

Crony-Owned Enterprises in Hungary



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The state's influence on the economy through company ownership is a peculiar issue. The Hungarian state's share in the economy is high – but mostly in line with other countries. What stands out among OECD countries is the number of companies owned par-

deprioritize market demands in favor of easy public money, COEs are no better. Transparency and legal sheltering by the state are issues for both types of enterprises. The only difference between SOEs and COEs is that COEs are not meant to

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tially or wholly by the state that attests to some degree of micromanagement. But state-owned enterprises (SOEs) are just part of the problem. What the statistics – and macroeconomists – cannot measure is how much of the economy is run not by the state, but by cronies. SOEs have a massive problem of not having to respond to market forces and becoming vehicles of rent-seeking. But crony-owned enterprises (COEs) are not driven by market logic either. If SOEs are less motivated to serve customers and

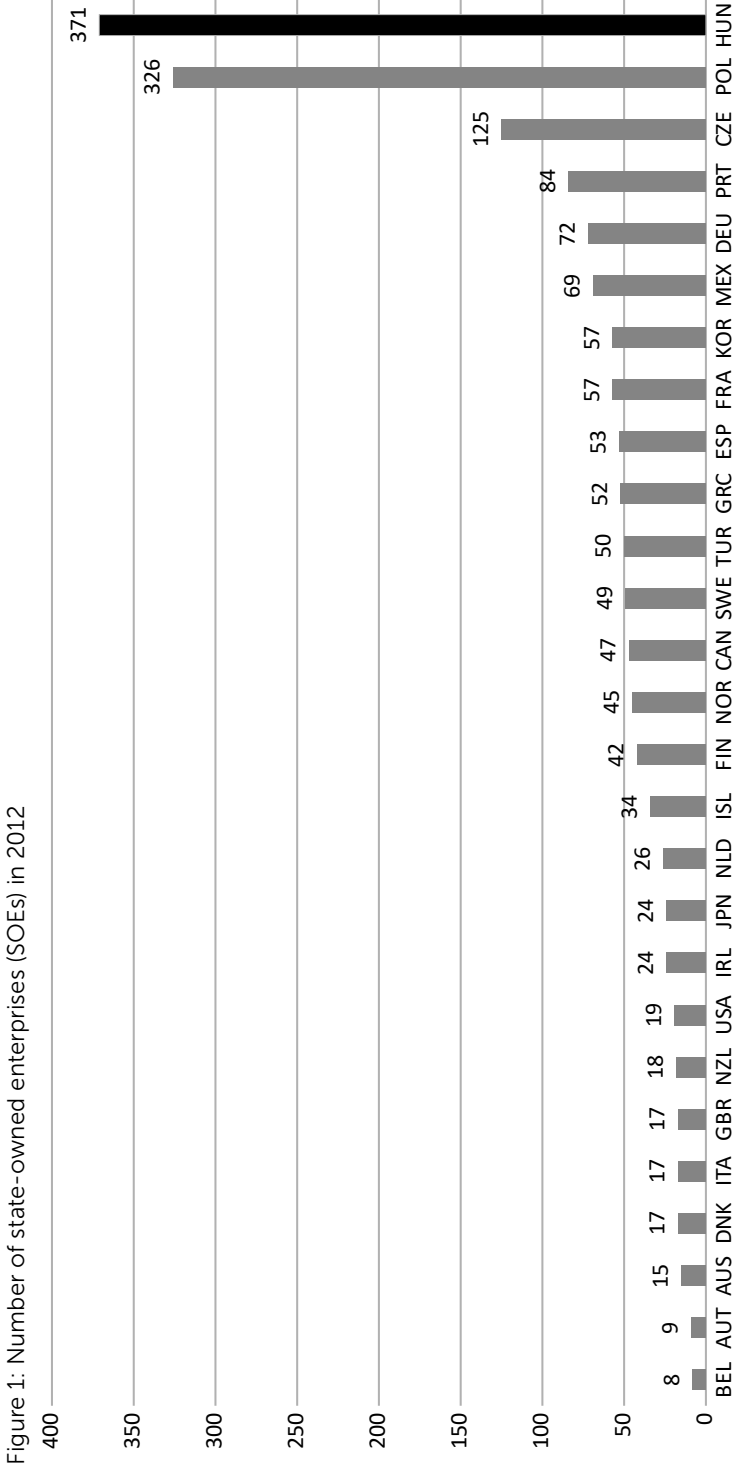
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benefit the budget or the public. They are a step backwards, even from a state-controlled economy (misleadingly called state capitalism).

