

The Developmental State Misunderstood  
A Political Economy Analysis of the Second Orbán Government

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## **Abstract**

This thesis contributes to this debate by investigating the merits of claims by the government about following the East Asian model of development in its political and economic policy making. We find that in every crucial area that played a role in the East Asian states' successes did inform the changes that were made in their Hungarian counterparts. We also establish that differences may be possible between the two due to the changed geo-political and historic circumstances. However the great differences between the two, especially in the areas of industrial development and state-business relations, bureaucracy and educational policy cannot be justified on those basis. Thus we conclude that the vast dissimilarities are the result of the underlying power motives in the Hungarian system.



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## Introduction

Is the second Orbán government building an East Asian style developmental state within the 21st century Eastern European context? It was clearly the stated aim of the prime minister-elect, Viktor Orbán and his party, *Fidesz – Hungarian Civic Alliance* (Fidesz). Mr Orbán argued that the likes of Singapore and China – countries that either founded the modern developmental state or built their own model on those foundations<sup>1</sup> – are the examples to follow for any governments today on the path to greatness<sup>2</sup>.

The question itself is a peculiar one because in order to be able to answer it we need to first identify what a developmental state is, which is not a straightforward task. Just like there are several varieties of capitalism,<sup>3</sup> the developmental state can take several different forms as well. As Ha-Joon Chang<sup>4</sup> reminds us, state-led development is not a novel phenomenon; in fact most of today's developed countries, at some points in their past, relied heavily on the state as a source of protection and/or guidance. However the term “developmental state” was coined by Chalmers Johnson in his seminal work on Japan's own trajectory to becoming one of the core countries of today<sup>5</sup>. The concept has since evolved through the different forms of implementation, from South Korea<sup>6</sup> through Taiwan and more recently to some of the

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<sup>1</sup> China as a developmental state: John Knight & Sai Ding, *China's Remarkable Economic Growth*, (New York: Oxford University Press 2002), p. 320-325

<sup>2</sup> Viktor Orbán, “Orbán Viktor teljes beszéde” *Magyar Nemzet Online* 29.07.2014 available: <http://mno.hu/tusvanyos/orban-viktor-teljes-beszede-1239645?oldal=2> (accessed: 29.04.2015)

<sup>3</sup> Peter Hall & David Soskice, *Varieties of Capitalism: Institutional Foundations of Comparative Advantage*, (New York: Oxford University Press, 2001)

<sup>4</sup> Ha-Joon Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective*, (Anthem Press: London, 2002)

<sup>5</sup> Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy : 1925-1975* (CA: Stanford University Press, 1982)

<sup>6</sup> Alice Amsden, *Asia's Next Giant: South Korea and Late Industrialization*, (New York: Oxford University Press 1992)

Southeast Asian states<sup>7</sup>. The time lag that separates the East Asian states in the 20<sup>th</sup> century from the Western European and North-American ones a few centuries earlier is the very essence that differentiates the two, as the former's incentives for development have been based on catching up, whereas the latter's were based on competition with one another. The developmental state's objective thus is to become an equal member within the capitalist world economy that can compete on all levels with the already developed states.

Developmental states go against the neoclassical developmental paradigm and do not wait for market forces to help them achieve their goals. As Mark Beeson put it, the term describes a set of institutional makeup where “governments try to actively ‘intervene’ in economic processes and direct the course of development”<sup>8</sup>. In other words, governments influence economic outcomes directly and indirectly, often with a supreme leader having the final say on the direction the economy takes. This entails, on the one hand, a centralized power structure where democratic institutions are far from ideal, while on the other hand that the governments of these types of states maintain very close ties with the business elite who they try to direct according to state set targets. This dissertation will show that the changes that took place in Hungary's political and economic make up during the second Orbán government between 2010 and 2014, are reflective of these characteristics of the developmental state.

Yet it is important to understand them in context. Policies that were possible between 1950 and 1990 are not anymore due to the World Trade Organization's (WTO), European Union's (EU) and Organization for Economic Co-operation and Development's (OECD) regulations: institutions in which Hungary enjoys memberships today. For example, both the Korean and

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<sup>7</sup> Francois Bafoil, *Emerging Capitalism in Central Europe and Southeast Asia: A Comparison of Political Economies*, (NY: Palgrave, 2014)

<sup>8</sup> Mark Beeson, *Regionalism & Globalization in East Asia: Politics, Security & Economic Development*, (NY: Palgrave, 2007), 141

Taiwanese governments utilized tariffs to protect their nascent industries while today countries are prohibited by the aforementioned organizations from employing them.<sup>9</sup> The reason why it is important to highlight this is because even if the developmental state model had a clear set of policies to be pursued by all states, a modern version of it in the context of the 21<sup>st</sup> century transnational regulations would only allow the emergence of a hybrid form. Several authors have actually given diverse names to some of its modern Southeast Asian versions; Suehiro<sup>10</sup> calls it *bureaucratic capitalism*, referring to the coalition between the political, administrative, and military elites in Thailand who manage firms in cooperation with foreign investors. Jaysrija, on the other hand, uses the term *nomenkultura capitalism* to “highlight the close connection between the political elites and insulated domestic cartels”<sup>11</sup>. Thus, it is evident that there is no set structure to the developmental state and several of its policies are determined contextually.

The East Asian developmental state proved to be very successful for some of the countries, especially for three of the so called Tigers (Singapore, Taiwan and South Korea) for example, Taiwan, starting from wide and deep poverty in the 1950s, today occupies the 38<sup>th</sup> highest position<sup>12</sup> in GDP per capita and 29<sup>th</sup> in its GDP at purchasing power parity<sup>13</sup> globally. This required the country to produce an average of 9% GDP growth after WWII, producing much higher growth rates than any developed countries at the time. Modern day Hungary is starting from a different position. With a diversified economy and in a limbo between high-middle

<sup>9</sup> Although, it has been pointed out that while tariffs are important, they are just one of many measures developmental states pursue as policy measures see: Chang, *Kicking Away the Ladder*, 65)

<sup>10</sup> Akira Suehiro, Industrial Restructuring Policies in Thailand: Japanese or American Approach in *Sustainability of Thailand's Competitiveness: The Policy Challenges*, eds. Patarapong Intarakumnerd, and Yveline Lecler, (Bangkok: IRASE C-ISE AS, 2010), pp. 129–73.

<sup>11</sup> Kanishka Jayasuriya, “Embedded Mercantilism and Open Regionalism: The Crisis of Regional Political Project,” *Third World Quarterly*, 24, no. 2, (2003): 348.

<sup>12</sup> IMF (2015) World Economic Outlook Database October – 2014, Washington, DC: International Monetary Fund available: <http://www.imf.org/external/pubs/ft/weo/2014/02/weodata/index.aspx>, (accessed: 10.03.2015)

<sup>13</sup> CIA (2015) *CIA Fact Book 2014*, Washington, DC: Central Intelligence Agency available: <https://www.cia.gov/library/publications/the-world-factbook/fields/2001.html>, (accessed: 10.03.2015)

and high income classification, it is already a part of the world's elite club of countries, represented by the OECD. Yet its GDP/capita is still only about half of its Western neighbors<sup>14</sup> while its economic output is only fifth of Sweden<sup>15</sup>, a country with a relatively similar sized population. Yet during the years under the second Orbán government, the country has also been producing some outstanding levels of GDP growth – relative to the region's average – exceeding the likes of Germany<sup>16</sup>.

This dissertation shall analyze the causes of this “miraculous” growth rate on the one hand, and consider whether it was sustainable on the other. By comparing the Hungarian government's political system and the policies that the Orbán government implemented between 2010 and - 2014 to the equivalent in the East Asian developmental states, my initial answer is no. That is because the Orbán government has only got the job half done and forgot about vital elements of the East Asian developmental states: investing into education, healthcare and maintaining a well-trained, independent and efficient bureaucracy, disallowing corruption to influence outcomes.

In this dissertation I shall argue that the changes that took place in the Hungarian political economy between 2010 and 2014 have been influenced by the tenets of the developmental state - in spite of some high profile opinions that the country's political economy has been based on ad-hoc measures<sup>17</sup>. However the paper equally asserts that it has been a job only half done as imperative features of the concept, from the perspective of education, healthcare and bureaucracy, have been neglected which is likely to hinder the reproduction of the East Asian

<sup>14</sup> IMF (2015) Data on Gross domestic product based on purchasing-power-parity (PPP) per capita GDP available: <http://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx> (accessed: 20.05.2015)

<sup>15</sup> IMF (2015) Data on Gross domestic product based on purchasing-power-parity (PPP) per capita GDP available: <http://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx> (accessed: 20.05.2015)

<sup>16</sup> World Bank (2015) *World Bank Indicators* DC: World Bank available: <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG/countries/HU?display=default> (accessed: 10.03.2015)

<sup>17</sup> László Csaba, Growth, Crisis Management and the EU: The Hungarian Trilemma, *Südosteuropa Mitteilungen* 53. no.3-4, (2013):164



successes. Before moving to the empirics, the next two chapters will deal with theoretical considerations in greater detail which shall provide the reader with a guiding hand in understanding the arguments put forward. First, the paper will outline the main features of a developmental state in theory, then it will discuss Peter Evans' famous concept on embedded autonomy. The chapters following after will look at the most important sectors of a developmental state and compare the East Asian with the Hungarian policies in each of them.

## Cahpter 1 - The Developmental State in Theory

According to the basic tenets of Adam Smith, markets are the product of people's "natural propensity to truck, barter, and exchange one thing for another"<sup>18</sup>. The market in this view is a "set of powerful organizing principles that comes to surface and guides participants without much need for previous foundations"<sup>19</sup>. World renowned theorists like Milton Friedman argued that markets are the most efficient tools for allocating resources among all circumstances – i.e. irrespective of the level of development of a country – thus, they should be allowed to operate freely in order to produce the most just and efficient outcomes<sup>20</sup>. Todaro and Smith, in their classic textbook on development, explain how such ideas penetrated the understanding of development economics especially from the 1980s, informed by Robert Solow's growth model. Mainstream development experts of the time argued in favor of "supply-side macroeconomic policies, rational expectations theories, and the privatization of public corporations. In developing countries, they called for freer markets and the dismantling of public ownership, statist planning, and government regulation of economic activities"<sup>21</sup>. For decades neoclassical economists that dominated - and some argue that they continue to do so<sup>22</sup> - the international financial institutions' agendas, based their development and structural reform programs on this rather simplistic view of the world.

A great deal of authors within the political economy literature however have refuted these

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<sup>18</sup> Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations*, (New York: Oxford University Press, 1776(ed.1993) ), 21

<sup>19</sup> An argument that was put forward by Barma and Vogel in Naazneen Barma and Seteven Vogel, *The Political Economy Reader: Markets as Institutions*, (New york: Routledge, 2008) 1-3

<sup>20</sup> Milton Friedman, *Capitalism and Freedom*, (London: University of Chicago Press, 1962 (ed. 2002) ), 22-23

<sup>21</sup> Michael Todaro and Stephen C. Smith *Economic Development*, (Boston: Addison-Wesley, 2013) 128-129

<sup>22</sup> CEPR, „IMF-Supported Macroeconomic Policies and the World Recession: A Look at Forty-One Borrowing Countries, *CEPR Working Papers* (October 2009) available: <http://www.cepr.net/documents/publications/imf-2009-10.pdf> accessed: 04.05.2015

ideas -and argued just the opposite. Neil Fligstein<sup>23</sup> asserts that the rules that govern markets possess a social background while W. W. Rostow, by following a historical approach to the understanding of markets, argues that they evolve in stages and transform over time instead of emerging in ready forms. Karl Polanyi, in his well-known work on the UK's development<sup>24</sup>, provides a convincing account on the state's involvement in formulating the country's economic make up over time. He argues that even in a highly liberalized economy, like the British economy, it was the state's conscious decision to first protect and develop, and later to open and liberalize its economy as opposed to it being the result of some kind of spontaneous 'invisible force'.

The East Asian developmental state serves as an example for the second school of thought<sup>25</sup>. At its core stands the state as the agent that guides and intervenes in the economy according to its own preferences not in an ad hoc manner, but through the government's planning agency or a pilot agency filled with very capable technocrats. In addition to the state's and bureaucracy's roles, close government and business ties are the third element that makes up the core of the system. As a result of such a close relationship between state and the domestic private sphere, the government offers different forms of protection for its business elites, either through financial or institutional means. Yet, despite the state's emphasis on its domestic elite, many East Asian states relied heavily on foreign direct investment (FDI) for their development in the absence of sufficient capital, know-how and markets. International investors were able to realize higher returns by producing with these countries' cheap, semi-

<sup>23</sup>Neil Fligstein, *The Architecture of Markets: An Economic Sociology of the Twenty First Century Capitalist Societies*, (New Jersey: University Press, 2001) 25

<sup>24</sup>Polanyi, K (1944(ed. 1957) *The Great Transformation: The Political and Economic Origins of Our Time*, Boston: Beacon Press

<sup>25</sup>However, there are theorists – in minority - who argued that the developmental states in East Asia achieved their successes due to having a truly free and open economy, and not because of state interventions. See: Benjamin Powell, State Development Planning: Did It Create an East Asian Miracle?, *The Review of Austrian Economics* 18 no.3-4 (2005):305-323

skilled and for most part oppressed labor, while the domestic economy, with the state employing the right policies and institutional mechanisms, were able to reduce what Paul Romer called the ‘idea gaps’<sup>26</sup> vis-à-vis its more developed global competitors.

It was already stated in the introduction that developmental states can vary substantially, yet in terms of general characteristics we can speak of policy directives that differentiate them from, say, the modern Western welfare and/or liberal market states. The state’s all mighty economic planning agency sets government targets and everything else is rendered to achieve them within the country. Yet while the economy is state based it is not state run in the Soviet sense. The policies of the state are market conforming thus growth is based on exports, while finance remains largely government dominated and therefore state loans are yet another means of achieving the government-set targets.

