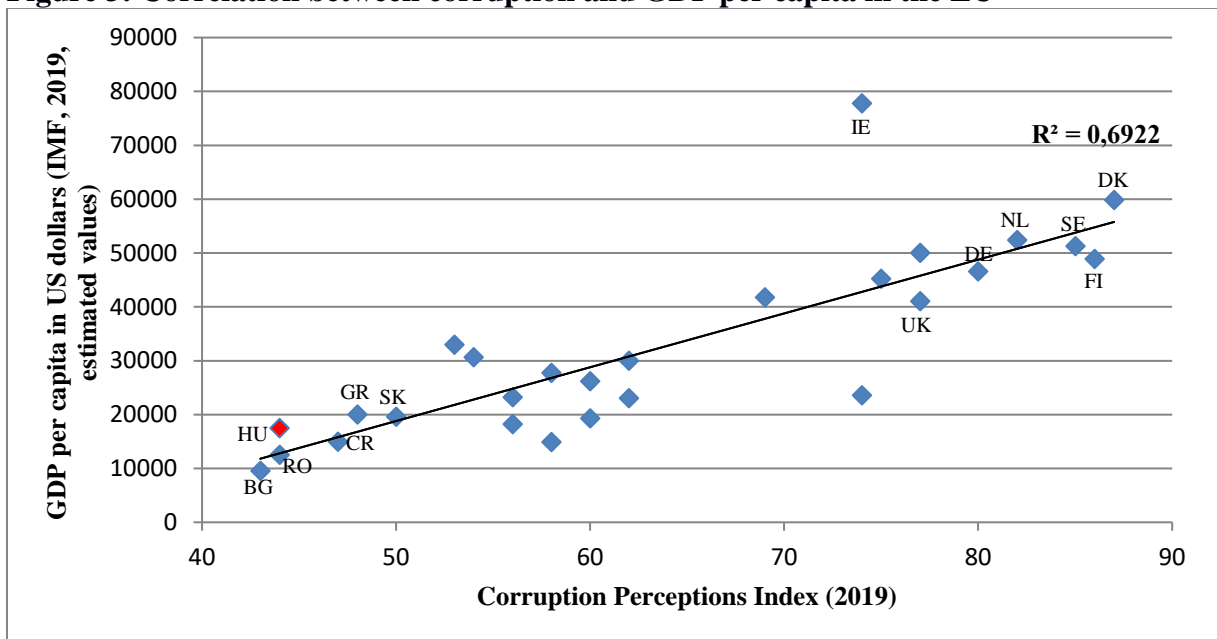
¹¹ The R² value in Figure 3 indicates the correlation rate between per capita GDP and the Corruption Perceptions Index score: the value of close to 0.7 indicates a strong correlation between the two variables. The R² value indicates the strength of the correlation between two variables, ranging from 0 to 1. Although there is no consensus among statisticians as to the exact level above which this coefficient of determination can be viewed as “high,” the value of around 0.7 indicates a strong correlation by all accepted thresholds.

¹² <https://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tec00001&plugin=1>

international experts and organisations – such as the Central Statistical Office (KSH) – put the rate of growth at 4-5% for the previous year as a whole.¹³

Figure 3 shows Hungary’s performance in a regional comparison. Among the Central and Eastern European countries, Slovakia’s performance exceeds that of Hungary both in terms of GDP per capita and the efficacy of fighting corruption. Croatia, while possessing lower per capita GDP, also shows a slightly lower level of corruption, thus outperforming Hungary, while Romania, which also has a lower level of GDP per capita than Hungary, shows a similar exposure to corruption. Among the EU Member States, Bulgaria is the only country that performs worse than Hungary on both indicators.

Figure 3: Correlation between corruption and GDP per capita in the EU



Source: TI Hungary calculations based on data from Transparency International and the International Monetary Fund (IMF)¹⁴. Note: The higher the Corruption Perceptions Score, the lower the exposure to corruption. For technical reasons, European Union member Luxembourg, which placed 9th on the 2019 CPI list with a score of 80 points, and has per capita GDP of USD 113,000, has been omitted from the figure.

2.2. Problems of competitiveness and the declining performance of state institutions

Despite the economic growth of the past seven years, there are significant problems with Hungary’s competitiveness. In the World Economic Forum’s (WEF) latest annual report on global competitiveness¹⁵ – which includes both hard indicators and surveys – Hungary placed 47th among the 140 countries ranked by their national competitiveness. This represents an improvement of one position from the previous year (due to changes in methodology, only limited comparisons should be made to earlier reports).¹⁶ Though not in a global comparison, but within the EU and the closer region Hungary’s competitiveness is noticeably poor. The

¹³ https://www.ksh.hu/brutto_hazai_termek_gdp_elozetes_adata

¹⁴ Related IMF statistics are available [here](#).

¹⁵ [World Competitiveness Report: http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf](http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf)

¹⁶ It is in any case worth noting that Hungary’s competitiveness has plummeted since the turn of the millennium: the country’s was the 28th most competitive economy in 2001, while it fell to 69th place by 2016.

only EU countries to perform worse than Hungary are – moving up the list from the worst – Croatia, Greece, Romania and Bulgaria.

One of the factors of competitiveness according to the international research team of the WEF is an “enabling environment,” which rests on four pillars, one of them being “institutions”. The efficiency, transparency and accountability of the functioning of the state has a fundamental effect on the business environment of a country. An economy can only operate efficiently if property rights are “sacred”. If public administration is not conducted in accordance with the written and unwritten laws of efficiency and impartiality, but the wheels are greased by corruption, then that makes getting ahead difficult both for private individuals and companies. If the state establishes systems that divert public funds into private pockets in ways that are unjustified from the standpoint of society, then competitive conditions will be unequal, skewing the market and the merit-based distribution of resources, and thus leading to a potential decrease in economic output. If the conditions expected under the rule of law are not applied, then no investor can be sure that the justice system will act impartially in case of a dispute.

In most of the index components that measure confidence in the institutions that regulate the conditions of the economy, Hungary performs worse than all of the 13 EU members of the region, with the exception of Croatia. The bane of Hungarian competitiveness and the obstacle to economic convergence has long been an institutional framework that is mired in corruption. Other factors inhibiting convergence that are worth noting are the poor state of healthcare and education and the low level of innovation capacity. With regard to institutional factors, while business executives note a high burden of government regulation, there is practically no efficient legal framework for challenging government decisions – as indicated by Hungary’s 134th position within this index component of the competitiveness report. The system of checks and balances, i.e. the accountability of public authority, is the most exemplary in Finland, with the Scandinavian country leading this list, while the extremely centralised Hungary ranked 101st in this respect (see Table 3).