HUNGARIAN STATE IN THE ECONOMY

According to OECD statistics, the share of the state in the Hungarian economy is large, but similar to other countries. When it comes to the number of companies owned by the state, though, Hungary leads by a gigantic margin.

According to 2012 OECD data, Hungary led OECD countries by number of SOEs, responsible for about 5% of state-dependent employment. The Hungarian state owned no less than 371 companies partially or



Source: OECD, 2014



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wholly, followed by Poland (326 SOEs), Lithuania (137 SOEs), and the Czech Republic (125 SOEs), among OECD countries [See Figure 1].

The data is startling, especially considering that the situation has worsened since 2012 when the data was assembled. The Fidesz-led Orbán government has since moved into the utilities market, for instance, by introducing price controls and making life difficult for private and foreign owners of utility companies. The move did not just make domestic energy and utility prices stay high during the general downward trend in Europe – leaving Hungary one of the most expensive countries for energy in Europe –

but also chased many of these utility providers out of business, their assets returning to the state or to well-connected cronies.

THE SIGNIFICANCE OF COES IN HUNGARY

However, SOEs are just part of the story. Prime Minister Viktor Orbán has an explicit goal to cement himself and his cronies in economic power and to increase the influence of Fidesz in the economy. The goal is to essentially create a party-state, and SOEs and COEs are part of his plan.

COEs and other curiosities, legally, might look like private market players, but are detached from market logic and rely on political connections, laws written for them, and other unfair means. When they misbehave or fail in business, political connections shelter them.

Nor are those the old state-mandated monopolies; new forms of COEs include licensed industries. But everything is always perfectly legal – to silence watchdogs and critics who yearn for an excuse to avoid confrontation.

CRONIFICATION OF THE ECONOMY

The question of where cronification hides in the economic statistics touches on the nature of SOEs and state capitalism. Is state capitalism a way-station to a more-private economy? The best SOEs have demonstrated that they can thrive without the instructions of the state – but the worst have proven that, however many market disciplines imposed upon them, they will find a way of turning state capitalism into crony capitalism.

So is cronification a step toward privatization, or is it merely rent-seeking by politically well-connected individuals? Given that many of the companies started as genuine businesses before they went

¹ OECD (2014), The Size and Sectoral Distribution of SOEs in OECD and Partner Countries, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264215610-en>



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bankrupt, then were sold to cronies who knew how to make the law that broke the business go away, the answer seems obvious.

Globally, is state capitalism a step toward the real thing, before the private sector regains control – or a step toward full-blown cronyism?

Does it create real economic value – or is it paper value designed to make its beneficiaries rich while socializing risks and losses? Above all, who are those beneficiaries?

FEELING HELPLESS? JUST ROLL WITH IT!

When people feel helpless, they can choose to become angry and eternally frustrated, or change their minds about it. Every well-executed theft of freedom and control gives the victims a way to feel they can get on board with the theft.

There has been a small craze on the Budapest Stock Exchange (BUX) lately. People who never took an interest in playing the stock market now rush to buy stocks – because they feel they can predict what will happen

(like the retail investors in Budapest rental property funds). The reason for this craze is that the world's best-performing stock just happens to be Hungarian and listed on BUX.

However, this miraculously performing company is not innovative. In fact, it has been languishing in penny-stock territory for most of its existence. Then something happened.

"Kids, state funding is about to pour in and the stock price will go skyward!" wrote an anonymous trader on an online forum when Lőrinc Mészáros, Orbán's new "oligarch-in-chief", bought a stake in Konzum.

"Sales at Hungarian conglomerate Konzum Nyrt. dropped 99% last year, its short-term debt ballooned sevenfold, and it cut its staff by 86%. This year? Konzum has the world's best-performing stock, its shares soaring more than fiftyfold on the Budapest exchange at one point. The company has a market value of about USD 142 million", a journalist wrote in *Bloomberg*². Konzum is neither innovative nor productive. It does not hold valuable patents, it did not invent anything. It does not even make prodigal profits right now. It had sales of just EUR 77,000 in 2016. It is not serving clients well, and has no flashy plans to do so. It is just amassing assets right now. Its selling point? That it belongs to the Hungary's new oligarch-in-chief.

"Maybe I'm smarter" than Mark Zuckerberg, Mészáros said, a former gas repairman and mayor of the prime minister's birth village, who in February 2017 sparked the rally when he bought a 20% stake in Konzum. He credited "God, luck, and Viktor Orbán" for his success on other occasions.