The above is also true of the states’ institutional make up. If, for example, the target is to develop manufacturing capabilities, then institutions are brought in line with that. A clear example of that was provided by Korea’s regulations on FDI. Entrance into the country’s economy by transnational corporations (TNCs) was granted under the condition that they had to set up joint ventures, preferably under local majority ownership and only in areas where the local industry was developed enough to absorb technology transfers<sup>27</sup>.

All the above practices in East Asia were informed by the theories of a well-known German

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<sup>26</sup> Paul Romer explains this as the lack of knowledge – technical, procedural etc. - used to create value in a modern economy. For more: Paul Romer, Idea Gaps and Object Gaps in Economic Development, *Journal of Monetary Economics* 32 no.3 (1993): 543 - 573

<sup>27</sup> Ha-Joon Chang “Regulation of Foreign Investment in Historical Perspective”, *UNU/INTECH Discussion Papers*(2003), available: <http://www.intech.unu.edu/publications/discussion-papers/2003-12.pdf> 24-26

economist from centuries earlier, Friedrich List<sup>28</sup> and his idea of infant industry protection. List, as opposed to neoclassical economists, argued that less developed countries (LDCs) should not open their economies completely to more competitive ones because that would inhibit the development of local industries and hamper any chance of the domestic economy catching up. Thus, he stressed the importance of government protection and state led nurturing of nascent industries for countries to be able to catch up.

Finally, while the above-mentioned components of the developmental state helped spark growth in East Asia, it was the heavy investment in skills and knowledge that maintained it. This was done through the constant development of the human capital. In order to be able to absorb foreign technologies, attract higher added value production as well as develop the domestic economy. Thus, heavy investments were directed towards education, trainings and research and development (R&D).

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<sup>28</sup>For more: Friedrich List, *The National System of Political Economy*, translated from the original German edition (Sampson Lloyd, London, Longmans, Green, and Company, 1881)

## **Chapter 2 - The Political System and State Capacity**

Taking into account the political system of the three most successful cases of state-led development in East Asia, a striking similarity one can immediately notice is how power in each country was centralized in the hands of a supreme leader. Singapore's Lee Kuan Yew, South Korea's Park Chung-hee and Taiwan's Chiang Kai-shek are iconic figures in the region, recognized for their economic successes but equally also known for running very repressive dictatorships.

It is certainly farfetched to call the second Orbán government a dictatorship, especially when measured against the above-mentioned East Asian leaders. However, the changes that were inserted in the country's institutional make up between 2010 - 2014 have all directed the country towards a system with less oversight and accountability. The emergence of the new system was greatly facilitated by Orbán's unique opportunity to govern the country with a two-third majority after the 2010 elections. This overwhelming majority resulted in the introduction of new legislation in an array of areas, the most prominent of which was a new constitution, one that Princeton's Kim Lane Scheppele described as an "unconstitutional constitution" for its lack of guarantees for checks on political power and insurances for the rights of citizens<sup>29</sup>. This was followed by measures limiting the Supreme Court's authority over the government's budgetary decisions while also expanding its bench from 9 to 15, with party loyalists. The court was given authority only to review the constitution or amendments to it based only on formal procedural aspects, not on their actual content. Additionally, all the court's decisions prior to the date when the country's new constitution came into force in 2012

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<sup>29</sup> For more: Kim Lane Scheppele, (2012) The Unconstitutional Constitution, *The Conscience of a Liberal* 02.2012 available: <http://krugman.blogs.nytimes.com/2012/01/02/the-unconstitutional-constitution/> (accessed: 11.05.2015)

were to be invalidated, essentially eliminating precedence.<sup>30</sup> The court system was also completely reformed. Centralized in the hands of the head of the National Judicial Office, with the leader of the organization also government appointed, the agency was provided with a power to take any legal case and move it to a new court for decision.

Oversight over the media was equally centralized in the hands of a newly created institution, the Media Council, packed with government friendly members. The most substantial source of revenue of a great deal of media outlets in the country has considerably decreased as both state institutions (e.g. national lottery) and domestic private businesses in bed with the government withdrew their advertisements from the ones that were critical with the changes that took place after the 2010 election, leaving them between life and death. The last standing independent institution, the Central Bank was the subject of constant attack from the government. Its head, And  as Simor – who was appointed by the previous government’s prime minister – was forced to take a 98% pay cut while Fidesz put its constitutional power to use again to limit the extent of his authority. When finally Mr Simor’s mandate came to an end, he was replaced by the government’s Finance minister and party member, Gy  rgy Matolcsy, which raised questions regarding the Bank’s independence.

With a great deal of other questionable legislations, the final decisive area that was transformed in the country’s political arrangement under the new government was the electoral system. With an eye on the future, Fidesz constructed a structure that would clearly favor them in an upcoming election by designing the constituencies in such manner that – based on past voting schemes - voters of the conservative party would make up the majority in each of them. All in all, the measures instituted by the newly elected government resulted

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<sup>30</sup> For more on the institutional changes that have taken place in the country read Princeton’s Professor of Law, Kim Lane Scheppele’s articles available through Paul Krugman’s popular blog: <http://lapa.princeton.edu/content/lapa-director-kim-lane-scheppele-analyzes-present-situation-hungary>

in a constant fall in rankings on political freedoms compiled by NGO Freedom House, gaining a status of partly-free, only a few positions below South Korea and East Timor.

As a result of the above listed changes in a 2015 study, Guriev and Treisman<sup>31</sup> likened Prime Minister Orbán to a “modern dictator”. Together with Turkey’s Erdogan, Russia’s Putin and to some extent Singapore’s Kuan Yew’s, the Hungarian prime minister’s title - what the authors also term as ‘illiberal democracy’ – entails a different system from the dictatorships of the 20<sup>th</sup> century, in so far as it does not resort to violence and terror. Instead, it ensures its power through means of manipulation, hacked elections, propaganda and censorship. Mr Orbán never denied these accusations in their entirety. In a speech referred to in the introduction of this paper<sup>32</sup> he expressed his admiration for illiberal democracies for making countries more “competitive for the decades to come in the face of the great global competition”, while in 2015, already serving his third term as the leader of Hungary, he emphasized the effectiveness of authoritarian regimes in achieving results against the democratic Europeans, which he argued “instead of acting are only arguing”<sup>33</sup>.

Mr Orbán’s words represent a long tradition of supportive understanding of what is termed as the “benevolent autocrat” concept. As Easterly<sup>34</sup> explains, developing countries under such leadership are understood to be ill-prepared for democracy while autocrats are regarded as alternatives who will take difficult decisions that pay off in the long run, which democracies would not choose in the short run. It is also argued that “development benefits from expert technical knowledge that the ruler must be free to implement without democratic checks and balances”. The prime minister’s legitimization for an illiberal political structure based on its

<sup>31</sup> Sergei Guriev and Daniel Treisman, “How Modern Dictators Survive: Cooptation, Censorship, Propaganda, and Repression” *CEPR Discussion Paper No. DP10454* (February 2015) available: [http://www.cepr.org/active/publications/discussion\\_papers/dp.php?dpno=10454](http://www.cepr.org/active/publications/discussion_papers/dp.php?dpno=10454) (accessed: 30.04.2015)

<sup>32</sup> Orbán, Orbán Viktor teljes beszéde, *Magyar Nemzet Online*

<sup>33</sup> HVG (2015) Orbán: Az autokratikus rendszerek cselekednek, a demokráciák csak reagálnak, *HVG Online* 09.05.2015 [http://hvg.hu/itthon/20150509\\_Orban\\_Az\\_autokratikus\\_rendszerek\\_cseleked](http://hvg.hu/itthon/20150509_Orban_Az_autokratikus_rendszerek_cseleked)

<sup>34</sup> William Easterly, “Benevolent Autocrats” *NBER Working Papers* (august 2011) available: <http://williameasterly.org/publications/working-papers/> (accessed: 10.05.2015), 1



effectiveness in achieving economic results is supported by empirical research as well. Termed as ‘performance legitimacy’<sup>35</sup> by Gurien and Treisman, De Luca et al. find that populations tend to be supportive of autocratic leaders as long as they produce above average economic growth<sup>36</sup>. The empirics may be new, but it was theorized many times before that benevolent autocrats are able to stay in power precisely because of their economic achievements. In a somewhat prescient article<sup>37</sup>, Fareed Zakaria already foreshadowed the possible rise of illiberal democracies in 1997. His predictions seem to have gained momentum especially since the 2008 financial crisis as leaders of the developing world are turning to the likes of China for guidance in successful economic development. Liberal theorists like Fukuyama wrote: “leaders in both the developing and developed world have marveled at China’s remarkable ability to bounce back after the crisis, a result of a tightly managed, top-down policy making machine that could avoid the delays of a messy democratic process. In response, political leaders in the developing world now associate efficiency and capability with autocratic political systems.”<sup>38</sup> Even an organization like the World Bank that was for decades blamed for failures in world development due to its overemphasis on neoliberal measures, argued in similar fashion in its 2008 Growth Commission Report, edited by Nobel Laureate Michael Spence, when writing: “Growth at such a quick pace, over such a long period, requires strong political leadership”<sup>39</sup>. Strong political leadership however, does not necessarily entail an authoritarian political system, yet it does require a more centralized political structure than what had been advocated by the international financial institutions previously, which raises an interesting point. As stated earlier, the second Orbán government

<sup>35</sup> Guriev and Treisman (2015) How Modern Dictators Survive: Cooptation, Censorship, Propaganda, 2

<sup>36</sup> Giacomo De Luca; Anastasia Litina, A.; Petros Sekeris, “Growth-friendly dictatorships” *Journal of Comparative Economics* 43 no.1 (2015):98-111

<sup>37</sup> Fareed Zakaria, “The Rise of Illiberal Democracies”, *Foreign Affairs* 76 no.6 (1997):22-43

<sup>38</sup> Nancy Birdsall and Francis Fukuyama, “The Post-Washington Consensus: Development After The Crisis”, *Center For Global Development: Working Paper 244* (march 2011) available:

<http://www.cgdev.org/publication/post-washington-consensus-development-after-crisis-working-paper-244>

accessed: 08.05.2015

<sup>39</sup> World Bank Growth Commission, “The Growth Commission Report”, Washington DC, (2008):18

certainly did not offer a mirror image of the oppressive dictatorships of the 20<sup>th</sup> century East Asian Tigers' political systems. But as we can see that is certainly not the primary quality of their political system that made them successful. The developmental state's main value in this regard lies not in its effectiveness of terrorizing its population but its *capacity* to determine and implement the right policies.

Leftwich<sup>40</sup> writes in similar manner when giving an account of the growth successes of the same period. Botswana (12.2%), South Korea (9.7%), Taiwan (9.7%) Singapore (7.8%), Thailand (6.4%) and Malaysia (6.5%) had very diverse regime types, from democratic to quasi-democratic to non-democratic polities. What they shared was an institutional environment that allowed the state to carry out its own economic objectives with relative freedom. Peter Evans' concept of *embedded autonomy* is reflective of this argument. According to Evans<sup>41</sup>, successful states need to be embedded in the economy in order to be provided with the necessary feedback and to be able to overcome collective action problems. The state must maintain channels through which it can interact with the population and the business elite it governs in order to be able to reflect on and evolve with any newly arising requirements. On the other hand, the state must also maintain its autonomy, staying free from popular and capitalist pressures so it can set long term developmental targets in its policy making. The developmental state's source of success therefore originates from its ability to maintain relative independence from the demands of interest groups while reflecting to social pressures in a way that allows the government to carry out developmental policies with a view on their long term returns.

From a political point of view there can be little doubt about the second Orbán government's

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<sup>40</sup> Adrian Leftwich "Bringing Politics back in: towards a model of the developmental state", *Journal of Development Studies* 31 no.3, (1995):400

<sup>41</sup> Peter Evans, *Embedded Autonomy: States and Industrial Transformation*, (Princeton University Press: New Jersey, 1995) 11-12 & 232-234

strength. Unconstrained by the constitution, it has reformed over and over again the country's institutional make up according to its own needs. In the following sections however, while taking into account the changes that have taken place in the most important sectors from the developmental state's point of view, the paper will also discuss the relative autonomy the government enjoyed from influential interest groups of the area with an eye on the level of embeddedness in its policy making.