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

Index components within the “institutions” pillar of the competitiveness report	Rank (out of 140)
Efficiency of legal framework in challenging regulations	134
Conflict of interest regulation	121
Property rights	99
Judicial independence	102
Public-sector performance	83
Burden of government regulation	106
Checks and balances	101

Note: The table shows Hungary’s rank in some institutional indicators, based on the World Economic Forum’s Global Competitiveness Report 2019.¹⁷

The Hungarian economy seems stable for now on the short term; its balance and growth indicators are mostly favourable, although there are some signs of overheating that are reflected in rising inflation. Looking back on a longer horizon, however, the Hungarian economy has not performed so well: among the countries of the region that joined the EU in

¹⁷ http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf, p. 271

2004 and 2007, Hungary's GDP showed the smallest growth between 2005 and 2018 (see Table 4).

Table 4: Economic growth in the region compared to 2005 base

Country	GDP growth, % (compared to the base year of 2005)	
	2005	2018
Hungary	100	122
Slovenia	100	126
Latvia	100	130
Estonia	100	133
Czech Republic	100	135
Lithuania	100	141
Bulgaria	100	142
Romania	100	155
Slovakia	100	159
Poland	100	166

Source: TI calculations, based on Eurostat data

Even if we compare GDP to a base of 2010, the picture is not too positive either: within the region, Hungary's economic performance showed average the growth (See Table 5).

Table 5: Economic growth in the region compared to 2010 base

Country	GDP growth, % (compared to the base year of 2010)	
	2010	2018
Slovenia	100	115
Czech Republic	100	120
Bulgaria	100	120
Hungary	100	123
Slovakia	100	126
Poland	100	132
Latvia	100	133
Lithuania	100	133
Romania	100	135
Estonia	100	135

Source: TI calculations, based on Eurostat data

On a longer horizon, corruption, the distorted (re)distribution of resources, dismantling the rule of law, and state-bureaucratic bias will cause a great deal of damage to the Hungarian society and economy. An early indication of this may be that – as the WEF report shows – businesses have become extremely risk-averse, and the private sector is also optimising its activity for the short term.

3. The rule of law after a decade of Fidesz governance

As a result of the decade-long rule of the current elite since 2010, it can now be considered a fact that the majority of democratic institutions in Hungary are in a defunct state. The government has almost completely snuffed out the professional and organisational autonomy of independent state institutions and put almost all of them under the control of loyalist appointees. But ten years of institutional destruction has not completely ended what was once a functioning system of checks and balances. This is because the courts, despite all efforts by the government to the contrary, have largely managed to preserve their professional autonomy. A further dismantling of the rule of law may be slowed by the fact that the EU is playing a more active role in defence of Hungary's democracy than at any time since 2010. Albeit in fits and starts, the so-called Article 7 procedure is going ahead unabated. Under this procedure, the entire Hungarian institutional system, as well as several laws and specific government measures, are under scrutiny. Election results in 2019, particularly those of municipal elections last autumn, were also a noteworthy signal that, despite the concentration of power by the government, it is still possible for voters to make their voice heard. In the following sections, we will focus on these three areas to find out to what extent conditions exist for the revival of the rule of law.

3.1. Still-autonomous courts vs. often partial prosecution authorities

The biggest institutional players of the judiciary are the courts and the prosecutors. While the government has attempted to rein in the courts on several occasions in the past decade, it appears to have a smooth relationship with prosecution service. This is quite remarkable, especially when we recall that governments in 2002-2010 had a much more hostile relationship with the prosecution service than they did with the courts.¹⁸ As a strictly centralised, hierarchical organisation under the control of a single leader, the prosecution service was a natural fit for Orbán's "System of National Cooperation." Despite the criticism of the Venice Commission¹⁹ and the recommendations of GRECO²⁰, the government insists that the rules governing the prosecution service remain unchanged. This indicates that it is important for the government to ensure that the prosecutor general possesses uncontrolled and unlimited power over the operations of the prosecution service. This trust is best exemplified by the fact that Mr Péter Polt, prosecutor general was re-elected for another nine-year term in 2019.

Let's just say that the prosecution service has done its best to deserve this trust, as it has decided in the government's favour in several corruption cases. In practice, this often simply meant turning a blind eye. This is how key players of the Elios case, including the prime minister's son-in-law, escaped justice, even though the European Anti-Fraud Office (OLAF) believes they have used mafia-like methods to secure HUF 13 billion (EUR 43 million) of public funds.²¹ Likewise, it was the absence of prosecution that kept off the hook beneficiaries of offshore companies that profited approximately HUF 60 billion (EUR 190 million) from

¹⁸ In support of this argument, see: Ligeti, Miklós: A látható ügyészség, *Belügyi Szemle* 2013/11, pp. 5–32., p. 9. (transparency.hu/uploads/docs/lathato_ugyeszseg.pdf)

¹⁹ The opinion of the Venice Commission on Acts CLXIII and CLXIV of 2011 (CDL-AD(2012)008, Section 87. ([http://www.venice.coe.int/webforms/documents/?pdf=CDL-AD\(2012\)008-e](http://www.venice.coe.int/webforms/documents/?pdf=CDL-AD(2012)008-e)).

²⁰ GRECO Fourth Evaluation Round – Corruption prevention in respect of members of parliament, judges and prosecutors (Evaluation Report Hungary), Sections 177 and 190 (<https://rm.coe.int/16806c6b63>).

²¹ See the official statement of the prosecution: <http://ugyeszseg.hu/reagalas-javor-benedek-ugyeszseggel-kapcsolatos-mai-valotlan-allitasaira/>

selling residency state bonds.²² Similarly, leaders of the Central Bank of Hungary evaded penal consequences for funnelling HUF 267 billion (EUR 900 million) of state funds into private foundations, even though they had no legal mandate whatsoever to do so.²³

However, it is no longer true that the prosecution service always goes easy on perpetrators of cases that are embarrassing for the government. For instance, former Fidesz MP Roland Mengyi is set to end up in prison.²⁴ It is also very likely that current Fidesz MP György Simonka will face a serious penalty.²⁵ The way things stand, Fidesz MP István Boldog also has reasons to worry.²⁶ These cases demonstrate that authorities do not prosecute all cases with equal enthusiasm, and do not provide reassuring explanations as to which corruption suspects will escape and which ones will be brought to court. Although the prosecution service is doing its job in selected corruption cases that are related to the governing elite, it has been indefensibly passive as it gave a free pass to those involved in corruption cases that are most sensitive for the ruling party. We have no choice but to assume that this cherry-picking among corruption cases is taking place on political orders, or at the very least with an eye on the interests of the ruling elite. And it is indeed the death of the rule of law if the prosecution, instead of probing guilt, is using the political value of suspected perpetrators as a gauge by which to decide whether to indict or to drop charges.