² *What's Boosting the World's Best-Performing Stock?* Bloomberg, July 25, 2017.



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After Mészáros replaced Orbán's former chief oligarch in 2014, his wealth increased fifteenfold. That makes him Hungary's fifth-richest citizen with an estimated net worth of EUR 390 million, according to the Top 100 list of *Napi.hu*, a financial daily. Companies linked to Mészáros and his family won HUF 225 billion (EUR 729 million) in public procurement contracts in 2016 alone, according to RTL Klub, the country's last major TV channel not controlled by the government.

That is enough to attract the trust and speculative hopes of even retail investors. People's savings are going into the chief oligarch's company, which specializes in winning public procurement tenders. People are investing in cronyism and a Münchausen-style economy based on winning public money – rather than investing in the productive economy.

As another sign of market sickness, the stock that seems to move BUX by sheer volume is deemed too opaque for analysts to discuss it. "Despite the popularity of Konzum's shares—its trading volume sometimes exceeds that of the Budapest Stock Exchange's four blue-chip companies combined – most brokerages have chosen not to publish regular reports and analyses about the company. Three analysts declined to discuss Konzum on the record, citing its opacity and saying they couldn't see any justification for its share price", *Bloomberg* found when inquiring into the miraculous shares³.

**CRONIFICATION THROUGH
LICENSING: TOBACCO INDUSTRY**

Nevertheless, Konzum is a new phenomenon, and pesky journalists did not have the time to fight their way through the courts to give the public a better picture.

In order to assess cronification from the viewpoint of tax revenues, we need to rely on another example of crony businesses defying market logic – one that had already been uncovered and documented: the case of the sudden licensing of the tobacco retail industry and the cronification of tobacco retail and distribution in Hungary.⁴

In 2015, a friend of the minister heading the Prime Minister's Office, János Lázár, won an exclusive license to supply tobacco products to the (previously also licensed) National Tobacco Stores. His company, Országos Dohányboltellátó Kft. (OD Kft.) won on an invitation-only tender for the exclusive supply of tobacco products to all

³ Ibid.

⁴ *A nemzeti újraelosztás rendszere: minden doboz cigarettán 30 forint nyereség*, *Átlátszó*, July 27, 2017. <https://blog.atlatszo.hu/2017/07/a-nemzeti-ujraelosztas-rendszere-minden-doboz-cigarettan-30-forint-nyereseg/>





tobacco stores for 20 years. Only OD Kft. was invited to the tender – despite protests from the original market players, the tobacco wholesale distributors, who had offered 10 times the amount for the license as a concession fee – but to no avail. They simply were not invited to submit an offer.⁵

But the national budget had to suffer other shortfalls, too. Most of the taxes OD Kft. is supposed to pay to the budget are channelled into spectator sports⁶ – a scheme that allows corporations to send undisclosed amounts to sports (mostly football) clubs⁷.

Despite the state-mandated increase of the price in now-licensed tobacco products, tax revenue from tobacco has decreased. With their new monopoly, OD Kft. made a decent profit, but paid less into the budget than the previous system.

The beneficiary of SOEs (whether created by subsidized purchase or by monopoly licensing) is undoubtedly neither the budget nor the public.

WHO PROFITS THE MOST?

There is very little reliable information on the relevance of SOEs in today's global markets and on the exact nature of the advantages they may enjoy. The political process serves to complicate ownership policy of SOEs, making them less transparent and insulating them from the legal framework applicable to other com-