### **Chapter 3 - The Political Economy of the Second Orbán Government vis-à-vis the East Asian Developmental States'**

#### **3.1. The Economy**

The developmental state's economy, as its name suggests, revolves around the activities of the state. But that is true only in so far as it helps nurture local industries by different means – technical, institutional and financial – to become competitive in the international markets. Despite liberal economists' resentment of state involvement in the economy – largely stemming from the truly dreadful experiences of the communist era – a well-functioning developmental state is a step towards a modern market economy and not away from it. In the words of Bonefeld “protectionism is merely a measure of defense *within* free trade”<sup>42</sup> (emphasis added). However, as Reinert points out, protectionism can vary. The form that that Latin America employed was deemed a failure while East Asia's is the model for success. The following table taken from Reinert's book, highlights the key differences in policy terms between Latin America's failed developmental attempts in the 20<sup>th</sup> century in comparison with East Asia's successful one:

Table 1<sup>43</sup>

#### Two Ideal Types of Protectionism Compared

<b>East Asian: 'Good'</b>				<b>Latin America: Bad</b>			
Temporary	protection	of	the new	Permanent	protection	of	mature
industries/products for the world market				industries/products for the home market			

<sup>42</sup> Werner Bonefeld, “The Spectre of Globalisation on the Form and Content of the World Market” in *The Politics of change: globalization, ideology and critique* eds. Werner Bonefeld and Kosmas Psychopedis (London: Palgrave Macmillan, 2000) 41

<sup>43</sup> Erik Reinert, *How Rich Countries Got Rich and Why Poor Countries Stay Poor*, (London: Constable, 2007), 311-312

(often very small)

Very steep learning curves compared to the rest of the world	Learning that lags behind the rest of the world
Based on dynamic Schumpeterian view of the world - market-driven 'creative destruction'	Based on more static view of the world - planned economy
Domestic competition maintained	Little domestic competition
Core technology locally controlled	Core technology generally imported from abroad/assembly of imported parts/'superficial' industrialization
Massive investment in education/industrial policy created a huge demand for education. Supply of educated people matched demand from industry	Less emphasis on education/type of industries created did not lead to huge (East Asian) demand for education. Investment in education tends to feed emigration
Meritocracy - capital, jobs and privileges distributed according to qualifications	Nepotism in the distribution of capital, jobs and privileges
Equality of land distribution (Korea)	Mixed record on land distribution
Even income distribution increased home market for advanced industrial goods	Uneven income distribution restricted scale of home market and decreased competitiveness of local industry

Profits created through dynamic Profits created through static rent-seeking  
'Schumpeterian' rent-seeking

Intense co-operation between producers and local suppliers Confrontation between producers and local suppliers

Regulation of technology transfer \_oriented Regulation of technology transfer \_oriented  
towards maximizing knowledge transferred toward avoiding 'traps'

As we will see the Hungarian government has followed to some extent the general directives of the East Asian model above and not without its results. In table 2 we can see that since the second half of the period investigated by this thesis it has produced outstanding growth rates, greater than the average of the Euro area. In the meantime, as evidenced by table 3 the country was also able to lower its national debt while also producing budget deficits comfortably below the ones required by the Maastricht treaty of the EU from 2012.

Table 2: Annual GDP Growth Rate in percentage

	2010	2011	2012	2013	2014
Euro area	2.0	1.6	-0.8	-0.5	0.9
Hungary	0.8	1.8	-1.5	1.5	3.6

source: Eurostat<sup>44</sup>

Table 3: Debt to GDP ratio and Budget deficit in Hungary between 2010 – 2014 in percentage

	2010	2011	2012	2013	2014

<sup>44</sup> Eurostat (2015) *Real GDP growth rate* available:  
<http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tec00115&plugin=1> accessed: 01.06.2015

Debt/GDP	80.9	81.0	78.5	77.3	76.9
Budget deficit	-4.5	-5.5	-2.3	-2.5	-2.6

source: Eurostat<sup>45</sup>

In the ensuing chapters we will take a closer look at political and economic policies underlying these numbers. Numbers can sometimes neatly cover for some deeper underlying problems within the economy. For example, placed first in Reinert's table is the export orientation of the East Asian economies. On the surface Hungary, from this perspective, follows their footsteps as the country can boast of a positive foreign trade surplus, exporting close to double the volumes it is importing<sup>46</sup>. However exports can differ. In East Asia, as the local economies were developing, exports were year by year increasingly carried out by domestically controlled firms, yet as we shall see that is not the case in Hungary. This is primarily the result of another missing element that is identified in Reinert's table: dynamic 'Schumpeterian' rent-seeking.

In the sub-chapters to follow the paper will look at the purely economic aspects and the policies connected to them that the government has put forward vis-à-vis the East Asian developmental states. The three main areas to be discussed are: finance, state-business and state-labor relations.

<sup>45</sup> Eurostat(2015) Real GDP growth rate available:  
<http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=teina225&plugin=1>  
 accessed:01.06.2015

<sup>46</sup> KSH (2015) Külkereskedelmi mutató available:  
[http://www.ksh.hu/docs/hun/xstadat/xstadat\\_hosszu/h\\_qkt001.html](http://www.ksh.hu/docs/hun/xstadat/xstadat_hosszu/h_qkt001.html) accessed: 28.05.2015

### 3.2 Finance

Dani Rodrik wrote a paper<sup>47</sup> in 1999 on the required institutions for high-quality and long term growth in which he argued that – amongst others – fiscal and monetary institutions are inevitable for long term development. In East Asia, it was primarily the role of the pilot agencies to handle both areas. Thus, central and other forms of banking, capital flows, the exchange rate and the budget were all centralized in the hands of the state agencies<sup>48</sup>. Liberal economists would often argue that it is through the price mechanisms of the market that resources may be distributed the most efficiently whereas allocation through the state will lead to crisis. The East Asian states were able to deny that theory, at least in so far that they were producing outstanding developmental results for decades, utilizing a state centered financial model<sup>49</sup>. In fact, Alice Amsden<sup>50</sup> argues that the East Asian developmental states gained their competitive edge partly by “getting prices wrong” which effectively entailed a strategy where government intervention into the market through different means was to make up for the countries’ relative economic backwardness and help kick start their catch-up process.

The financial sector in the East Asian developmental states<sup>2</sup> was the channel through which resources were allocated to the domestic entrepreneurial classes according to the state set targets. Thus, it was utilized as a mean to guide the economy<sup>51</sup>. This allowed the East Asian states to develop rapidly but in stages, starting with the primary (agriculture, textile) then

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<sup>47</sup> Daniel Rodrik, “Institutions for High Quality Growth: What They Are and How to Acquire Them?” *NBER Working Papers no. 7540* (February 2000), available: <http://www.nber.org/papers/w7540.pdf> (accessed: 17.05.2015), 8

<sup>48</sup> Tun-Jen Cheng.; Stephan Haggard.; David Kang, “Institutions and Growth in Korea and Taiwan: The Bureaucracy”, *Journal of Development Studies* 34 no.6, (2007):87-111

<sup>49</sup> The question of the 1997 East Asian financial crisis remains a debated one from this perspective. For more on that see: Robert Wade, “The Asian Debt and Development Crisis of 1997?: Causes and Consequences” *World Development* 26 No.8 (1998)1535 -1553

<sup>50</sup> Beeson *Regionalism & Globalization In East Asia*, 163

<sup>51</sup> Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialism*, (New Jersey: Princeton University Press, 1990) 159-172



from the 1950-1960s onwards moving on gradually to the secondary (industrial) and tertiary (services) sectors. The pilot agencies thus were essentially playing the role of a development bank, yet somewhat differently than their Western counterparts, as a great deal of those finances were essentially subsidies where the state helped businesses to incur heavy losses in so far as they were catching up in terms of competitiveness with their Western counterparts<sup>52</sup>.

However, after the change of regime in 1990, Hungary followed a different path, despite its underdeveloped status vis-à-vis both the West and the newly industrialized countries (NIC) of East Asia. With little trust in the country's institutional and governance capabilities, development banking was de facto ruled out under the guidance of the World Bank during the 1990s reform period<sup>53</sup>. In the meantime the banking system, similar to the rest of the region, was soon privatized and came to be dominated by foreign ownership, so much so that by 2010, banks with headquarters abroad were in control of the country's lending market in the access of 70-80% (measured in terms of assets)<sup>54</sup>. Rachel Epstein thus, points out that the lack of control over finance does not necessarily result in economic catching up, but no developed country has achieved in modern history with a majority foreign owned banking system (unless it possessed some extraordinary natural resource advantage). She further argues that the fact that banking was domestically controlled played a major part in the East Asian states' ability to distribute funds according to the plans of the pilot agencies<sup>55</sup>.

Epstein's words resonated well with Orbán's objectives. The prime minister declared in the same vein his intention to return at least 50% of the banking sector under domestic control

<sup>52</sup> Dani Rodrik, "The 'Paradoxes' of the Successful State", *European Economic Review* 41 no.3-5, (1997):423-424

<sup>53</sup> Alice Amsden; Jacek Kochanowicz; Lance Taylor, *The Market Meets its Match: Restructuring the Economies of Eastern Europe*, (Cambridge: Harvard University Press, 1994) 120

<sup>54</sup> Rachel Epstein, "Overcoming 'Economic Backwardness' in the European Union", *Journal of Common Market Studies* 52 no.1, (2014):26

<sup>55</sup> Epstein, "Overcoming Economic Backwardness" p.26

which, just before the elections in 2014, were turned into reality, upon buying MKB Bank from Bavaria; the ratio of the domestically controlled credit institutions was raised to 50.5%<sup>56</sup>.

The way the government retained its ownership over the country's banking system carried another important element resembling the developmental state's policy directives. There was a kind of crusade taking place against the foreign financial institutions, both on the level of rhetoric and policy. Together with other non-domestic companies in the service sector, especially insurance and utilities companies they were deemed to have exploited the country while taking out the "extra profits" they were making<sup>57</sup>. This was done primarily through the introduction of several super taxes. In line with the government's economic ideal of turning the country into a manufacturing center of Europe<sup>58</sup> MNCs in the industrial production were however spared such taxes. Moreover, they received support through shady "strategic partnership contracts"<sup>59</sup>. Emphasis on industrial production can be regarded as yet another element taken from the East Asian developmental states. Not only did they base a great deal of their development on manufacturing production but, as Robert Wade<sup>60</sup> explains, even in the 90s, when many of them already broke successfully into the service industries, they remained reluctant to downsize their industrial productions leaving, amongst others, the Eastern European countries with serious competition.

Unlike the financial sector, the situation regarding development banking in Hungary has changed vis-à-vis the first years of the 1990s and a development bank was readily available

<sup>56</sup> Portfolio, "Megerősítette Orbán a portfólió számításait – tényleg megvan az 50%" *Potfolio Online* 26.07.2014 available:

[http://www.portfolio.hu/finanszirozás/bankok/megekositette\\_orban\\_a\\_portfolio\\_szamitasait\\_tenyleg\\_megvan\\_az\\_50.201822.html](http://www.portfolio.hu/finanszirozás/bankok/megekositette_orban_a_portfolio_szamitasait_tenyleg_megvan_az_50.201822.html) (accessed: 28.05.2015)

<sup>57</sup> Soma Jankovics, "Miért tudná a Fidesz amit már Marx sem tudott" *Origo Online* 28.10.2013 available:

<http://www.origo.hu/gazdasag/gazdasag-plusz/20131024-mi-szomit-extraprofitnak.html> (accessed: 30.05.2010)

<sup>58</sup> MTI, "Szijártó: termelési, nem pénzügyi központ lehet Magyarország" *HVG Online* 02.07.2011 available:

[http://hvg.hu/gazdasag/20110702\\_termelesi\\_kozpont\\_kozep\\_europa](http://hvg.hu/gazdasag/20110702_termelesi_kozpont_kozep_europa) (accessed: 28.05.2011)

<sup>59</sup> Tamás Sárközy (2014) *Kétharmados Tűzaskormányzás: Avagy Gólerős Csatár A Mély Talajú Pályán* (Budapest: Park Könyvkiadó) 298

<sup>60</sup> Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialism*, (New York: Princeton University Press, 1990) 348

for the reelected Orbán government in 2010. Yet it preferred to rely rather on the independent (at least on paper) Central Bank for such purposes. With soaring private sector investments in the aftermath of the 2008 financial crisis and businesses crippled by fx loans denominated in Euros, Swiss Franc and Japanese Yen against the Hungarian currency that was constantly losing value, the government had to find a way to inject blood into the economy. Thus it set up the Funding For Growth Scheme (FSG) with the Central Bank's money. Within the FSG, banks were given interest-free loans to distribute with a maximum of 2.5% interest rates among investors and businesses either to finance new projects or to replace their highly volatile fx loans with HUF denominated ones<sup>61</sup>. FSG loans thus, are essentially subsidized ones as they appear as losses on the Central Bank's balance sheet, in order in order to cover the base rate it waived in favor of the banks on the market<sup>62</sup>. In line with the government's emphasis on manufacturing retail businesses were disqualified from applying within the program<sup>63</sup>. According to the latest data, the loans have provided the economy with a boost as decline in corporate lending stopped; according to data reported to the Hungarian Central Bank by borrowers - depending on the kind of loan - between 60-85% of the lending would not have taken place without the FSG<sup>64</sup>. Yet the loan was aimed at small and medium sized businesses primarily. The developmental state however focused more on the leading corporations in the country, the capitalist elite.

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<sup>61</sup> MNB, "Terms and Conditions of refinancing loans in Pillar I and II of the first phase of the Funding for Growth Scheme" available:  
[http://english.mnb.hu/Root/Dokumentumtar/ENMNB/Monetaris\\_politika/fgs/NHP\\_termektajekoztato\\_EN.pdf](http://english.mnb.hu/Root/Dokumentumtar/ENMNB/Monetaris_politika/fgs/NHP_termektajekoztato_EN.pdf)  
 accessed: 14.05.2015

<sup>62</sup> Istvan Palkó, "Itt az új ingyenhitel – Mi lesz Matolcsy százmilliárdjaival?" *Portfolio Online* 30.09.2013 available:  
[http://m.portfolio.hu/vallalatok/itt\\_az\\_uj\\_ingyen\\_hitel\\_mi\\_lesz\\_matolcsy\\_szazmilliardjaival.189816.html](http://m.portfolio.hu/vallalatok/itt_az_uj_ingyen_hitel_mi_lesz_matolcsy_szazmilliardjaival.189816.html)  
 (accessed: 29.05.2015)

<sup>63</sup> MNB, "Terms and Conditions of Refinancing Loans in Pillar I and II of the first phase of the Funding for Growth Scheme". *MNB Publications*(2015) available:  
[http://english.mnb.hu/Root/Dokumentumtar/ENMNB/Monetaris\\_politika/fgs/NHP\\_termektajekoztato\\_EN.pdf](http://english.mnb.hu/Root/Dokumentumtar/ENMNB/Monetaris_politika/fgs/NHP_termektajekoztato_EN.pdf)  
 accessed: 14.05.2015

<sup>64</sup> CBH "What are the reasons behind the launch of FGS+?" available:  
[http://english.mnb.hu/Root/Dokumentumtar/ENMNB/Monetaris\\_politika/fgs/2015/Hatterelemzes\\_final\\_ENG.pdf](http://english.mnb.hu/Root/Dokumentumtar/ENMNB/Monetaris_politika/fgs/2015/Hatterelemzes_final_ENG.pdf)  
 f (accessed: 14.05.2015)2

### 3.3 Industrial Development and Capitalist Classes

Dependency theorists point out the importance of the emergence of a domestic capitalist elite for a country's long term development. It is not out of a nationalist creed but based on clear economic grounds that they argue in favor of nurturing locally owned but internationally competitive enterprises. Perhaps it is Nölke and Vliegthart who expressed the bases for these arguments the most coherently: "Western owners of Eastern production sites may well have a certain interest in the short- and medium-term viability of their investments (...), but they have less incentive than domestic bourgeoisies to invest in the long-term sustainability of these economies. At the same time, the current comparative advantages of" Central Easter Europe "may gradually be eroded, given the decreasing value of the skill in the absence of substantial investment into R&D and education<sup>65</sup>."