Court decisions are another matter entirely. Thanks to various measures of the government, courts have had plenty of opportunity to demonstrate their commitment to independence and autonomy. Cutting short the tenure of the president of the former Supreme Court²⁷; creating the National Judicial Office (bringing scandal after scandal during its operations); and forcing several senior judges into retirement²⁸ were only the beginning in a series of conflicts between the courts and the executive branch.

Among attempts to weaken an impartial judiciary, the creation of special administrative courts – first floated in 2016 – was by far the most significant.²⁹ Laws adopted after the 2018 parliamentary elections³⁰ suggest that the government did not give up on its plan, which failed the first time around owing to the opposition of judges. While there are legitimate arguments that Hungary, similarly to many other EU members, should once again delegate special legal disputes affecting the state bureaucracy to a separate court system, the government's intent to curb judicial independence is indefensible. The reason we are assuming such malicious intent is that the new laws would have made it possible to fill the special administrative courts with legal professionals previously working as career bureaucrats.³¹ Moreover, regulations would

²² https://transparency.hu/wp-content/uploads/2018/12/Imak_tanulmany_final_magyar_lektoralt.pdf

²³ See Ligeti, Miklós: Prosecuting No Longer ("Elveszíti ügyészség jellegét"), in: Magyar Narancs, 2016/30, 28 July 2016.

²⁴ On 25 September 2019, a court sentenced Roland Mengyi to four years in prison for budget fraud (source: <https://www.hirosveny.hu/hirek/jogerosen-negy-ev-letoltendo-bortonre-iteltek-mengyi-rolandot>)

²⁵ The case against György Simonka and similar cases were covered in detail by a series of articles by 24.hu that later won the Transparency-Soma 2019 Award for Best Investigative Journalism (see: <https://transparency.hu/hirek/a-24-hu-ujsgirojanverte-az-idei-transparency-soma-dijat/>).

²⁶ See: <https://168ora.hu/itthon/boldog-istvan-fidesz-korrupcio-vizsgalat-magyarorszag-reszlet-179121>

²⁷ The European Court of Human Rights ruled that this was in violation of the European Convention on Human Rights (Case of *Baka v. Hungary*, 20262/12). See also: Political Discrimination in Hungary. Policy Solutions, 2017. (http://www.policysolutions.hu/userfiles/elemzes/265/political_discrimination_in_hungary.pdf).

²⁸ The European Court of Justice ruled that the law on the early retirement of judges is incompatible with EU law (Case C-286/12, *European Commission v. Hungary*). The Constitutional Court arrived at a similar conclusion in its 33/2012 (VII. 17.) ruling.

²⁹ See the Justice Ministry's initiative for this bill: JEFHÁT/93/2016 – ME/1584/2016. (the document, which has not been made public, is in TI Hungary's possession).

³⁰ See Acts CXXX and CXXXI of 2018 on special administration courts; and Article 7 of the 7th Amendment of the Fundamental Law of Hungary.

³¹ See Paragraph 66 of Act CXXX of 2018.

have allowed any case – such as freedom-of-information disputes, which are hardly bureaucratic in nature – to be delegated to the special administrative courts.³²

This attempt ultimately failed for a second time, as the government – shortly after the European Parliament elections – withdrew the bill on the introduction of the special administrative courts.³³ Of course, this does not mean that it has abandoned its intent to curb judicial independence. For instance, the latest judicial legislative package³⁴ makes it possible for state institutions to initiate the constitutional review of any regular court decision before the Constitutional Court. Expanding the notion of fundamental rights – originally designed to protect individuals against state power – to also include state institutions makes little legal sense, but it does suggest that the government trusts the Constitutional Court much more than it does regular courts. Among the latter, judicial ethos and a 2,900-strong decentralised organisation have so far successfully blocked pro-government endeavours from prevailing during judicial processes. By contrast, the Constitutional Court, which has by now fallen victim to politics, has not excelled at being a check on government power in recent years; therefore, the government has every reason to hope that in sensitive cases it will consistently hand down pro-government rulings.

As for the latest developments, we can only guess whether Viktor Orbán’s outbursts against the courts should be viewed as mere political declarations or the prologue to a new wave of legislation designed to curb judicial impartiality and court autonomy. TI Hungary has no direct information regarding school segregation in Gyöngyöspata (a case sealed by a court decision); nor about the operations of the national compensation mechanism available to inmates who protest prison conditions. However, we have no reason to doubt that the respective court decisions were well-founded. Therefore, we must emphasise that the government’s refusal to respect court rulings against it, and its attempts to incite public hatred against these rulings, foreshadow a plunge in the quality of politics that would be unimaginable in the EU and without precedent even in Hungary.

3.2. The “Article 7” procedure – will the European Union protect Hungary?

Hungary ranks second in the European Union in two aspects – per capita EU funds, and procedures launched for breaches of the fundamental values of the EU. Hungary is the second member state, after Poland, that has triggered the so-called Article 7 procedure. This happened because the European Parliament believes that human rights are in jeopardy in Hungary, and that respect for democracy and the rule of law are in doubt. The procedure may well have grievous consequences for Hungary: in a worst-case scenario, the country could temporarily lose its voting rights in the European Council. Although right now the probability of such an outcome is extremely small – in effect, zero – the procedure itself is still significant. This is because before the EU decides whether Hungary’s government is in serious and permanent breach of fundamental EU values, it will carry out a full review of the entire state administration.

The procedure is based on a report adopted by the European Parliament on 12 September 2018.³⁵ Popularly known as the “Sargentini report”, the document raised serious concerns

³² See Article 25, section (3) of the Fundamental Law of Hungary, and Paragraph 1, section (3) of Act CXXX of 2018.

³³ <https://www.parlament.hu/irom41/06295/06295.pdf>

³⁴ Act CXXVII of 2019

³⁵ <http://www.europarl.europa.eu/news/hu/headlines/eu-affairs/20180222STO98434/a-jogallamisag-helyzete-a-tagallamokban-es-a-hires-7-cikk>

over government attacks against judicial independence; systemic corruption; and the weakening of the system of checks and balances, among others. The government summarised its arguments in a rather lengthy response,³⁶ but as it so often has done in the past few years, it offered a significantly doctored version of reality. Therefore, TI Hungary and several other NGOs prepared a parallel report³⁷ to counter the government's (often false and misleading) statements. Among others, TI Hungary explained in this civil society report that, contrary to what the government claims, the current system of asset declarations is inadequate for identifying the true extent to which parliament members are amassing wealth, and the origin of such enrichment. We also stressed that campaign finance rules are strict on paper only, but in reality they are easily circumvented and have enabled the theft of HUF 8 billion of public funds by fake political parties to occur unpunished. TI Hungary also noted that while the Hungarian prosecution service launched investigations into 45 % of all cases recommended by OLAF, it failed to take action in 20 high-level corruption cases in the past seven years despite OLAF's recommendations.