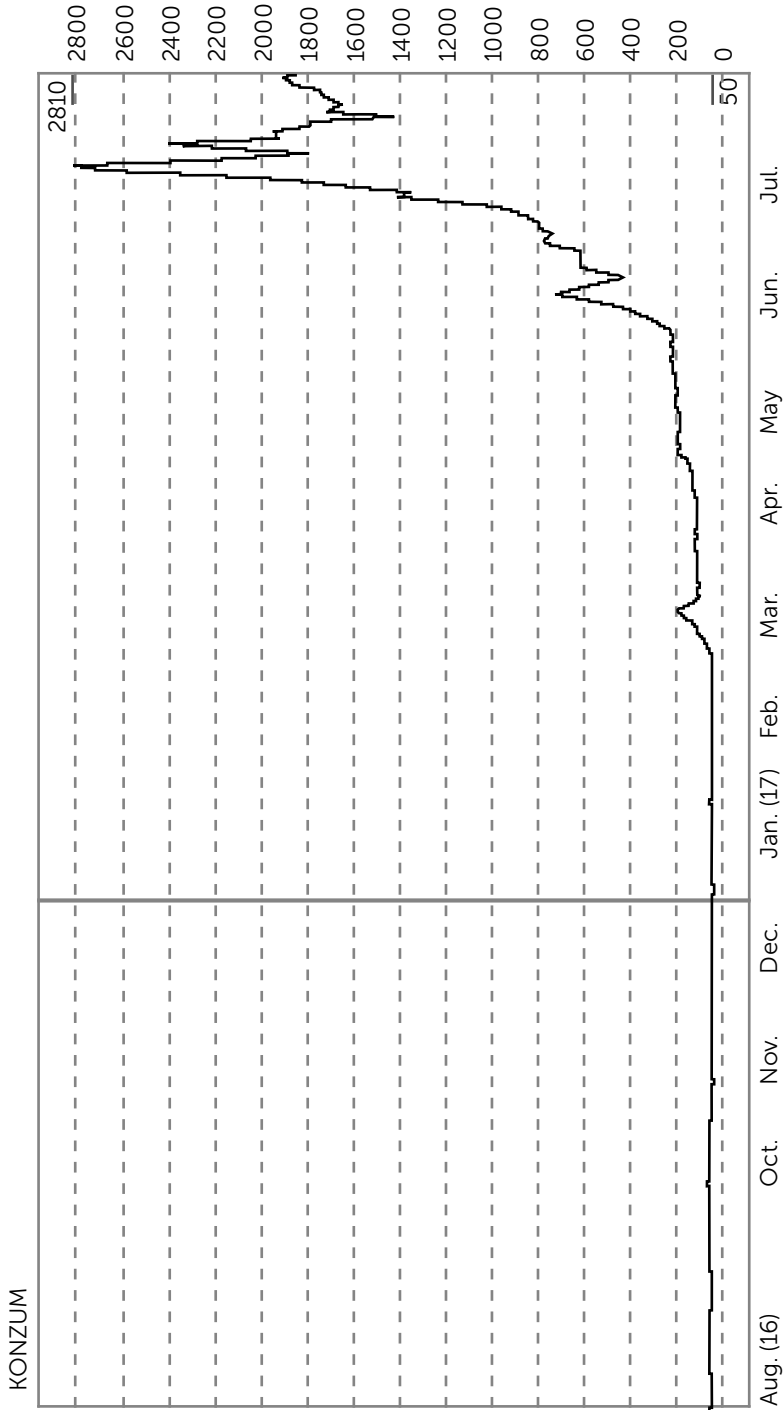
SOEs ENJOY
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⁵ Ibid.

⁶ *Irdatlan pénz a látvány sportokra: 415 milliárdot öltek bele Orbánék*, 24.hu Bita Dániel, Pető Péter, March 16, 2017. <http://24.hu/belfold/2017/03/16/irdatlan-penz-a-latvanysportokra-415-milliardot-oltek-bele-orbanek/>

⁷ Since 2011, EUR 1.5 billion of diverted corporate tax went into sports this way – according to data obtained by journalists. The companies that feel obliged to spend their taxes this way are not disclosed, yet it is an open secret that pushing money into the prime minister's pet projects increases their chance to win public tenders.

Figure 2: Share price of Konzum since August 2016, HUF



Source: Tőzsdék & Piacok

panies⁸. However, SOEs are not a sign of economic health. Unfortunately, people tend to focus on the lame and unfulfilled promises and excuses states give when they take control of something that could be done by civilians. SOEs exist in a legal gray zone, their activities sheltered from publicity and legal obstacles that shackle ordinary businesses.

In addition to their sheer size (that escapes the attention of antitrust authorities), SOEs enjoy a range of unfair advantages: guaranteed profits, state backing, and official banks lending to them at a fraction of the cost available to private companies. The government showers tax breaks, subsidies, and special laws on state firms, and favors them in procurement contracts. All those are true for COEs, while the public benefits are even more dubious – if even applicable.

The profit motive in SOEs is not miraculously replaced by a selfless concern for the (captive) customers. Rather, a blatant disregard for its core activity develops in favor of attracting easier-to-get public money in subsidies, credit, and bailouts. The abuse of market position is the norm – even when SOEs do not get a legal monopoly. COEs are, if possible, even worse on all those counts.