The East Asian developmental states, in agreement with the above theory, also supported the emergence of national corporate elite. The most famous ones are perhaps the Japanese *keiretzous* and the South Korean *chaebols*, but there were examples of such state supported conglomerates in other developing countries of the region as well<sup>66</sup>. What they had in common was their special relationship with the state as the government ensured special treatment for them against foreign investors. As discussed in previous chapters, the capitalist elites were provided with institutional, financial and other forms of support from the state. However, unlike in many of the Latin American cases, relationships did not turn into pure nepotism and cronyism. Subsidies were available only for those who were able to meet certain performance requirements<sup>67</sup>. As Sato explains, "the government pursued dual policies

<sup>65</sup> Andreas Nölke and Arjan Vliegthart, "Enlarging the Varieties of Capitalism: The Emergence of Dependent Market Economies in East Central Europe." *World Politics* 61 no.4, (2009):695

<sup>66</sup> For example, Indonesia: Yuri Sato, "The Salim Group in Indonesia: The Development and Behavior of the Largest Conglomerate in Southeast Asia", *The Developing Economies* 31, no.4, (2007):408-441

<sup>67</sup> Alice Amsden, *The Rise of "The Rest": Challenges to the West from Late-Industrializing Economies*, (New York: Oxford University Press, 2001) 148-53

(import-substitution and export promotion) on the corporate level”<sup>68</sup> to avoid the emergence of one-dimensional domestic monopolies. As money was often distributed through developmental banks –also state run as we have seen – they played key role in monitoring these funds, looking at whether they were used according to their designated purposes. Thus, for example in Korea, funds already authorized were transferred into a Credit Control Account from where withdrawal was only permitted for actual expenditures. This way the bank was part of the process and was able to look after how the money was spent<sup>69</sup>.

These are all very important measures because if there is one narrow group of society that can completely diminish the state’s autonomy in policy making than it is the economic elite. The diversions such groups may cause in a country is perhaps best exemplified by Hirschman’s theory on the origins of Latin America’s developmental failure in the 20<sup>th</sup> century, namely the *feudal shackles*<sup>70</sup>. In Hirschman’s original theory these shackles are former feudal landlords of the colonial times and when change in the region’s economic system came they were able to, for example, block policies that would have contributed to development but losses in their power. In Latin America, the extensive redistribution of lands that was one of the first policies to take place in East Asia after the colonial powers left, never took place because of these landlords. Similarly, one of the reasons in Reinert’s table for the Latin American region’s developmental failure, i.e. the one dimensional import-substitution strategy was never replaced with an East Asian type export led one due to the prohibiting powers of the elite there. In other words this is the question of state capture, something that has been discussed in

<sup>68</sup> Yuri Sato, “Diverging Development Path of the electronics Industry in Korea and Taiwan” *The Developing Economies* 35 no.4, (1997):413

<sup>69</sup> Amsden, *The Rise of “The Rest”*, 145

<sup>70</sup> Albert Hirschman “Rival Interpretations of Market Society: Civilizing, Destructive, or Feeble?” *Journal of Economic Literature*, (1982)1474-1480

other studies to some extent already with regards to the pre-2010 era in the Eastern European region as well<sup>71</sup>.

Unlike, however the homogenous societies that the East Asian autocrats inherited from the colonizers, the second Orbán government, after 20 years of market economy, inherited a fairly strong capitalist elite together with some very influential MNCs. On top of that, Orbán himself did not come without his own “shackles”. The Prime Minister and more importantly his party, Fidesz, had surrounded and financed itself with some rather influential business people in the decades following the change of regime in 1990. The former socialist Minister of Economy refers to them as “The Family”<sup>72</sup> insinuating a mafia like relationship for the close ties between the two. However, in spite of this, one can argue that as many of the former elite were on the losing end of the newly elected government’s decision; the two-third constitutional majority allowed the government enough room to design policies relatively autonomously. This included the richest and one of the most influential Hungarian, Sandor Csányi, the president of the largest domestic run bank and owner of several other large agricultural and manufacturing businesses. Csányi and other influential Hungarian people from the retail sector were left out when the government centralized the credit unions under its own egis, handing leading roles to loyalists instead<sup>73</sup>. More recently, the third Orbán government – while still enjoying a two-thirds majority - broke ties publicly with one of its most favored tycoons from its previous term<sup>74</sup>.

This however did not mean that the Hungarian government was cracking down on the old elite in order to make competition fairer. Orbán was very much informed by the East Asian

<sup>71</sup> Joel Hellman.;Geraint Jones;Daniel Kauffman “Seize the state, seize the day: state capture and influence in transition economies” *Journal of Comparative Economics* 31 n.4, (2003):751–773

<sup>72</sup> István Csillag, A küldetés: vagyonosodni – Elitcsere családi alapon in *A Magyar Polip: A Poszkommunista Maffiaállam*, ed. Magyar Bálint (Budapest: Noran Libro, 2013) 222-223

<sup>73</sup> Éva Várhegyi, A Maffiaállam Bankjai in *A Magyar Polip: A Poszkommunista Maffiaállam* ed. Magyar Bálint (Budapest: Noran Libro, 2013) 254

<sup>74</sup> Népszabadság Online, „A Simicska-Orbán háború: Csak egy maradhat?” *Népszabadság Online* 17.10.2014 available: <http://nol.hu/gazdasag/harci-hidfoallasok-1493021> (accessed: 27.05.2015)

system when he repeatedly stressed the importance of the construction of a national entrepreneurial bourgeoisie<sup>75</sup>. Yet his means were largely different; on the one hand with reforms in the tax system already (to be discussed in more detail in the inequality section) while on the other with different types of preferential treatment.

A number of means have been employed by the government to aid its own entrepreneurial elite. In a book recently published by the former American ambassador to Hungary under the second Orbán government, Eleni Tsakopoulos Kounalakis claimed that she was told by former Minister of Development of Hungary that at any time there was a Hungarian company capable of carrying out a project, it would always win against its foreigner counterpart<sup>76</sup>. Matters of efficiency or the price were not part of the criteria. However the issue went deeper than that; in certain sectors, tenders were put forward to match the exact profile of certain companies, while in other cases only companies invited by the government were able to apply. Furthermore, certain projects were often declared to be of “national priority” with no explanation attached as to why, but the new title effectively gave control over them to the government-appointed commissioners<sup>77</sup>. One of the biggest beneficiaries of the system was Prime Minister Orbán’s old college roommate’s construction business which, in four years, more than doubled its revenues from HUF 40 billion<sup>78</sup> in 2010 to HUF 98 billion<sup>79</sup> in 2014, while also diversifying its portfolio by becoming one of the largest media moguls in the country<sup>80 81</sup>.

<sup>75</sup> Sárközy, *Kétharmados Tűlzáskormányzás*, 294

<sup>76</sup> Márk Herczeg, “Orbán beismerte, hogy hetente leül a fejlesztési miniszterrel, hogy eldöntse, ki nyerje a beszerzést” 444.hu 17.05.2015 available: <http://444.hu/2015/05/17/orban-beismerte-hogy-hetente-leul-a-fejlesztési-miniszterrel-hogy-eldontse-ki-nyerje-a-kozbeszerzest/> (accessed: 27.05.2015)

<sup>77</sup> Sárközy, *Kétharmados Tűlzáskormányzás*, 299

<sup>78</sup> András Pethő Hódítók a politika árnyékában – a politikához kötődő Közgép felemelkedése in *Origo* 06.12.2010 available: <http://www.origo.hu/itthon/20101206-a-kozgep-es-a-fidesz-kapcsolata-a-ceg-tortenete.html?pid=1> (accessed: 27.05.2015)

<sup>79</sup> Népszabadság Online A Simicska-Orbán háború: Csak egy maradhat? *Népszabadság Online* 17.10.2014 available: <http://nol.hu/gazdasag/harci-hidfoallasok-1493021> (accessed: 27.05.2015)

<sup>80</sup> Atila Bátorfy, “How Has the Media Empire of Orbán and Simicska Operated?”, *The Budapest Sentinel* 29.04.2015 available: <http://budapestsentinel.com/articles/how-viktor-orban-channeled-tens-of-billions-of-forints-to-lajos-simicskas-media-empire/> (accessed: 27.05.2015)

It is thus evident that the government was active in distributing money to domestic enterprises and more importantly to the ones that it favored. However-, unlike in East Asia, the objectives were more political than economic. The element of competition or export requirements that in the developmental states were so characteristic, were completely missing in Hungary when distributing these funds. A distinction needs to be made however, as historical circumstances play an important role here. As emphasized in the introduction, the new world order of transnational regulations in institutions that Hungary belongs to disallow the use of tariffs and other clearly protectionist measures. Thus, domestic companies in Hungary had to compete with several international corporations in an open market. That normally should mean that they have to innovate and add further value to their products. Yet the problem is that it would only be true in the case that companies closest to the government had only smaller portions of their revenue coming from state tenders and the larger from the market. However in a country where close to 97%<sup>82</sup> of all investments have been realized with the help of the EU funds (money that is distributed through the domestic governments' agencies), companies (small or large) remain heavily reliant on the state. It was proved empirically that clear correlation may be established between the distribution of EU funds and political favoritism in the period discussed<sup>83</sup>.

In Nölke and Vilegnhart's previously quoted 2009 study the authors found that 93.2% of automotive production, 60.3% of manufacturing and 92.2% of electronics production were

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<sup>81</sup> He is just one of the numerous loyal beneficiaries of the system (often referred to as oligarchs in the media, by opposition parties and in popular discourse). For sort of databank on the oligarchs find: Átlátszó, "Kis Oligarchatározó" *Átlátszó*, available: <http://atlatszo.hu/category/cikkek/oligarchatarozo/> (accessed: 27.05.2017)

<sup>82</sup> Péter Magyar, "Beragad a sokmillió euro" *Index.hu* 07.09.2012 available: [http://index.hu/belfold/2012/09/07/beragad\\_a\\_sokmillio\\_euro/](http://index.hu/belfold/2012/09/07/beragad_a_sokmillio_euro/) (accessed: 28.05.2015)

<sup>83</sup> Mihály Fazekas,; Lawrence Peter King; János István Tóth. "Hidden Depth: The Case of Hungary" *ERCAS Working Papers*, Vol.1 No.6, available: [http://www.crcb.eu/wp-content/uploads/2013/12/Fazekas-et-al\\_WP-36-Hidden-depths-Hungary\\_2013.pdf](http://www.crcb.eu/wp-content/uploads/2013/12/Fazekas-et-al_WP-36-Hidden-depths-Hungary_2013.pdf) (accessed: 28.05.2015)



foreign owned in Hungary<sup>84</sup>. These are incidentally also the sectors that cover more than two-third of the country's exports. In neither of them has there been a significant change made with regards to the ownership structure since. Thus, in the light of the above it should come as little surprise that in Hungary, according to estimates from 2015 of three Hungarian economists, of the top 200-200 largest and emerging companies respectively, the ones that actually have Hungarian majority ownership, only between 25-38 have the potential to be or are internationally competitive and as such able to export value added products<sup>85</sup>. This has resulted in a resulted in state-business relationship that resembles much more to the Latin American than the East Asian, where 'profits are created through static rent-seeking' rather than the previously discussed "Schumaterien" rent seeking.

### 3.4. Labor

The role of labor is uniquely important in any developing country. Investment and more importantly the quality of the investment – be it foreign or domestic – is largely dependent on the kind and amount of labor available. This is well reflected by the European Union's emphasis on the enhancement of the human capital to keep Europe competitive. The 2008 financial crisis has shown clearly the merits of this objective. According to analysts the Nordic model, based largely on this principle for constant upgrading of people's skills, was rather successful at overcoming the 2008 financial crisis by investing in its people. The labor force proved to be resilient to any sudden changes in employment structures and were able to find work in new sectors<sup>86</sup>. The Hungarian government, despite its membership in the EU, seems to follow a different model however. One that is more in line with the East Asian type

<sup>84</sup> Nölke and Vliegenthart "Enlarging the Varieties of Capitalism: The Emergence of Dependent Market Economies in East Central Europe", 683

<sup>85</sup> Zoltán Pogátsa, "Kiből lesz a magyar multi, avagy miért nem lett belőlünk Ausztria" *Átlátszó PogiBlog* 30.05.2015 available: <http://pogiblog.atlatszo.hu/2015/03/30/kibol-lesz-a-magyar-multi-avagy-miert-nem-lett-belolunk-auztria/> (accessed: 27.05.2015)

<sup>86</sup> Kees Van Kersbergen and Anton Nemerjick, "Two Decades of Change in Europe: The Emergence of the Social Investment State, *Journal of Social Policy* 41, no.2 (2012):481-483

developmental states' than its western partners.