The report to counter the government's position was completed during the Finnish presidency of the EU, at a time when the initially sluggish procedure appeared to gain momentum. During this time, Justice Minister Judit Varga testified on two occasions. Many believe that Croatia, which currently fills the EU's rotating presidency, is not as committed to the rule of law as Finland, its immediate predecessor. Therefore, it is possible that Article 7 procedures against the two Visegrad countries will get stuck again or will be closed without serious sanctions. Even so, all these developments were not in vain. First, the more attention the state of democracy and the rule of law in Hungary receive from the outside, the less opportunity the government has to further erode them. Abandoning the controversial idea of the special administrative courts for a second time also signals that the Orbán-regime is not too happy with the special attention lavished on it by the EU. Second, the scandalous behaviour of government representatives at their hearing on 10 December 2019 exposed decision-makers of other EU member states to the Hungarian government's often cynical and hate-mongering propaganda campaign, which has repeatedly blamed rule-of-law criticism levied against Hungary on a global conspiracy led by George Soros. Third, the report compiled by numerous NGOs to deny the government's untrue statements gave many EU decision-makers a glimpse at the government's practice – all too familiar for those living in Hungary – of bending reality to its current needs.

Participating NGOs presented the findings of this parallel report during some half a dozen roundtable forums to citizens both in the capital and in countryside cities.³⁸

3.3. Eppure si muove, or the consequences of the local government elections

Local government elections in 2019 resulted in the biggest loss for the governing party since 2006; but it did not merely lose out politically against an opposition alliance in the autumn of 2019. Instead, it is the institutional system created by Fidesz that suffered a spectacular defeat. This means that the will of voters can indeed be realised, despite central and local bureaucracies that clearly serve the governing party in a biased way, and despite a propaganda empire propped up by billions in public funds. However, it remains to be seen whether this

³⁶ https://www.kormany.hu/download/2/81/81000/sargentini_cafolat.pdf

³⁷ https://transparency.hu/wp-content/uploads/2019/10/NGO_rebuttal_of_Article_7_Hun_gov_info_note_18102019.pdf

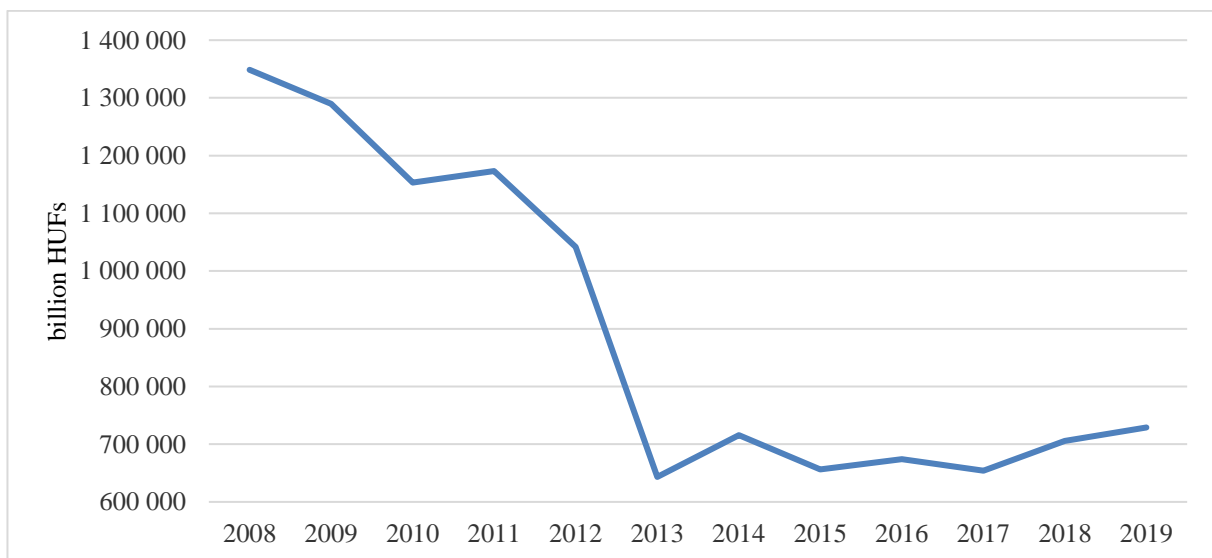
³⁸ See e.g. a report by Debreciner.hu on the presentation of the shadow report in Debrecen:

https://www.debreciner.hu/cikk/1720_a_nagy_cafolat_debrecenben_tenyek_a_7_cikk_szerinti

victory – achieved in spite of a regime built to defy the rule of law and operated for the sole purpose of holding on to power – can make it possible to break down systemic corruption and restore the rule of law at the municipal level.

One-third of Hungarian citizens now live in cities or towns led by opposition forces.³⁹ The economic power and income-generating capacity of these settlements, especially the big cities, is far bigger than that of smaller municipalities. However, the fiscal and institutional weight of local governments has changed greatly since 2010, which is having a considerable impact on local governments’ manoeuvring room. First, financial support for local governments from the central budget has fallen significantly. This item consistently exceeded HUF 1000 billion each year within municipal revenue until 2012; while since 2013, annual transfers from the central government have amounted to only about HUF 640-730 billion (see Figure 4). Moreover, reforms introduced in 2011 mean that municipalities receive central funding tied to specific tasks; meaning, in practice, that the size of unrestricted funds that can be freely spent (or saved) has shrunk, and local government budgets have become less flexible.

Figure 4: Central budget funding for local governments, 2008-2019



Source: Appendices of annual Budget Acts detailing local government subsidies and the fiscal balance of the general government.⁴⁰

In the years after 2010, it was not only central budget funding for local governments that fell markedly, but also local government expenditure. Annual expenditures of the municipal sector amounted to roughly one-eighth of GDP in 2008-11 but made up just 6 % of GDP in the past three years (see Figure 5). In the decade before 2011, local governments typically

³⁹ Haász, János: More than 3.5 million Hungarians now live in places led by non-Fidesz mayors

(https://index.hu/belfold/2019/10/14/nem_fideszes_polgarmester_onkormanyzati_valasztas_varos). If, in Budapest, we only count the population of the districts that are led by the opposition, the total population of settlements led by forces other than Fidesz is closer to 3 million.