In principle, national antitrust law can be used to deal with the abuse of dominant position by SOEs. It should apply to crony-owned empires as well, but not when the empire is as diverse as Konzum. Since February 2017, Konzum has acquired stakes in at least five companies with assets from campsites and banks to newspapers and media, adding to the portfolio of hotels it bought in 2016. Mészáros also

controls a considerable amount of land, energy companies, and is rumored to get a piece of the Russian mega-investment in the nuclear power station in Paks.

So why is the public complacent, apart from the obvious legal sense of helplessness? Because the men on the streets hope to benefit from the political pull of the cronies. However, only one can be right. Konzum's (and Mészáros' other prodigy company, Opimus') stocks have, unsurprisingly, retreated [See Figure 2]. What no one is concerned about is creating economic value [See Figure 2].

ALARMING WORDS

The new Hungarian constitution was replaced by a Basic Law by the Orbán government in 2011. The latter portrays a fundamentally different view of the economy.

The terms “private property” and “market economy” have disappeared altogether. The old constitution stated that public and private property are equal and deserve the same legal protection. The term “market economy” is now also missing, referring to the less-than-voluntary ways of use and conveyance of property.

Given that the Hungarian government overwhelmingly consists of lawyers, they must certainly know what those terms denoted – and that they do not want that. Losing the phrase that private and public property enjoy equal legal protection is worrying. Losing the market as a means to convey property is even more alarming. And it is not just *de facto* ownership that can be misleading. Conditional ownership, or the way ownership is conveyed, can also negate the concept of private property.

⁸ Including competition laws, bankruptcy provisions, or securities laws.





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It is one thing to keep something of private property on paper. It gives the illusion of being the nice kids. International organizations will be obliged to take their word for it, and macroeconomists will be confused to no end, sticking their quantitative noses deep into data and missing the forest for the trees. Yet the public cannot be misled. Given their sense of helplessness in setting up their own businesses due to punitive taxation, tax policing, and regulatory hostility, they try to jump on the bandwagon of the obvious winner: The company that will now win all public tenders and has been listed on the stock exchange.

Prime Minister Viktor Orbán has an explicit goal to cement himself and his cronies in economic power and increase the influence of the governing Fidesz party in the economy. The plan is enticingly called “creating a national capital-owner class”, implying that they are “our” state-supported capital-owners and that it is actually good news for the people in Hungary.

Ditching *de facto* nationalization in favor of COEs is also smarter than communism because party-state regimes are organized around the opportunity to siphon public money, not to boost the state. Some cronies might genuinely believe that gaining ownership of something big was all they needed to become businessmen, but most have no illusions. Just as many Chinese and Russian strongmen are investing westwards, in countries where the rule of law is more solid and reliable, Hungarian businessmen are also smart enough to spread their interests across other countries, all west of the border. Rather than trickling down, capital put into their hands becomes private wealth stored and invested abroad.

CONCLUSIONS

If SOEs are less than motivated to serve customers and respond to market demands in favor of easier-to-get public money, crony-owned enterprises are no better. They are similarly sheltered from transparency requirements and unshackled from regulatory obstacles their market-based peers must overcome.

Every criticism of SOEs is also valid for COEs. Crony-owned enterprises may look like private market players, but they are detached from market logic and rely on political connections.

However, things get worse when we look at the purported beneficiaries of each model. COEs are not even meant to serve public goals or benefit the budget. Not only are they hidden from statistics, they are out of the government's reach – only responding directly to the party or a specific group of influencers.

The example of Konzum (and its tangled web of companies) shows how a company specializing in winning public tenders can attract a speculative mania on the stock exchange, attracting the savings of average people and making them invest in a non-productive sector of the economy. The example of the non-competitive licensing of tobacco distribution shows how those moves are not meant to benefit the public.

The Hungarian Basic Law of 2011 portrayed a novel view of the economy. The terms "private property" and "market economy" have disappeared altogether. The equal protection of public and private property has disappeared from the text. The market as a means to voluntarily convey ownership has taken a secondary role.

The proportion of the economy owned directly by the state is high in Hungary, but that fails to take into account companies that are indirectly state-controlled or otherwise serve as economic leverage for the governing party (not the state).

Prime Minister Viktor Orbán returned to power in 2010 with the explicit goal to cement the economic power of Fidesz, creating essentially a party-state. SOEs and COEs are part of his plan. This plan is called "creating a national capital-owner class", but it is doubtful whether it benefits the country or its citizens. ●



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