The source of competitiveness in the likes of South Korea after 1950 also largely stemmed from the state policies directed towards labor. Leverage in the international markets against the already industrialized countries was gained through oppressed wages as the likes of Korea and Taiwan were producing similar products but at much lower costs<sup>87</sup>. The institutional make up of these countries was adjusted to this end. Workers were banned from forming unions on their own; instead as Deyo<sup>88</sup> points out, “politically docile trade unions” were set up by the state. Following from the nature of the system strikes were illegal, especially in areas deemed vital for the state’s economic objectives. Resting on three pillars, labor oppression was to a large extent politically charged phenomenon. The developmental states of the region explained the necessity of harsh labor policies with the preservation of security and territorial integrity; cultural and political reassertion; and economic growth<sup>89</sup>. To keep the worker’s spirit in line with the harsh state policies, culture was also exploited in the government propaganda. Confucianism, the region’s leading belief system, proved to be of a great asset to that end, as at its core, it promotes a hierarchical social arrangement. This helped to legitimize the initially large gaps between the upper and lower strata of society.

Of the policies that were put forward between 2010 – 2014 it is in the area of labor that resembles the closest to the East Asian developmental state’s. They were informed by Orbán’s declared quest to create a “workfare society” that effectively entailed the break down on the welfare state while allowing greater flexibility in labor rights<sup>90</sup>. Thus, the newly elected government wasted no time in 2010 and as one of its first measures completely transformed

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<sup>87</sup> Amsden, *Asia’s Next Giant*, 57-63

<sup>88</sup> Frederic Deyo, *Beneath the Miracle: Labor Subordination in the New Asian Industrialism*, (London: University of California Press, 1989) 185-188

<sup>89</sup> Joseph Camilleri, *States, Markets and Civil Society in Asia Pacific: The political economy of the Asia-Pacific Region, Volume I*, (Cheltenham: Edward Elgar, 2000), 359

<sup>90</sup> Szikra Dorottya, “Democracy and welfare in hard times: The social policy of the Orbán Government in Hungary between 2010 – 2014” *Journal of European Social Policy* 24 no.5 (2014):492

the Labor Code, which regulates the relationship between labor and employer and details basic rights of the workers. According to both experts and opposition parties of all spectrums in the parliament (from far right, through the greens to the classical left) the new regulations largely benefited the employers to the disadvantage of the employees<sup>91 92</sup>. Bearing a striking similarity to the East Asian regulations, strikes, although not banned, were made ineffective, disallowing sector wide walkouts<sup>93</sup>; layoffs without justification were introduced, trial periods - when the employee may not go on vacation or receive additional benefits from the firm – was replaced with a rule for a period not exceeding 3 months with a rule to extension subject to mutual agreement<sup>94</sup>.

In parallel with diminishing the rights of the employed, the government also overhauled the entire system of social benefits with drastic implications for the unemployed. The Public Works Program (PWP) was reformed based informed by the on the idea of people living off of labor instead of entitlements, an aim that in theory has merit. However, the way it was carried out has raised questions to the extent that some argued the program not only hurt basic human rights but human dignity too. The Ombudsman responsible for basic human rights argued, after closer inquiry, that people within the program are in an extraordinarily vulnerable situation as the precise rules of procedure are missing, which in turn hurts the principle of legal certainty, allowing abuse from the authorities. This is toppled by that fact that public workers are stripped of the general legal rights and mechanism protecting the

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<sup>91</sup>Policy Solutions, "Munkahelyteremtés Magyarországon: A Policy Solutions elemzése es javaslatai a Friedrich Ebert Alapítvány számára". (szeptember 2012) available :

[http://www.policysolutions.hu/userfiles/elemzesek/FES-Policy%20Solutions\\_Munkahelyteremt%C3%A9s.pdf](http://www.policysolutions.hu/userfiles/elemzesek/FES-Policy%20Solutions_Munkahelyteremt%C3%A9s.pdf) (accessed: 19.05.2014) 25

<sup>92</sup> Adrienne Zemplényi, "A Munka Méltósága Projekt", *AJB Projektfüzetek* (April 2013) available:

[http://konyvtar.eski.hu/tmpimg/1747089636\\_0.pdf](http://konyvtar.eski.hu/tmpimg/1747089636_0.pdf) (accessed: 12.05.2015) 13

<sup>93</sup> Ádám Kéri, "Munkajogi érdekek – Imsét változhat a Munkatörvénykönyve, a sztrájk és a nyugdíj szabályozás" *Jogi Fórum* 16.04.2015 available: <http://www.jogiforum.hu/hirek/33630> (accessed: 28.05.2015)

<sup>94</sup> Policy Solutions, *Munkahelyteremtés Magyarországon: A Policy Solutions elemzése es javaslatai a Friedrich Ebert Alapítvány számára*, 25

employed<sup>95 96</sup>. It came as little surprise then when the Helsinki Committee found that the PWP went against the 1966 International Covenant on Economic, Social and Cultural Rights. This is especially true for article 7 that states: “The States Parties to the present Covenant recognize the right of everyone to the enjoyment of just and favorable conditions of work”—such as, “remuneration which provides all workers, as a minimum” with “fair wages and equal remuneration for work of equal value without distinction of any kind”<sup>97</sup>, yet people in the program only receive half of the minimum wage, an amount that does not even come close to maintaining one’s own basic necessities, let alone that of an entire family. The most pressing issues with the program however from the thesis’ point of view is best exemplified in table 4 below. It shows how in less than a year the average number of workers finding employment reduced by almost 30% within the reformed program of the government. On top of it the PWC contributes little to the GDP in terms of value-added production as it represents the most basic manual labor. The program traps the people participating in it, especially those with the lowest qualifications. This is in sharp contrast with what East Asian states’ approach as we shall see in the section on education, who continually elevated workers skills to be able to find higher quality jobs.

**Table 4: Exit possibilities into market employment in %**

	2011 – 2012	2012-2013
Does non-complex labor	12	7
Does complex labor	21	16

<sup>95</sup> MTI ‘‘Kiszoigaltatott Helyzetben a Kozmunkasok’’, *Metropol* 27.12.2012 available:

<http://www.metropol.hu/cikk/980107-kiszoigaltatott-helyzetben-a-kozmunkasok> accessed: 15.05.2015

<sup>96</sup> Adrienne Zemplényi, ‘‘A Munka Méltósága Projekt’’, 48

<sup>97</sup> Norwegian Helsinki Committee, ‘‘Democracy and Human rights at Stake in Hungary: The Viktor Orbán Government’s drive for centralization of power’’ available:

[http://nhc.no/admin/filestore/Publikasjoner/Rapporter/2013/Rapport\\_1\\_13\\_web.pdf](http://nhc.no/admin/filestore/Publikasjoner/Rapporter/2013/Rapport_1_13_web.pdf) (accessed: 10.05.2015)48

What the above listed changes are meant to illustrate is a system that is more subtle in its means of labor oppression than the East Asian one yet just as effective. However the puzzle would not be complete without discussing the unions, the very organizations that should represent the interests of the labor against such disadvantageous system. Ever since the beginning of the capitalist transformations at the start of the 1990s, the consecutive governments have been able to enjoy relative autonomy from the labor unions' interests, on the one hand due to the drastically declining membership. According to the Tax Revenues Agency's numbers in 1992 there were close to 2.7 million membership fee paying members; by 2011 this number declined to a mere 410,747<sup>99</sup>. On the other hand unions were not spared from politicization. Both major political parties were fast to establish their own favored

<sup>99</sup> Rainer Grindt, "Magyarország szakszervezeti mozgásban: Kísérlet az erők koncentralasára" *Friedrich Ebert Stiftung Study*(2013) available:  
[http://www.fesbp.hu/common/pdf/Nachrichten\\_aus\\_Ungarn\\_juli\\_2013\\_Rainer\\_Girndt\\_HU.pdf](http://www.fesbp.hu/common/pdf/Nachrichten_aus_Ungarn_juli_2013_Rainer_Girndt_HU.pdf),3

unions and support them with hefty sums in exchange for a benevolent attitude towards their policies. The Fidesz-led government after 2010 has taken that to a new level however, by directing almost all the funds to its favored union, Liga, and a few others associated with it<sup>100</sup>

<sup>101</sup> .

The Orbán government was not only able to spare itself from internal pressures with relation to ensuring wide ranging labor protections, but external as well. The EU's *Acquis communautaire's* relevant pages offer only general guidelines, instead of binding regulations and, as Bafoil explains, social regulations within the community are left to the discretion of each country's government<sup>102</sup>.

The East Asian type policies regarding labor are a clear outcome of the wide autonomy the government was able to enjoy from political pressures between 2010 – 2014. Taking into account the above we can argue that the policies regarding labor were in line with the East Asian developmental state's model.

## Chapter 4 - Bureaucracy

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<sup>100</sup> Reiner Grindt, 'Magyarország szakszervezeti mozgáspolitikája', 10-11

<sup>101</sup> ATV, 'Felmilliódos támogatás: Gasko szakszervezete ismét tarolt', ATV 15.10.2013 available: <http://www.atv.hu/belfold/20131015-felmilliarodos-tamogatas-gasko-szervezete-ismet-tarolt> accessed: 20.05.2015

<sup>102</sup> Bafoil, *Emerging Capitalism in Eastern Europe and Southeast Asia*, 159

The bureaucracy represents the backbone of the developmental state in Evans' embedded autonomy theory. It continuously informs the private sphere and maintains cleavages between society and the leadership. Its main role is to be a professional mediator that allows the state to be embedded while at the same time keeping its distance from popular pressures. Evans sights Weber when he argues in similar fashion: "operation of large-scale capitalist enterprise depended on the availability of the kind of order that only a modern bureaucratic state could provide"<sup>103</sup>. Many of the East Asian countries have inherited very powerful state bureaucracies upon breaking free from their colonial overlords in the 1950s. Not only the Tigers but also Indonesia<sup>104</sup> were able to direct their distinct economies with the help of these institutions, the most vital being the economic planning agencies that helped design and execute the developmental policies of the state, primarily by overseeing and aiding domestic economic elites in achieving the government set targets. The most well-known are Japan's famous MITI and South Korea's Economic Planning Board (EPB). Through them the distinctive states were able to constantly intervene into their economies and maintain growth<sup>105</sup>. Their relative importance is perhaps best exemplified by the fact that the EPB's head in Korea was provided with the title of Deputy Prime Minister, the second highest position in the government hierarchy<sup>106</sup>. The first description of the functioning of an efficient bureaucracy within the framework of the developmental state was provided by Chalmers Johnson<sup>107</sup>. His portrayal of Japan's state lead development in the 20<sup>th</sup> century set the example later for authors to use as bases to investigate later the other developmental states' political economy. Given that most Tigers and other less successful developmental states also modeled their bureaucracies based on the Japanese example, it is only logical to utilize Johnson's

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<sup>103</sup> Evans, *Embedded Autonomy*, 29

<sup>104</sup> The local bureaucracy was often referred to as the "Berkley Mafia". For more: Malcolm Dowling and Chin-Fang Yap, "Indonesian Economic Development: Mirage or miracle?" *Journal of Asian Economics* 19 no.5-6, (2008):474-485

<sup>105</sup> Beeson, *Regionalism & Globalization in East Asia*, 141-160

<sup>106</sup> John Minns, "Of Miracles and Models: the Rise and Decline of the Developmental State in South Korea" *Third World Quarterly* 22 no.6, (2001):1026

<sup>107</sup> Johnson, *MITI and the Japanese Miracle*, 35-82

account for our purposes.

Two distinct features of the East Asian bureaucratic make up may be identified that differentiate it vis-à-vis its Western counterparts: accountability and quality. With regards to the former the reason is rather straightforward; in an authoritarian state, officials are not elected and neither are they appointed by democratically chosen leaders. Thus, they are only liable to their supervisors. While this may result in divergent policies from the general demand of the population, it is also partly the reason why the bureaucratic elite was able to preserve their relative autonomy from social pressures and formulate long term policies. Japan's bureaucrats designed and implemented economic policies that developed the economy and, with that, brought benefits to all layers of society. It was by no means an incident or a result of some kind of cultural advantage that they were able to design such effective policies, but of the second element that differentiated them from much of the West: their outstanding quality. Technocrats working for the state came from the most prestigious universities – often from the West, due to very generous scholarships – and received a very competitive salary. Working in the state bureaucracy was appreciated culturally as well, with only the best of the best able to get a job. The majority of the system was made up of employees of what Downs referred to as *mixed-motive officials*<sup>108</sup>. They were on the one hand motivated by self-interest but in the meantime had “altruistic loyalty to larger values”<sup>109</sup>. In other words they believed in the project that the state pursued and wanted to contribute to it positively. Education from an early age and state propaganda was used effectively to this end as well<sup>110</sup>.

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<sup>108</sup> Anthony Downs, “A Theory of Bureaucracy”, *American Economic Review* 55 no.1, 1965 441

<sup>109</sup> Downs, “A Theory of Bureaucracy”, 441

<sup>110</sup> Andras Tétényi, A fejlesztő állam és a politikai intézményrendszer, illetve a közigazgatás kapcsolata in *A Látható Kéz: Fejlesztő Állam a Globalizációban* ed. Csáki György (Budapest: Napvilág Kiadó, 2009) 107



However what perhaps made the most significant difference was the level of professionalism within the system which, in exchange contributed to the consistency of the policies. Bureaucrats for the most part were not appointed based on political loyalties but on merit. Candidates had to pass very rigorous exams to be able to enter civil service, yet, once in one of the ministries, young professionals had a lifelong career path designed for them<sup>111 112</sup>. Table 5 from Chu’s work collects the main features of the state’s relationship vis-à-vis its bureaucracy and society of the Tigers that sums up in a few sentences what has been argued regarding state capacity and bureaucracy.