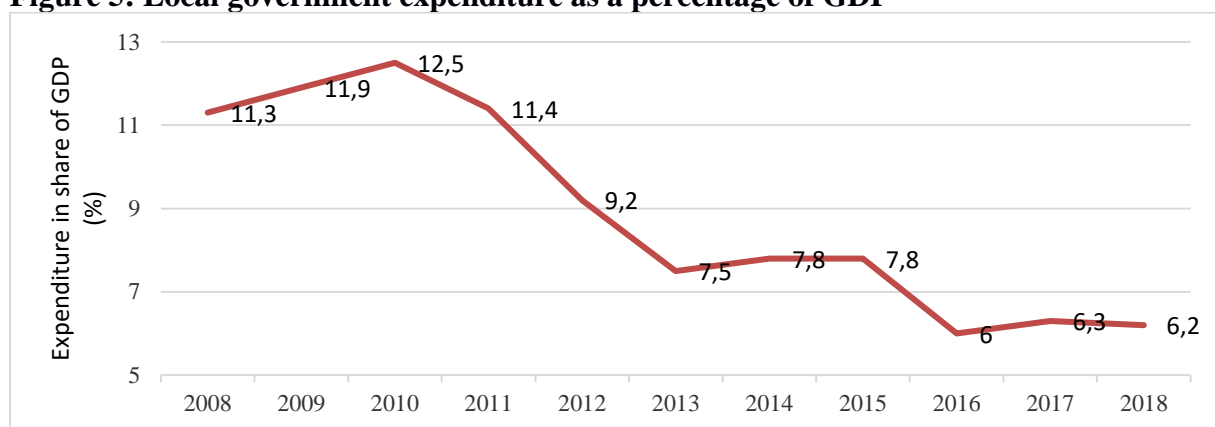
⁴⁰ Péter Bordás points to a similar drop in central budget funding for the municipal sector, see: Is Task-Based Financing Really Task-Based Financing? Evaluating Hungarian Municipal Funding Mechanisms, in: *Közjogi Szemle*, X/2. (available at: http://real.mtak.hu/74496/1/Bord%C3%A1s%20P._Feladatfinansz%C3%ADroz%C3%A1s..._K%C3%B6zjogi%20szemle%20%282017%29.pdf). It is worth noting that annual data on central budget funding for local governments in 2005-16 in the article are slightly different from what is cited here.

spent EUR 11-12 billion annually, while in the past three years, expenditures of municipal governments have stabilised at about EUR 8 billion.

It is important to note that total public expenditure as a percentage of GDP remained high throughout the period: it typically added up to about 50 % of GDP, though it fell to 46 % in 2018. Growth in GDP meant substantial growth in total public sector expenditure between 2011 and 2018. However, local government spending in the same period fell significantly, both nominally and as a percentage of GDP.

During this period, the institutional role of local governments has narrowed significantly: primary and secondary schools as well as hospitals were all removed from local control. Centralising formerly local public services has been a main driver of the drop in municipal expenditure. Equally important was the assumption of local government debt by the central budget; as a result, debt service expenditure has been largely erased from local budgets.

Figure 5: Local government expenditure as a percentage of GDP



Source: TI Hungary calculations, using data in the appendices of annual laws on the execution of the budget, plus GDP data published by the Central Statistical Office.⁴¹

The extent of publicly-financed services has not changed; what really happened was that public primary and secondary education, as well as hospital care were simply moved from the local to the central government level. However, the still-high share of public spending as a percentage of GDP – despite a three percentage-point drop in recent years – and the significant increase in nominal expenditure suggests that centralisation has not made these public services any cheaper.

These developments fit a larger pattern of centralisation by the government since 2010; by taking away responsibility for locally-provided public services, and by considerably reducing the fiscal autonomy of local governments, “they can be relegated to a mere executive role”.⁴²

Considering these, all we can say is that it will be difficult for opposition-led cities and towns to break out from under central-government rule. Still, TI Hungary is working to provide practical advice to strengthen the rule of law at the local level. For local governments to operate transparently and fairly, it is not necessary to reclaim former responsibilities and diverted revenue, it is sufficient to merely craft quality legislation and execute it consistently.

⁴¹ Gábor Péteri makes a similar observation regarding the drop in municipal expenditure, see: Experimenting: Municipal Task-Based Financing (available at: <https://kozjavadoc.hu/kiserletezgetunk-onkormanyzati-feladatfinanszirozast>).

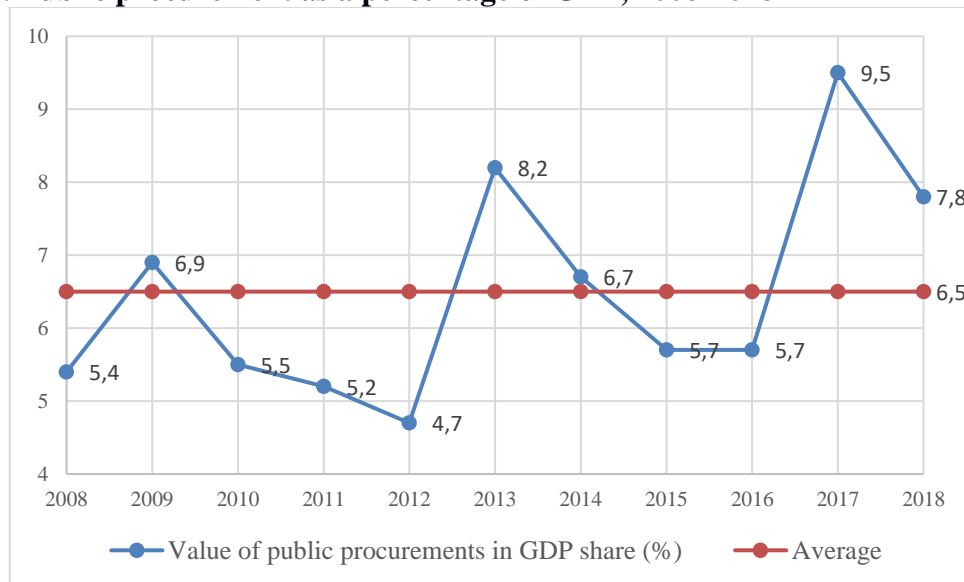
⁴² Gajduscheck, György: Changes in the Local Government System – An Interpretation, in: *Fundamentum* 2012/2, p. 70.