Table 5

NIC	<i>Organization of State Economic Relationship between the state and</i>
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<sup>111</sup> Chalmers Johnson, The Developmental State: Odyssey of Concept in *The Developmental State*, ed. Meredith Woo-Cumings (London: Cornell University Press, 1999) 38-39

<sup>112</sup> Cheng, T-J.;Haggard,S.;Kang,D., “Institutions and Growth in Korea and Taiwan: The Bureaucracy”,105

Singapore	Autonomous fiscal and monetary authority and decentralized planning regime; technocrat-dominated, multiclass authority; excessive control of alliance with corporatist inclusion of the production resources.	Inclusionary party-based authoritarian urban popular sector
Taiwan	Dominant fiscal and monetary authority with checks on the activities of the regime; alliance between the national planning technocrats; extensive state involvement in production activities	Preemptive party-based authoritarian minority elite and the local dominant class
South Korea	Dominant planning authority and compliant fiscal and monetary regime; alliance between the military, big authority; centralized and resourceful business, and state technocrats bureaucracy.	Exclusionary military-based authoritarian

source: Chu (1989)<sup>113</sup>

Finally it has to be highlighted that the bureaucratic systems in East Asia were not perfect. Corruption was ever present<sup>114 115</sup> but it was systematic, which allowed it to become just another institution to calculate with for the participants in the market. The East Asians proved that the economy can function and achieve results despite corruption being present in it. What is necessary is for entrepreneurs to have a good knowledge about this informal institution and not have to bribe thousands of officials to be able to set up a project – hence the emphasis on a centralized bureaucracy. Put differently by Alan Beatie: “If corruption is stable and

<sup>113</sup> Yu-han Chu, “State Structure and Economic Adjustment of the East Asian Newly Industrializing Countries” *International Organization* 43 no. 4, (1989):662

<sup>114</sup> Jari Vartianinen, “The Economics of Successful State Intervention in Industrial Transformation” *The Developmental State* ed. Meredith Woo-Cumings, (London: Cornell University Press), 220

<sup>115</sup> To different extent where Singapore represented one with close to none while at the other end of the scale Indonesia with extensive corruption

predictable enough, it essentially becomes simply a tax<sup>116</sup>”.

When discussing the second Orbán government’s bureaucratic system one cannot discount the weight of historic legacy. Hungary, having been part of the Soviet Union for decades, also inherited a highly centralized bureaucracy but without the merit based admission system or the East Asian type market conforming entrepreneurial expectations from its employees. While more professional than other post-communist bureaucracies in the Eastern European region<sup>117</sup>, policy makers at the beginning of the 90s believed that the Hungarian bureaucracy was not ready to deal with the complexities of a market economy. Thus, the country opted for a complete overhaul, becoming perhaps the fastest to transform its bureaucratic system according to western examples<sup>118</sup>. Despite the changes, the system has remained highly politicized, since party members and functionaries of the party that was in opposition overtook most offices after every electoral victory<sup>119</sup>.

Yet influence over the bureaucratic transformations came not only from within but externally as well. On the one hand, the World Bank insisted on revoking the powers of the ministries of industry, i.e. the agency responsible for industrial development policy, while supporting the ministries of privatization, both financially and with know-how. As Bugaric<sup>120</sup> explains, the EU Commission, together with SIGMA<sup>121</sup>, has pursued everywhere in the Central European

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<sup>116</sup> Alen Beattie, *False Economy: A Surprising Economic History of the World*, (London: Penguin Books, 2010) 222

<sup>117</sup> Balázs, I., Creation of the personal conditions of the new machinery of public administration in *Public administration in Hungary* ed. Horváth T.-M. (Budapest: Hungarian Institute of Public Administration, 1993), 54-57

<sup>118</sup> Jan Hinrik Meyer-Sahling, (2004) The bumpy road to depoliticization: Civil service reform in post-communist Europe, *West European Politics*, 27no.1, (2004):72

<sup>119</sup> Jan Hinrik Meyer-Sahling, J.-H. „The changing colours of the post-communist state: The politicisation of the senior civil service in Hungary”, *European Journal of Political Research* 47 no.3, (2008):22-24

<sup>120</sup> Bojan Bugaric, “Law and Development in Central and Eastern Europe: Neoliberal Developmental State and Its Problems” *Jerusalem Papers in Regulation & Governance*, Working Paper No. 50, (2013):11

<sup>121</sup> It is a joint initiative of the European Union and the OECD. Its key objective is to strengthen the foundations for improved public governance. For more: <http://www.sigmaweb.org/about/>

(CEE) region the adaption of the classical Weberian model of “centralized hierarchy, with the emphasis on formalization of civil service management and the minimization of managerial discretion”. The idea was to depoliticize the countries’ bureaucracy by establishing a professional and neutral public administration. However by the end of the 2000s it became clear that the model failed to live up to its expectations and the Gyurcsány government that preceded the 2010 Orbán administration decided to employ the elements of the so called New Public Management (NPM) model instead<sup>122</sup>. What that entailed in practice was the introduction of a government personnel center to assume responsibility of the state administration’s new *concours*-like examinations system, the management of job vacancies and the preselection of civil service candidates. The reforms also required a competency-based evaluation system and reformed performance related pay system, paying up to six months bonus for outstanding performances<sup>123</sup>. Thus, the changes that were initiated before the Orbán government assumed control were clearly steps toward a more merit based, and well compensated civil service. While more in line with EU standards than with the East Asian, the two in this regards correlated.

One final aspect of the pre-2010 era needs to be taken into account before an analysis may be conducted of the second Orbán government from the chapter’s perspective: the cultural perception of civil service in Hungary. Historically speaking, the institutions of the bureaucracy have never been highly regarded in the country. This was largely determined by the policies after the change of regime in the 1990s. The regime change took place at the height of the Washington Consensus era that was associated with neoliberal economic

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<sup>122</sup> Jan Hinrik Meyer-Sahling, “The Durability of EU Civil Service Policy in Central and Eastern Europe after Accession”, *Governance* 24 no.2, (2011):247

<sup>123</sup> Meyer-Sahling, “The Durability of EU Civil Service Policy in Central and Eastern Europe after Accession”, 247-49

policies<sup>124</sup>. Amongst others this entailed the promotion of a small state. In line with this philosophy Western advisors to the government in the 1990s kept the market in a higher regard than the state bureaucracy (hence the previously mentioned disablement of the likes of ministries of industry in favor of privatization). The Hungarian policy makers were eager to meet their expectations<sup>125</sup>. Rhetoric was soon adjusted to the policies, as under the two periods of structural reform (1994-95, 2007-09), it was to a large part the ‘over-extensive state’ with ‘large and inefficient bureaucracy’ that bore most of the blame<sup>126</sup> consequently resulting in mass lay-offs within in the civil service. The theme of reductions in the bureaucracy became a popular subject among the voters in Hungary<sup>127</sup> that parties irrespective of their political affiliation began to advocate measures to reduce it ever since the 1990s—often without any concrete policies to underpin it.

In terms of cultural perception, not much changed after 2010 either. If anything the Fidesz-led government continued the rhetoric of ‘a too extensive and ineffective civil service’, arguing in favor of mass lay-offs<sup>128</sup>. In spite of this, real initiatives for an overarching state reform did not take place until the third Orbán government took office (a period however not covered in this thesis). Yet, measures that at least to some extent were similar in East Asia took place. Most importantly: centralization. The reformed institutional make-up of the country required a more centralized state to ensure greater oversight and control for the few leading the country with the prime minister at the top assuming responsibility for final decisions. The most

<sup>124</sup> Despite the resentment of its founder John Williamson, for more see: John Williamson, ‘Lecture: The Washington consensus as a Policy Prescription for Development’, available: <https://www.piie.com/publications/papers/williamson0204.pdf> (accessed: 12:05:2014) 8-9

<sup>125</sup> Alice Amsden; Jacek Kochanowicz; Lance Taylor., *The Market Meets its Match*,

<sup>126</sup> Világgazdaság Online, ‘‘Nem vállalkoznak a kirúgott közszolgák’’ *Világgazdaság Online* 15.08.2007 available: <http://www.vg.hu/kozelet/nem-vallalkoznak-a-kirugott-kozszoigak-184639> (accessed: 28.05.2015)

<sup>127</sup> Gallai Sándor and Láncki Tamás Személyre szabott kormányzás. A második Gyurcsány kormány anatómiája in *A 2006-os Országgyűlési Választások . Elemzések es Adatok*, ed. Karácsony Gergely (Budapest: DKMKA, 2006) 296-299

<sup>128</sup> HVG, ‘‘Jön az államreform: megtizedelik a közszférát, lesz állami rezsicsökkentés’’ *HVG Online* 22.09.2014 available: [http://hvg.hu/itthon/20141022\\_Jon\\_az\\_allamreform\\_megtizedelik\\_a\\_kozszfe](http://hvg.hu/itthon/20141022_Jon_az_allamreform_megtizedelik_a_kozszfe) accessed: 29.05.2015

prominent element of that was the reduction in the number of ministries overlooking the affairs of the country to eight– the lowest since 1990. From the thesis’ perspective it is the Ministry of National Development that holds the greatest importance since it is comparable to the developmental pilot agencies that we discussed above in relation to the developmental states. The similarity between the two was striking after reading quotes from Eleni Tsakopoulos previously mentioned book. In it, she claimed that she was told that the so called Developmental Cabinet within the ministry, during their weekly meetings, decided over the fate of the developmental funds (primarily from the EU)<sup>129</sup>. The cabinet was set up in 2012 and had only four permanent members, including the prime minister. Mr Orbán later confirmed these statements. This selection process resembles to a large extent to how, for example in Korea, such funds were distributed, based on the decisions of a few high ranking officials and the supreme leader<sup>130</sup>

Yet, while the above aspects of the bureaucracy have certainly come to resemble the East Asian developmental states’, its quality and thus to an extent its efficiency cannot claim the same. Unlike in East Asian, the salaries in Hungary were far from competitive for the civil service, thus the most talented of the population tried to look for vacancies in the private sector with better financial opportunities. Translated into numbers, there was no raise in the salaries of the people working in the civil service between 2008 and 2014. The former date is incidentally also the beginning from where wages in the public sector began to divert from the private sector’s, with an average of 30% in difference today by 2014<sup>131</sup>. To topple this, according to a recent study 16% of the people employed by the state made less than the

<sup>129</sup>Márk Herczeg, ‘Orban elismerte, hogy hetente leül a fejlesztési miniszterrel, hogy eldöntse ki nyeri a közbeszerzést’

<sup>130</sup> Amsden, *The Rise of “The Rest”*, 149

<sup>131</sup> Álmos, T, ‘Csoda, hogy még dolgoznak a közszférában’ *Defacto blog* 04.08.2014, available: [http://index.hu/gazdasag/defacto/2014/08/04/csoda\\_hogy\\_meg\\_dolgoznak\\_a\\_kozszferaban/](http://index.hu/gazdasag/defacto/2014/08/04/csoda_hogy_meg_dolgoznak_a_kozszferaban/) accessed: 29.05.2015

minimum living wage<sup>132</sup>. With such low earning potentials the Hungarian state was unable to attract the ‘best of the best’ and it was not even the primary criteria.

The salaries in the civil service were only one side of the coin. The issue of politicization instead of aspects of professionalism in the selection process is the other. Best exemplified with the foreign ministry where 76 foreign representatives (mid-level diplomats and ambassadors) were recalled and fired within a year after 2010 while of the 112 mission leaders, 100 were replaced as well. In 2012, in the name of rationalization and again efficiency, close to 100 people were fired; however soon more than 300 were hired with a clear focus on the support for the conservative mandate. The situation spiraled out of the hands of the reigning minister, to the extent that at the time when he needed expert opinion urgently on a matter, he received the answer, “There is no one who could respond to your inquiry in a substantive manner as the personnel formerly responsible for the given area was just fired”<sup>133</sup>.

It was not only the middle man to have been selected based on political aspects but some of top officials too, like the head of National Tax and Customs Administration and the Ministry of National Development. While the former’s leadership was filled with scandals and unresolved corruption allegations<sup>134</sup> – not aiding the Hungarians’ tax moral – the latter’s lack academic qualification is perhaps the more pressing issue from the thesis’ perspective. In the previous chapter on the economy it was mentioned that the East Asian states partly made up for the lack of market feedback by getting the best qualified bureaucrats, usually a very highly

<sup>132</sup> Policy Agenda, Dolgozói szegénységről és Kitorési Lehetőségekről, 30.03.2015 available: <http://www.policyagenda.hu/hu/kutatas> accessed: 04.05.2015

<sup>133</sup> Ara-Kovacs Attila, Nemzeti diplomácia helyett családi üzlet in *A Magyar Polip 2: A Posztkommunista Maffiaállam*, ed Magyar Bálint (Budapest: Noran Libro, 2014) 271

<sup>134</sup> The Budapest Beacon (2012-Present): A collection of articles about the year-long scandals surrounding the tax revenues office and its head after a whistleblower, named Andras Horvath came forward. Available: <http://budapestbeacon.com/?s=andras+horvath> accessed: 30.05.2015

trained from a prestigious foreign university, to guide the economy. In the face of this, Laszloné Németh, Minister National Development, faced many questions regarding her qualities and capabilities to guide a ministry in the absence of a diploma; more importantly she was one of the only 4 people to decide the distribution of the development funds. Yet, she was appointed regardless. Based on the investigation of a Hungarian watchdog NGO, it can be argued that her appointment had more to do with her close ties and career long affiliation with the previously mentioned former college roommate of the prime minister than her credentials<sup>135</sup>.

In conclusion to the chapter the reforms in the civil service and especially state bureaucracy have conveyed to the East Asian developmental state's own model to the extent that it helped create a more centralized state. A development agency was set up and it was put under the control of a few with the constant oversight of the prime minister regarding the distribution of the funds for the businesses. However in terms of quality of the technocrats and other state employees Hungary failed to follow the East Asian path due to lack of funds provided for it and the persistence of appointments made based on political rather than professional aspects.

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<sup>135</sup> Atlatzso, 'A Nemzeti Együttműködés Rendszere: Kik ejtették foglyul a Magyar államot?' *Atlatzso Online* 24.09.2012 available: <http://atlatzso.hu/2012/09/24/a-nemzeti-egyuttmukodes-rendszere-kik-ejtettek-foglyul-a-magyar-allamot/> (accessed: 29.05.2015)



## Chapter 5 - Growth without social policy

Having read through the section on the labor the reader can establish a rough picture about the developmental states' social policy. Wide ranging safety nets were unknown during the process of the development of the Tigers. In the words of an observer the East Asian developmental states were 'welfare laggards': "The few social programs that existed were for bolstering national economic productivity, not socioeconomic redistribution per se<sup>136</sup>". Instead, relative equality within society was achieved through spending substantial amount of the revenues on education and health care; areas that would allow workers to achieve higher productivity. Typically, such an approach to spending should fit well with the Orbán government's aim of building a "workfare society<sup>137</sup>". Yet if the government wanted to follow the East Asian example, it only got job half done because spending substantially decreased not only on social services, but also on education and healthcare, resulting in widening inequality, increasing poverty and mass migration from the country. In this final section of the thesis we are going to look at areas where the government diverged the most from the East Asian exemplar and the possible consequences to it.

### 5.1 Education and Health Care

Education was the single most important factor in the sustainability of the East Asian economies' outstanding growth rates. Setting off growth may not be primarily the result of money spent on education, but maintaining it is. The reason is very simple: a consistently upgraded human capital can enter into newer and newer sectors of the economy with more value added production. The paper has already discussed the importance of the well-educated technocrats in East Asia's development, however it appears that with the likes of Singapore,

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<sup>136</sup> Joseph Wong, "The Adaptive Developmental State in East Asia", *Journal of East Asian Studies* 4 no.2 (2004):351

<sup>137</sup> Discussed in the chapter on labor

Taiwan and more recently China having based much of their development on FDI, a well-trained labor force is just as pivotal. Not only does it help to attract more FDI<sup>138</sup>, but better quality as well<sup>139</sup>, while allowing spillovers to take place into the local economy<sup>140</sup>. Moreover it also contributes to an increased return on capital. For the East Asian countries the importance of education was clear from the outset as, in the 1950s, Taiwan and Korea already had a much higher educated population than other nations at the same stage of development<sup>141</sup>. Furthermore, it was empirically shown that the quality of the human capital contributed to South Korea's growth more than either physical capital or labor-endowment<sup>142</sup>. The small city state of Singapore was no exception either as both experts and the country's founding father – also one of Orbán role models - attribute its economic success primarily to its highly developed and well financed educational and healthcare systems<sup>143 144</sup>. More importantly, the educational system, similar to the country's institutional make up, evolved as the economy progressed. What this entailed was that state finances were distributed for education and research in line with the economic plan set by the government. Thus, if the state wanted to break into the heavy industry sector, the amount of financial support for students and research was adjusted to that end while other areas received less<sup>145</sup>. As a general

<sup>138</sup> Namsuk Choi, "Accounting for quality differences in human capital and foreign direct investment" *The Journal of International Trade & Economic Development: An International and Comparative Review* 24 no.2 (2015):242

<sup>139</sup> Muhamad Tariq Majeed and Eatnaz Ahmad, "Human Capital Development and FDI in Developing Countries", *Journal of Economic Cooperation* 29 no.3 (2008):83-84

<sup>140</sup> Blomstorm, M. & Kokko, A, "FDI and Human Capital: A Research Agenda", *OECD Development Centre Working paper no.195* available: [http://www.oecd-ilibrary.org/development/fdi-and-human-capital\\_658557635021.jsessionid=60a87qht4g3fo.x-oecd-live-02](http://www.oecd-ilibrary.org/development/fdi-and-human-capital_658557635021.jsessionid=60a87qht4g3fo.x-oecd-live-02) 10-11

<sup>141</sup> Rodrik, "The 'Paradoxes' of the Successful State", 424

<sup>142</sup> Lee, Jinsoo. Education Policy in the Republic of Korea: Building Block or Stumbling Block in World Bank Departmental Working Paper (2002) available: <http://documents.worldbank.org/curated/en/2001/01/1561388/education-policy-republic-korea-building-block-or-stumbling-block>, 15

<sup>143</sup> Stavros Yiannouka, "The Secret of Singapore's Success", *Project Syndicate* 08.04.2015 available: <http://www.project-syndicate.org/commentary/lee-kuan-lew-singapore-education-legacy-by-stavros-n-yiannouka-2015-04> (accessed: 22.02.2015)

<sup>144</sup> Amartya Sen "Amartya Sen on Lee Kuan Yew: "Something very important in what Singapore has done", *BBC: Business Daily* 23.05.2015 available: <http://www.bbc.co.uk/programmes/p02mlqff> (accessed: 29.05.2015)

<sup>145</sup> Gustav Ranis, "Labor Markets, Human Capital and Development Performance in East Asia" *Yale University Economic Growth Center Discussion Paper*, no. 97 (September 1993) available: [http://www.econ.yale.edu/growth\\_pdf/cdp697.pdf](http://www.econ.yale.edu/growth_pdf/cdp697.pdf), (accessed: 17.05.2015), 30-37

rule however “education {...} has been heavily geared toward the production of technicians, engineers, and businesspeople, which in turn has also been conducive to economic growth based on manufacturing”<sup>146</sup>. To help increase the absorbing capacities of domestic firms from FDI, research and development (R&D) was subsidized by the state for the domestic firms<sup>147</sup>.

It is not entirely true that the Hungarian government went completely against the above system. Conforming to its economic policy directives - i.e. supporting manufacturing production - it financed education in a targeted manner. The aim was clearly stated in the government’s program that argued that the universities are “providing students with diplomas that have no value on the market {...} while technical and engineering knowledge remain too low in proportion<sup>148</sup>”. The war, thus, began against otherwise very popular social sciences and humanities courses like communication, arts and even economics by slashing the places available through government support to a bare minimum while also raising the minimum points for the entrance requirements<sup>149</sup>. The government was forced to retreat from its original plans of cutting back on most humanities programs altogether after student demonstrations broke out. However they did manage to significantly cut down the undesired courses.

The programs that the government did deem desirable, however, did not have all that much to be cheerful about. Hungary has never spent so little in proportion of its GDP on education than under the second Orbán government. Based on data taken from the Hungarian Central Statistical Office (HCSO) shows how, in the past decade, spending on education has been

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<sup>146</sup> Pempel T.J., The Developmental Regime in a Changing World Economy in *The Developmental State*, ed. Meredith Woo-Cumings, (London: Cornell University Press, 1999) 169

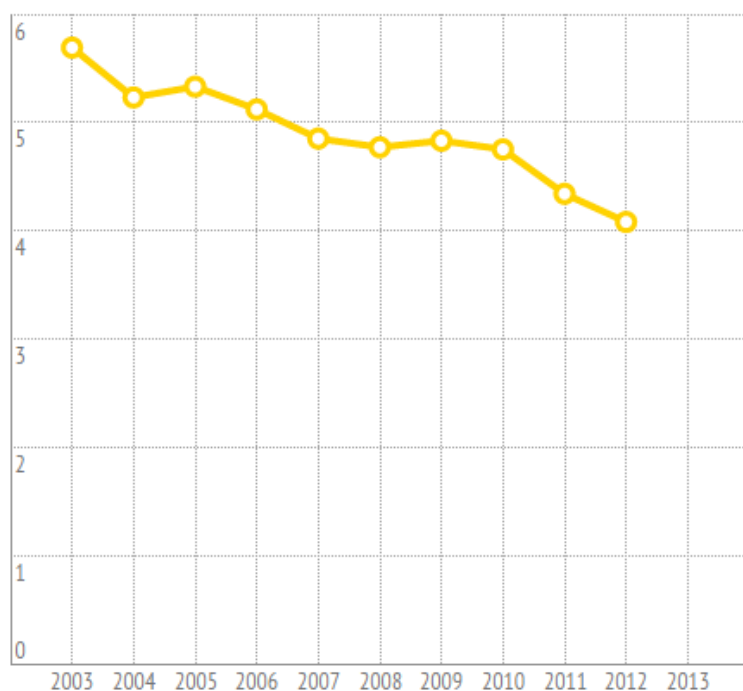
<sup>147</sup> Joseph Stiglitz, “Some Lessons from the East Asian Miracle”, *The World Bank Research Observer*, vol.11 no.2, (1996)p.157

<sup>148</sup> György Matolcsy, “Széll Kálmán Terv: Összefogás az Adósság Ellen”, *Polgári Szemle Online* (2011) available: <http://www.polgariszemle.hu/app/data/szellkalmanterv.pdf>, p.25

<sup>149</sup> HVG, “Nyolc egyetemi szakot alakíthat át a kormány” *HVG Online* 12.03.2015 available: [http://hvg.hu/itthon/20150312\\_felsooktatas\\_atalakitas](http://hvg.hu/itthon/20150312_felsooktatas_atalakitas) (accessed: 30.05.2015 )

decreasing when measured against the country's GDP. Moreover, how since 2010 this decrease has turned into a sharp decline.

## Spending on Education as a % of GDP in Hungary 2003-2012



### 1. Source: KSH

This is all the more troubling knowing that there is - similarly to Korea - a very high potential in the Hungarian education system in producing GDP. According to a 2006(!) study of a well-known Hungarian educational expert, investment into a Roma student's education –being from an ethnic that usually start from a more disadvantaged background than their non-Roma counterparts – to “complete secondary school would yield significant direct long-term benefits to the national budget. According to our benchmark estimate, discounted to age 4 (a possible starting age for such an investment), the present value of the future benefits is about HUF 19M (EUR 70,000) relative to the value the government would collect on the

representative person in case if she had not continued her studies after the primary school<sup>150</sup>”.

The other factor emphasized by amongst other Singapore’s former supreme leader, health care has also experienced a staggering decline between 2010 and 2014; a percentage of total government expenditures in this period suffered a 40% decrease, from 14.3% to 8.6%.

## 5.2 - Inequality

The findings of the previous chapter have severe consequences. If the trends are not reversed, then any short term benefits of the second Orbán government’s attempts at creating above average growth could be wiped out with possible political consequences. Education in the absence of other state endowments is the means through which social mobility may be conceived. Writing for the World Bank, Jisoon Lee explains why education played a vital role for example in South Korea’s developmental successes:

“When the country entered its modern economic development period in the early 1960s, Korean society consisted of a handful of extremely rich people and a mass of very poor people. There was no middle class. By participating in the economic development process, most poor people have turned themselves into members of the middle class. (Most of today’s middle-class citizens over 40 are from very poor families.) Education has hastened this process by providing the educated with better

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<sup>150</sup> Gábor Kertesi, és Kézdi Gábor, “Expected long-term budgetary benefits to Roma education in Hungary” *Budapest Working Papers On The Labor Market* (June 2006) available: <http://www.econ.core.hu/doc/bwp/bwp/bwp0606.pdf> (accessed: 12.05.2015) 2

economic opportunities. It is also the case that most high-ranking bureaucrats, businessmen, generals, professors, and lawyers are from poor families<sup>151</sup>,

Thus, education helps create social equity while lack of it leads to greater inequality (if the state fails to redistribute in other ways), which is a topic that has gained momentum in recent years. As one of the prominent figures from the debate suggests through the title of his book, it is a problem that comes with a price<sup>152</sup>. Inequality, or the hollowing out of the middle class, from a purely economic point of view, leads to lower consumer spending, fewer investments and reduced tax revenues for the state<sup>153 154</sup>. Put differently, inequality leads to lower growth rates and detaches the state from society. Thus if it is maintained in the long run, it can have negative economic as well as political outcomes.

Below is a chart with the Gini coefficient associated for each year of the second Orbán government. It shows rather explicitly that the social and educational policies of the government have lead to a rising inequality in the country. Based on Eurostat measurements, around 30% of the total population lives in poverty in the country today<sup>155</sup>. Moreover, Hungary has the highest proportion of poor people in the entire region<sup>156</sup>. In the meantime, consumption already decreased by 1.8 %<sup>157</sup> in 2012. While on the other hand the number of

<sup>151</sup> Jisoon Lee, "Education Policy in the Republic Of Korea: Building Block or Stumbling Block?" *World Bank Working Paper* No. 37164 (2002) available: <http://siteresources.worldbank.org/WBI/Resources/wbi37164.pdf> (accessed: 19.05.2015), 17

<sup>152</sup> Joseph Stiglitz, *The Price of Inequality*, (London: Penguin Books, 2013)

<sup>153</sup> Stiglitz, J (2013) Inequality is Holding Back the Recovery in *New York Times Op-ed* 19.01.2013 available: [http://opinionator.blogs.nytimes.com/2013/01/19/inequality-is-holding-back-the-recovery/?\\_r=0](http://opinionator.blogs.nytimes.com/2013/01/19/inequality-is-holding-back-the-recovery/?_r=0) (accessed: 30.05.2015)

<sup>154</sup> Stiglitz, *The Price of Inequality*, 104-147

<sup>155</sup> Poverty is defined as wages of a household below 60% of a given country's median income.