Átlátszó.hu, K-Monitor and TI Hungary summarised their proposals in a programme called Ez a Minimum!⁴³ (“The Least We Can Do”) that can help local governments greatly improve their credibility. The main point of our proposal is that the transparency of the use of public funds and local decision-making must be strengthened. To achieve this, progress must be made in key areas such as access to information of public interest; clarity of municipal budgets; public access to local government contracts; fairness of public procurement deals; transparency of local government leaders’ asset and interest disclosures; and reliable operations by municipality-owned businesses. During the campaign, a total 389 local candidates pledged to realise these proposals on transparency. Of the 389 candidates, 184 were eventually elected in 60 different locations, including 16 who were elected mayor. This is a major success, and raises the possibility that a network of municipalities committed to transparency may be formed across the country. Transparency International Hungary aims to help this process by preparing a model transparency guideline.⁴⁴

4. Public procurement and EU funds

Although 2019 data are not yet available, it is important to note that state organisations (such as public institutions, state and municipally-owned companies, and public utilities) spent considerably more budget funds via public procurement in 2017-18 than in previous years. On average, the state is spending about 6.5% of GDP via public procurement, in line with the EU average. However, public procurement volume reached almost 10% of GDP in 2017, and about 8% in 2018 (see Figure 6).

Figure 6: Public procurement as a percentage of GDP, 2008-2018



Source: 2018 annual report of the Public Procurement Authority for Parliament.⁴⁵

⁴³ <http://www.ezaminimum.hu/>

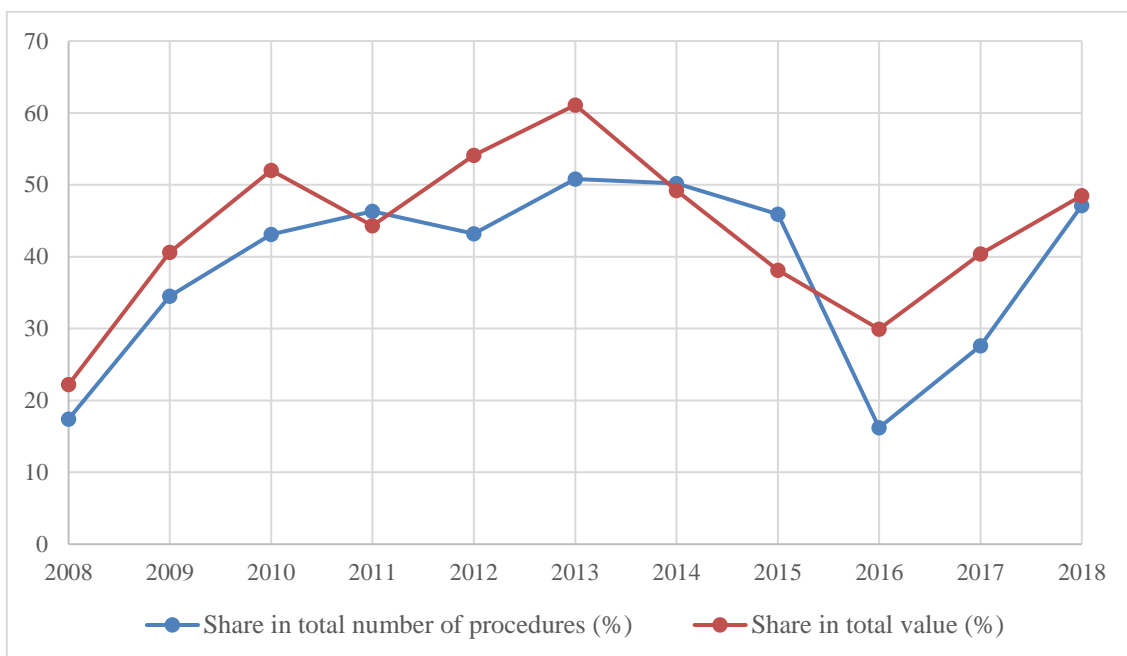
⁴⁴ <https://transparency.hu/wp-content/uploads/2019/12/%C3%96nkorm%C3%A1nyzati-%C3%A1tl%C3%A1that%C3%B3s%C3%A1gi-mintarendelet.pdf>

⁴⁵ See: https://www.kozbeszerzes.hu/data/filer_public/ea/ea/eaead05-c892-4ec0-a02c-071e84cd1e7d/a_kozbeszerzesi_hatosag_2018_evi_beszamoloja.pdf

As you can see in Figure 6, the volume of public procurement in Hungary can change greatly from one year to the next. The primary reason for this is that roughly one-half of public procurement projects in Hungary are financed partly or fully from EU funds. Therefore, the annual volume of public procurement contracts depends greatly on how much EU funding the government is able to draw in that specific year. The surge in 2017-18 can be attributed to the fact that this was the halfway-point of the 2014-20 EU budget cycle, where actual funding flows began after a planning and application period.

In the 2014-20 budget cycle, Hungary is set to receive almost HUF 8 trillion (EUR 25 billion) from the European Structural and Investment Funds. On average, this amounts to 4% of Hungary's annual GDP. Hungary ranks second among EU member states in terms of such funding per capita.

Figure 7: The share of public procurement procedures that involved European Union funding, 2008-18



Source: 2018 annual report of the Public Procurement Authority for Parliament.⁴⁶

In its 2015 report on corruption risks linked to the use of EU funds, TI Hungary was the first in the country to call attention to absorption pressure.⁴⁷ Since then, the Hungarian government has repeatedly stated that its primary goal is to utilise as much EU funding as possible, in the shortest time possible.⁴⁸ With that in mind, the government is planning to allocate some 110-115% of available EU funding, so that if a project fails scrutiny by the European Commission, the government can submit invoices of another project instead. One example for this was the so-called Elios case, where, although public lighting systems were "modernised" in the

⁴⁶ https://www.kozbeszerzes.hu/data/filer_public/ea/ea/eaead05-c892-4ec0-a02c-071e84cd1e7d/a_kozbeszerzesi_hatosag_2018_evi_beszamoloja.pdf