<sup>156</sup> Index, "3,3 Milliő szegény országa lettünk", *Index Chart* 18.08.2014 available:

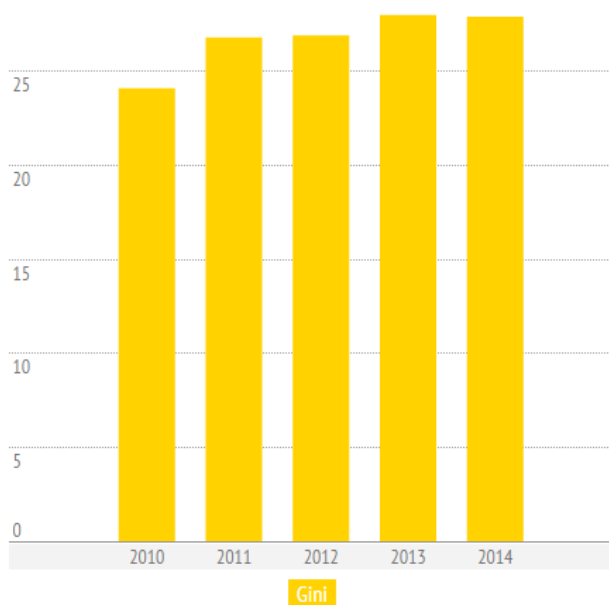
[http://index.hu/chart/2014/08/18/3\\_3\\_millio\\_szegeny\\_oroszaga\\_vagyunk/](http://index.hu/chart/2014/08/18/3_3_millio_szegeny_oroszaga_vagyunk/) accessed: 30.05.2014

<sup>157</sup> Napi Gazdaság, "Így szakad szét Magyarország – megjöttek a friss adatok" *Napi Gazdaság Online* 11.10.2013, available:

[http://www.napi.hu/magyar\\_gazdasag/igy\\_szakad\\_szet\\_magyarorszag\\_megjottek\\_a\\_friss\\_adatok.569067.html](http://www.napi.hu/magyar_gazdasag/igy_szakad_szet_magyarorszag_megjottek_a_friss_adatok.569067.html) accessed: 21.05.2015

students leaving school earlier has increased with a decrease in students applying to higher education in the country<sup>158</sup>.

## GINI coefficient for Hungary 2010-2014



Source: Eurostat

Despite all of this, the government was able to maintain an outstanding growth rate relative to the EU countries<sup>159</sup>. However that was primarily due to two factors. On the one hand the heavy investments that took place from the funds of the EU; something that is not only going to decrease in the future but in a more distant future it is going to completely disappear as, for example, Budapest - Hungary's capital – is already experiencing a sharp cut back on funds available to it due to its GDP average reaching that of the EU's<sup>160</sup> problems due to the lack of

<sup>158</sup> Júlia, Varga, "A közoktatás indikátorrendszere 2015" *MTA Indikátorrendszere* 2015.04.10 available: <http://econ.core.hu/file/download/kozoktatasi/indikatorrendszer.pdf> accessed: 24.05.2015 p.209-214

<sup>159</sup> Government publication, "Hungary's growth rate among EU top 5 in Q1 2015" (2015) *Ministry for National Economy Publication* available: [http://www.kormany.hu/download/4/aa/50000/Hungarian%20Outlook\\_Hungary%E2%80%99s%20GDP%20growth%20among%20EU%20top%20five%20in%20Q1%202015.pdf](http://www.kormany.hu/download/4/aa/50000/Hungarian%20Outlook_Hungary%E2%80%99s%20GDP%20growth%20among%20EU%20top%20five%20in%20Q1%202015.pdf) (accessed: 31.05.2015)

<sup>160</sup> Eurologus, "Tíz éve dől a lé", *Index Online* 12.02.2014 available: [http://index.hu/gazdasag/2014/02/12/tiz\\_eve\\_dol\\_a\\_le/](http://index.hu/gazdasag/2014/02/12/tiz_eve_dol_a_le/) (accessed: 29.06.2015)

incoming EU funds. On the other hand, sustaining the growth rate was largely due to the increased volumes of exports and a heavily devalued currency<sup>161</sup> since 2010. However as we have seen, exports – just like EU funds – are somewhat out of the control of the government as it is not primarily domestic but transnational corporations who export their products. Both of these sources of growth establish a relationship of dependency and are also unreliable. The EU has already withheld funds from Hungary – between 2010 and 2014 for lack of transparency and extensive corruption<sup>162</sup>, which can happen again at any time. Meanwhile, international corporations are very mobile, allowing them to pack up and move between nations whenever they see fit, causing severe economic backlashes in countries relying on them in the process. Thus, sustainable growth and fight against the above listed volatilities requires only a strong domestic economic foundation. For that however relative equity and high quality human capital must be maintained, both of which Hungary began to experience a sharp decline in under the second Orbán government.

<sup>161</sup> 1 Euro in 2010 January was worth HUF272, by the end of 2014 it was around HUF 310

<sup>162</sup> Financial Times, "Brussels suspends funding to Hungary over alleged irregularities", *Financial Times* 14.08.2013, available: <http://www.ft.com/cms/s/0/9b85c228-04f1-11e3-9e71-00144feab7de.html#axzz3blbsoiBQ> (accessed: 31.05.2015)



## Conclusion

After taking into account the most important elements of the East Asian developmental state in relation to Hungary's political economy between 2010-2014 we shall now return to the original question of this thesis: Is the second Orbán government building an East Asian type developmental state in the 21<sup>st</sup> century Eastern European context? Based on the above account the answer is no. The analysis of each sector suggests that the government's policies have been informed by the developmental state but in the overall it has failed to grasp its essence.

What did the Hungarian government get right? First (1) and foremost its prioritization on growth is perfectly in line with the original developmental state's objectives; second (2) it built out its capacity: the state got centralized holding a firm grip over the economy; third (3) it managed to maintain relative autonomy from social pressures; consequently the fourth (4) element was that the state remained strong to be able to discipline capital; (5) while fifth, it kept labor oppressed and under control as well; sixth (6), the economic decision making process was placed under the egis of a pilot agency with a narrow elite picking the projects to be pursued; seventh (7), finance was brought back under national control (not state though) and a new channel of developmental banking was set up; eighth(8) it followed an export led strategy; ninth(9), the financing of education was transformed according the government's economic objectives.

The listed elements in the previous paragraph do characterize a developmental state yet not a successful one. To begin with while growth is vital there can be qualitative differences between the different types. The Hungarian government's emphasis on achieving it through manufacturing is a misguided one. The East Asian countries after WWII pursued an industry

based development because on the one hand at the beginning they had vast amounts of unskilled and unemployed workforce, for which even today the best remedy remains to be the elevation of manufacturing production in order to absorb it<sup>163</sup>. While, on the other, because in that period manufacturing, especially in heavy industry and chemicals, often represented the highest value added production. That is important because as Chang explains<sup>164</sup> the most crucial contribution of the state led development to the process of catching up - be it in the 18<sup>th</sup> or the 20<sup>th</sup> century – is in aiding the economy to shift to high value-added activities and thereby induce competitiveness.

Hungary in 2010 already had a modern and diversified economy with services taking up the greatest share of its GDP. It is true however that unemployment, similarly to the rest of Europe, was relatively high after the 2008 financial crisis, yet neither the nature, not its extent was comparable to the 1950s and 1960s East Asian states'. More importantly a Hungarian type of economy in the 21<sup>st</sup> century Europe manufacturing may not represent the highest-added value production. A developmental state in this context invests first and foremost into its people. Similarly to the Hungarian government in a targeted manner but the target should be the high-tech technologies like software development and renewable energies. As we have seen the Hungarian economy is heavily reliant on foreign investment and it is unlikely to change in the near future as the country shall remain a small and open economy in the EU. Yet the quality of that investment can be influenced to a great extent depending on the quality of the human capital and infrastructure available in the country. Attracting the production capabilities and service providers of the 21<sup>st</sup> century requires the skills of the 21<sup>st</sup> century. The example is available and not in the East but in the West. Ireland a country that in 1990 shared a GDP size with Hungary began to produce growth rates in the next decades on par with the

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<sup>163</sup> Dani Rodrik(2014)"Are Services the new Manufacturers?" *Project Syndicate* 13.09.2014, available: <http://www.project-syndicate.org/commentary/are-services-the-new-manufactures-by-dani-rodrik-2014-10> (accessed: 01.06.2015)

<sup>164</sup> Chang, *Kicking Away the Ladder*, p.126

East Asian developmental states<sup>165</sup>. Ireland decided to shift its emphasis from developing capabilities to building capacity. The state invested heavily via grants – and with the help of EU - into marketing, management, knowledge transfer support and most importantly R&D<sup>166</sup>. What Ireland taught to the world is that the modern developmental state must exploit globalization. It has to attract the highest quality FDI with the highest quality workforce and through that create linkages for the domestic economy allowing spillovers to take place. Modern economics agree with Ireland's approach and not Orbán's. The alternative to welfare state is not a workfare one but the "innovation state"<sup>167</sup>, where state funded innovations are the benefits shared by the whole society while creating advantages for both the economy and the people in it. Thus the state shall remain central to development. Many of the lessons learned from the East Asian developmental states continue to be true to date. State capacity and an efficient bureaucracy consisting of some of the highest quality talents to design and monitor developmental policies and are essential in the 21<sup>st</sup> century as well. However Hungary with a diminishing budget for education and healthcare; a large share of the workforce trapped in the public works; an underpaid state administration; and questionable quality to its highest ranking officials who are responsible for designing the state's developmental policies, is going to the exact opposite direction.

Former Hungarian politician and fellow social scientist Balint Magyar in his book argues that the Orbán government after 2010 built up a Mafia like state that uses its power to extract resources for itself. Yet the conclusion we draw based on the research conducted slightly

<sup>165</sup> Vigvári Gábor, Változó szerepek: Ágazati politikák a fejlesztő állam tevékenységében in *A látható kéz: A fejlesztő állam a globalizációban*, (Budapest: Napvilág Kiadó, 2009) 146

<sup>166</sup> Sean Ó Riain Liberal Globalization, Capabilities and the Developmental Network State in Ireland in *The End of the Developmental State?* ed. Michelle Williams, (London: Routledge, 2014) 63.

<sup>167</sup> Dani Rodrik, "From Welfare State to Innovation State", *Project Syndicate* 14.01.2015 available: <http://www.project-syndicate.org/commentary/labor-saving-technology-by-dani-rodrik-2015-01> (accessed: 01.06.2015)

differs from this view. What Magyar and other people from the liberal left<sup>168</sup> entail argue remind us more of the description of a predatory state, one that disappears after it enriched its leaders. In my view however the system that was constructed after 2010 was built to stay. Power in it is utilized for the sake of power, i.e. the primary purpose of the second Orbán government's' political economy design is to maintain power in the long run. In this system the economy is made to serve the politics which explains the country's one dimensional focus on growth together with the lack of interest in the polarization<sup>169</sup> of society. According to the findings of De Luca *et al.*'s<sup>170</sup> study, on the one hand growing inequality can enhance the support for a dictator while on the other the elite remains supportive until there is growth in the economy. We have already established that Prime Minister Orbán is not a dictator in the classical sense however he is a representative of a growing trend that Guriev and Treisman described as 'modern dictator'. Thus, when Mr Orbán set the East Asian developmental states as the examples to emulate the objective on the surface may have been to pinpoint a successful model to achieve growth with but in the meantime he was also aware that authoritarian leaders of such successful economies do not tend to last forever. Except for Singapore's Lee Kuan Yew<sup>171</sup> neither South Korea's nor Taiwan's supreme leaders stepped down on their own, instead, they were overthrown by a forceful demand from society for democratization and liberalization. In this manner the lack of spending on education in Hungary can also be better understood. Had there been a modern knowledge economy (or innovation state) created and thereby greater income redistribution from the growth in the period, it could have greatly diminished the chances of a government, that allows the elite's to rent seek, to stay in power. That is because history has proved from East Asia to the Middle

<sup>168</sup> Sárközy, *Kétharmados Túlzáskormányzás*, 375-376

<sup>169</sup> Polarization not only in terms of income but also in ethnicity. For more see: Szikra, *Democracy and welfare in hard times*: The social policy of the Orbán Government in Hungary between 2010 – 2014 in *Journal of European Social Policy* vol.24 no.5 p.486-500

<sup>170</sup> De Luca, G; Litina, A; Sekeris, P, "Growth-friendly dictatorships", 98-100

<sup>171</sup> Whose system is argued by some to have been democratic to a large extent: Mixin Pei, "The Singapore Model", *Project Syndicate* 26.03.2015, available: <http://www.project-syndicate.org/commentary/china-misappropriates-singapore-model-by-minxin-pei-2015-03> (accessed: 01.06.2015)

East that a widening middle class demands measures against corruption and more democratic oversight. From this perspective the lack of export requirements on the elite can also be explained. Had rent seeking been replaced with the ‘dynamic ‘Schumpeterian’ rent-seeking’ the domestic elite could have become internationally competitive, which would have allowed it to gain its primary revenues from the markets instead of the state. This would have left the elite with too much space to challenge the government’s power<sup>172</sup>. Moreover, following this line of argument, the occasional abandonment of some of these capitalists<sup>173</sup> was mainly a means of containing their strength. Thus, in Orbán’s system where long term control over the country was the main objective of the government, it was not in the government’s interest to truly develop the economy either from the bottom or from the top, but to maintain status quo.

As we have seen the second Orbán government’s time in power has already attracted much attention from both academia and the mainstream media. Studies and articles from legal, political and economic perspectives have been carried out on many aspects of the political economy of this period. This thesis contributes to this debate by investigating the merits of claims by the government about following the East Asian model of development in its political and economic policy making. We find that in every crucial area that played a role in the East Asian states’ successes did inform the changes that were made in their Hungarian counterparts. We also establish that differences may be possible between the two due to the changed geo-political and historic circumstances. However the great differences between the two, especially in the areas of industrial development and state-business relations, bureaucracy and educational policy cannot be justified on those basis. Thus we conclude that the vast dissimilarities are the result of the underlying power motives in the Hungarian system.

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<sup>172</sup> That is exactly what happened in Korea in the 90s. See: Jang.-Susm Shin & Ha.-Joon, Chang., *Restructuring Korea INC.*, London: Routledge, 2003

<sup>173</sup> As we saw for example in relation with the credit unions and Mr Csányi

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