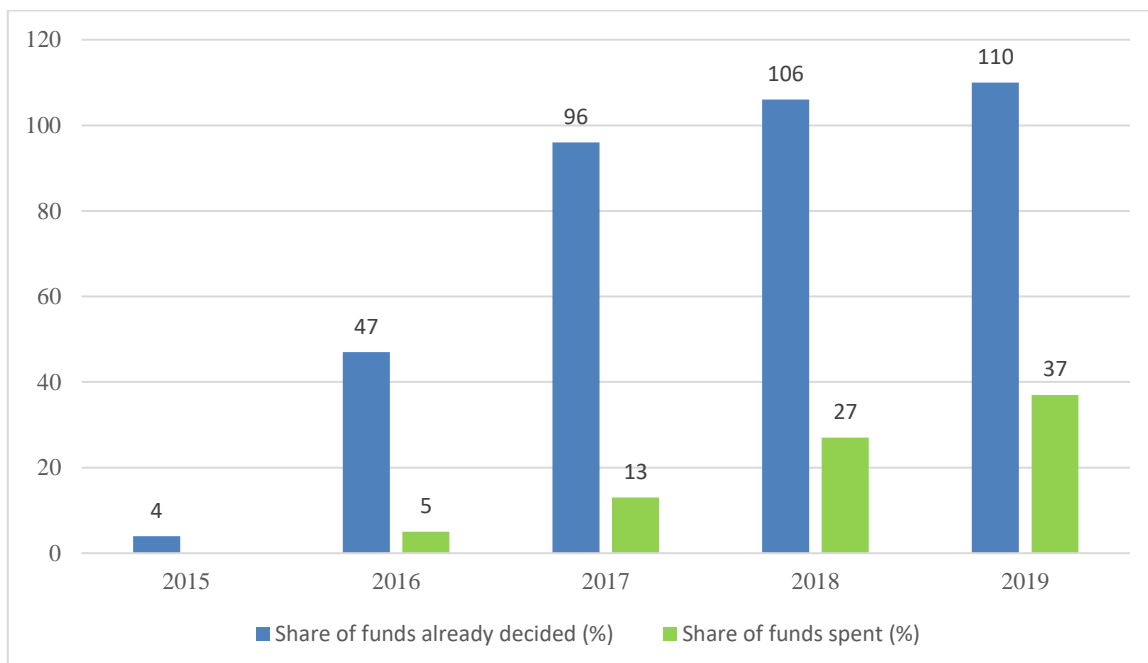
⁴⁷ <https://transparency.hu/hirek/resze-lett-a-rendszernek-tularazzak-az-unios-projektek/>

⁴⁸ <https://www.kormany.hu/hu/innovacios-es-technologiai-miniszterium/europai-unios-fejlesztésekert-felelos-allamtitkar/hirek/magyarorszag-toronymagasan-vezet-a-regioban-az-unios-forrasok-felhasznalasa-teren>

framework of an EU-backed project, the government ultimately chose not to submit project invoices to the European Commission (for well-known reasons), and therefore the project was realised, in effect, at the expense of Hungary's central budget.⁴⁹ As a result of this approach, project planning, the justification of project goals, and project monitoring are all relegated to secondary importance as the government pursues its main goal of absorption.

On Figure 7, we can see that actual project execution in the 2014-20 budget cycle began in 2016. By 2017, Hungary had allocated 96% of funds, in effect spending – on paper – the seven-year EU funding budget in just two years (see Figure 8). By mid-2019, this rate already increased to 109%. On the other hand, it must also be noted that the government only paid out a small share of actual EU funds to beneficiaries, amounting to just 34% by mid-2019. This – especially when compared with other countries⁵⁰ – hints at poorly prepared projects, and in general a not very well-planned use of EU funds.

Figure 8: Annual progress in the utilisation of EU funds in Hungary



Source: European Commission⁵¹

The utilisation of EU funds in Hungary carries several additional systemic corruption risks. State institutions are not only incapable of evading risks, but in many cases, it is these very institutions that facilitate abuse. Since the goal is to spend these enormous funds as fast as possible, EU-backed projects are often overbudgeted, meaning that a higher financing amount is approved than what is actually needed. Overbudgeting and inadequate oversight contribute significantly to widespread overpricing of EU-funded projects. (TI Hungary's 2015 report cited above concluded that overpricing affects more than 90% of projects and may on average be as high as 25%.)

⁴⁹ This is because EU financing is *ex post*; projects are carried out using advance payments from the Hungarian state budget.

⁵⁰ https://korrupcio.blog.hu/2019/12/19/magyar-portugal_ki_menedzseli_hatekonyabban_az_eu-s_forrasokat

⁵¹ <https://cohesiondata.ec.europa.eu/countries/HU>

Organisations that decide on EU fund beneficiaries, those that monitor project spending, and those that design projects applying for EU funding are subordinated to the same authority. In other words, these organisations belong under the control of the same leader (a deputy state secretary and, ultimately, a government minister). Organisations responsible for oversight therefore have very little incentive to actually monitor projects, as first, this would slow down fund absorption; and second, if any deficiencies or irregularities came to light, the government would end up incriminating itself by revealing that it had failed to exercise due diligence when awarding funds.

The institutional guarantees of independence are strongly questionable both at the organisational and the personal level. It is revealing that the Directorate General for Audit of European Funds, an organisation mandated by EU law and intended to be independent of the Managing Authorities, is actually part of the Finance Ministry, and its employees are classified as government bureaucrats.

Oversight of EU fund utilisation is a task that belongs to Member States; it is the respective authorities in Member States – primarily the Managing Authorities, but ultimately also prosecution authorities in cases of fraud or other corruption – that are responsible for this task. Monitoring bodies of the European Commission – the European Court of Auditors, and the European Anti-Fraud Office (OLAF) – are incapable of monitoring every one of tens of thousands of projects. To put things in perspective: OLAF launches about 300 probes each year in the 28 Member States; the number of Hungarian projects thus reviewed is in the double digits each year. By contrast, under the previous seven-year EU budget cycle in 2007-13, more than 60,000 projects were realised fully or partially with EU financing in Hungary alone. In 2018, OLAF concluded nine investigations involving Hungary, seven of which uncovered irregularities. This meant that Hungary ranked first among all Member States, ahead of Greece and Poland, as the country with the highest number of probes launched by OLAF. Hungary also stands out among Member States in that in 2014-18, OLAF concluded 52 investigations with a recommendation, proposing that Hungary repay 3.84% of EU funds received. Just for comparison, Slovakia ranked second on this list with 2.29%, and Spain ranked third with 0.43%.

When it comes to cases investigated by OLAF, it must be noted that for many years, Hungarian prosecution authorities had one of the worst indictment rates in the EU. This improved somewhat in 2018, and prosecution authorities and the government like to point out that the indictment rate of Hungarian prosecution authorities (45%) is better than the EU average (36%). Still, there are 20 cases where, despite OLAF recommendations, Hungarian prosecution authorities have failed to make a decision for several years now, the highest rate in the EU. Romania and Italy have a similar number of unconcluded cases (20 and 21, respectively), but these countries have a higher number of OLAF cases to begin with. By contrast, there are only four cases in the Czech Republic where the prosecution has yet to make a decision; while the indictment rate is 78% in Poland and 80% in Greece. It must also be noted that the overall EU indictment rate is low because there are Member States where OLAF is investigating only one or two cases, which then result in no indictments.⁵²

Hungarian state organisations spent HUF 3.3 trillion via public procurement in 2018. Of these projects, 48.5% were fully or partially financed from EU funds; and the total amount is equal to 7.8% of Hungary's 2018 GDP.

⁵² For instance, Cyprus or Croatia; https://ec.europa.eu/anti-fraud/sites/antifraud/files/olaf_report_2018_en.pdf

In light of these, it is particularly worrisome that state contracts are increasingly concentrated in the hands of a few individuals. Three companies controlled by Lőrinc Mészáros, and various consortium partners of these companies have been securing an increasing share of public procurement contracts since 2011. While they won less than 1% of such contracts annually in 2011-16, they were awarded 5.4% of total public procurement value in 2017 and 3.7% in 2018. Their share of EU-financed projects was even higher. They won some 20% of public procurement value that involved EU co-financing, landing them HUF 426 billion.⁵³

It is also remarkable that while final contract prices are usually on average 6% lower than the original estimate, in the case of public procurement contracts won by Lőrinc Mészáros and his partners it was 8.6% higher. When it came to projects financed by the EU, companies associated with Lőrinc Mészáros had an odds of 23.5 to secure public procurement contracts, meaning that they only lost one tender for every 46 won. This made his companies by far the most successful on the public procurement market.⁵⁴

Meanwhile, Public Procurement Authority statistics show gradually improving competition in recent years – at least in theory. For instance, the share of single-bidder procedures within large tenders that exceed the EU value threshold fell to 24% in 2018, according to figures by the Public Procurement Authority.⁵⁵ By contrast, 2018 data from the European Commission show that 39% of tenders exceeding the EU value threshold only had a single bidder. In its 2018 country report, the Commission stressed that the Public Procurement Authority cannot back up its improving statistics with adequate methodology.⁵⁶ It must be noted that the database of public procurement tenders exceeding the EU threshold are handled by the European Commission. The European Commission has said that in 2019, the share of single-bidder public procurement tenders in Hungary increased to 42%. We can therefore conclude that the domestic public procurement market sees only very limited competition.

5. The nature of corruption in Hungary

In the past decade, corruption in Hungary has become extremely centralised. The essence of today's state corruption is the redistribution of resources using various means; thus creating a new elite and aiding or rewarding players close to the governing party. The state would buy or legally take away assets from certain groups and pass them on to other groups. Often this would happen in an institutionalised way.⁵⁷ Via "public money drains"⁵⁸, and via the breach

⁵³ Calculations of the Corruption Research Centre Budapest: <https://g7.hu/kozelet/20190521/nyolc-abra-egy-magyar-csodarol/>

⁵⁴ Calculations by the Corruption Research Centre Budapest: <https://g7.hu/kozelet/20190521/nyolc-abra-egy-magyar-csodarol/>

⁵⁵ https://www.kozbeszerzes.hu/data/filer_public/ea/ea/eaead05-c892-4ec0-a02c-071e84cd1e7d/a_kozbeszerzesi_hatosag_2018_evi_beszamolaja.pdf

⁵⁶ https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-hungary_en.pdf

⁵⁷ Already in 2008, under a left-wing government, we pointed out that corruption in Hungary had become institutionalised. (see: TI Hungary (2008): Corruption Risks in the Business Sector. National Integrity Study. <https://transparency.hu/adatok-a-korruptiorol/nemzeti-integritas-tanulmany/nis-2008-uzleti-szektor/>) However, before 2010, we viewed corruption as a by-product of the system rather than a defining feature. This changed later on, and by now corruption has become a fundamental feature of the Orbán-regime. At the same time, elements of poor governance already appeared before 2010, including extreme fiscal overspending that led to spiralling state debt (on whether 2010 was a turning point or a continuation of earlier trends, see: József Péter Martin (2017): Continuity or Disruption? Changing Elites and the Emergence of Cronyism after the Great Recession – the Case of Hungary. CJSSP, VOL.8 (2017)3S, pp. 255-281. <http://unipub.lib.uni-corvinus.hu/3273/>)

of rule-of-law norms, taxpayer money is transformed into private wealth. Corruption is part of the system, not merely its side effect.

The official ideology behind this is the creation of a national capitalist and middle class; this is why pro-government ideologues say that what TI Hungary and other critics call corruption is the very essence of the system. Of course, what we are really seeing is that a strong and growing middle class and citizenry (above all in an intellectual sense) are very much absent from Hungarian society. Instead, what we have is an artificially bloated clientele.

Hungary is a hybrid regime – somewhere between democracy and dictatorship – while in the economic arena it has become a crony state capitalist regime. Having endured decades of state socialism, we have reached (or returned to) a state where in certain segments of the economy, loyalty trumps merit. We are witnessing an attempt to monopolise political and economic resources. Friends and family of the ruling class have a much better chance of securing state contracts or coveted jobs. Citizens and economic actors seeking favours with the state are often more interested in rent-seeking than in showing (market-based competitive) performance. Oligarchs getting rich off public funds do not serve any kind of public interest; but they do distort market competition and usually become permanently dependent on the state.

The concentration of power that has occurred in Hungary is extremely unique in the EU, though not unprecedented worldwide. Nowhere in the EU does the government, the state and, ultimately, one person – the prime minister – possess such power. As checks and balances have been almost completely removed from the political system, ensuring virtually unlimited power for the government, oligarchs close to the government are taking up key economic positions. This version of state capture is slightly different from what we have seen in, for instance, the Czech Republic. Here, it was "politics" – via an informal network of politicians, businesspeople and background operators – that captured the state, enriching a clientele using public funds. By contrast, in the Czech Republic, it was an already wealthy oligarch, Andrej Babis, who bought his way into power, grabbing the prime minister post. The institutionalised diversion of EU funds shows a similar pattern in both countries, but in the Czech case the irregularity is even more obvious: the prime minister is funnelling EU funds – not just in reality but also on paper – to his own private businesses.

At the same time, Hungary has shown improvement in some forms of street-level corruption, most notably police bribes, have become less frequent. Among other positives, the grey economy is in retreat, as online cash registers have resulted in fewer undocumented purchases, in turn boosting tax revenue from retail trade. In the bureaucratic field, centralised government offices and "government windows" brought some improvement. Still, in TI Hungary's experience, many towns and villages have relapsed into a near-feudal state, where formal structures have been replaced by informal ones and where public investments are corrupt to the core. Local power pyramids – which partly mirror the nationwide pyramid – operate on principles directly opposed to the rule of law, democracy, and market economy. It is not merit, transparency or accountability that dominate, but personal loyalty.

The erosion of the rule of law is at the same time the cause, and the consequence of corruption. Successfully reviving the rule of law cannot be fully achieved by simply amending regulations. It is just as dependent on the attitude of the governing elite, and the

⁵⁸ One such example is the residency state bond scheme, which TI Hungary covered in detail in this report: https://transparency.hu/wp-content/uploads/2018/12/lmak_tanulmany_final_magyar_lektoralt.pdf

ability of civil society and the media to exert sufficient impact on the ruling elite and act as a check on its actions.