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The Model of Capitalism of Hungary's Dependent Economy as Compared to Other Visegrád Countries

Summary: The theoretical school of thought known as 'varieties of capitalism' (VoC) grew significantly in popularity following the turn of the millennium. In the 2000s, it formed an excessively simplified typology, which was unable to integrate into its theoretical system the Central European economies located – both geographically and in the theoretical sense – between the opposite poles of the Estonian liberal market economy and the Slovenian coordinated market economy. For this reason, in 2009, Nölke and Vliegenthart created the category of dependent economies, by which they primarily meant the Visegrád countries. The distinguishing characteristic of the operating mechanisms of this type of capitalism is foreign capital. Nölke et al., however, fail to consider that within the group of dependent economies, Hungary found itself in a privileged position in the first twenty years following the political regime change, carrying out earlier, faster and more extensive privatization compared to other countries of the region. Our study presents with the help of its own set of criteria how, before 2008, the Hungarian economy could be regarded as a special, extreme case of a dependent economy.

Keywords: varieties of capitalism, institutional economics, comparative economics, dependent economy
JEL codes: O57, P10, P17

A defining contribution to the '*varieties of capitalism*' (VoC) school of thought was the *dependent economy* category of *Nölke* and *Vliegenthart* (2009), by which the authors primarily meant the Visegrád countries. Our hypothesis is that, with all of its merits, this typology errs by making an excessive generalization. Therefore, this study establishes a set of criteria to show the specificities of the Hungarian model of capitalism that existed from the 1990s through 2010 and its differences as compared to V3 countries. The period from 2008 to 2010 brought along a crisis that led to a change in terms of politics and economic policy aiming to change the Hungarian model of capitalism, which is why this analysis only extends to 2010.

First, our study presents the model of capitalism of dependent market economies, then analyzes how the characteristics of a dependent economy came about – with particular attention paid to the dependent banking system – in Central European economies. Afterwards, it examines how stabilization in the 90s followed by privatization contributed to creating a dependent Hungarian economy. However, our analysis also shows that the Hungar-

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ian economy had numerous distinguishing characteristics compared to other dependent Visegrád economies. Finally, we draw the lessons of a model of capitalism distinguished on the basis of our own set of criteria, pointing out the need to reinterpret in foreign literature the role of foreign capital on the real economy on the part of the recipient countries.

THE CHARACTERISTICS OF DEPENDENT MARKET ECONOMIES – THEORETICAL INTRODUCTION

In a significant break from previous analyses discussing the different types of capitalism, Nölke and Vliegenthart (2009) started analyzing the market economies of the Visegrád countries by emphasizing the effect foreign capital had in terms of shaping the economy, society and institutions. What distinguishes their model from the prevailing model opposing liberal and coordinated market economies, which can only be applied to Visegrád countries to a limited extent, is that the coordination mechanism, the sources of investment, corporate management, industrial sector connections, the education and training system, the 'flow' of innovation and the comparative advantages of the economy are defined by the dependence on foreign direct investments. (*see Table 1*).[1] Furthermore, these economies have weak social conventions, their labor markets are only partially organized, and their system of innovation is weak (Koltay, 2010). This is the position all dependent economies are trapped in, in which they are all extremely vulnerable to external macroeconomic and financial shocks because of their exposure to foreign capital (Stockhammer et al., 2015; Vliegenthart, 2010).[2]

The distinguishing characteristic of dependent market economies is the dependence on the investment and other decisions of transnational corporations (Nölke and Vliegenthart, 2009; Vliegenthart, 2010). According to this model, in the process of creating social-economic institutions, transnational corporations seek to create an institutional environment that will support their needs. For this, the weakness – compared to the West – of the regulatory and negotiating processes of Central Europe form a good basis for them (Koltay, 2010). Corporations are also helped by the absence prior to 1989 of a class of local high-capital stakeholders (Vliegenthart, 2010).

In a dependent economy, capitalism's main mechanism of coordination is the system of decisions and hierarchies within transnational corporations (Vliegenthart, 2010). Because these corporations cause an extraordinary influx of capital into the economies of the Central European region, transnational corporations strive to maintain local subsidiaries under strong hierarchical controls from their headquarters abroad (Gál, 2013; Nölke, Vliegenthart, 2009). In order to limit their exposure to the local economy, they develop their own practices of corporate management and financing, rejecting the practices of liberal and coordinated market economies (Nölke, Vliegenthart, 2009). Therefore, they get their funds not from the international capital market or international banks, but from the parent company. This entails transnational companies operating in the region maintaining a relatively closed management structure and don't open them up to the possibility of outside control by shareholders (Cornel, 2013). It follows from all of this that in this model, transnational corporations impede improvements in human capital and production. They are not interested in allowing a generous public education system to be created, therefore, they don't invest in the enhancement of skills relevant to creating workforce innovation, because their economic success is based on low wages and

Table 1

THE CHARACTERISTICS OF LIBERAL, COORDINATED AND DEPENDENT MARKET ECONOMIES

Institution	Liberal market economy (LME)	Coordinated market economy (CME)	Dependent market economy (DME)
The mechanism of coordination distinguishing the system	Competing markets and formal agreements	Inter-company networks and organizations	Dependence on hierarchies within transnational companies
The primary financial source of investments	Domestic and international capital markets	Domestic bank lending and internal funds created within the economy	Foreign direct investments and foreign banks
Corporate management	External control and fragmented ownership structure	Internal control and concentrated ownership structure	Companies are controlled by the foreign headquarters of transnational corporations
Industrial connections	Pluralistic, market-based; little collective bargaining	Corporatist, consensus-based; agreements extending to whole sectors or country-level agreements	Remuneration of the trained workforce; company-level collective agreements
Education and training system	Importance of generic skills, high research & development expenditure	Importance of skills specific to a company or sector, specialized training	Limited training options and funds used for further training
Innovation transfers	Based on markets and formal agreements	Importance of joint ventures and business organizations	Innovation transfer within transnational corporations
Comparative benefits of the system	Radical capacity for innovation in the technology and service sectors	Incremental innovation of capital goods	Assembly platforms of partially standardized products

Source: Nölke and Vliegenthart (2009)

tax credits (Nölke, Vliegenthart, 2009; Cornel, 2013). Furthermore, they import innovation into Central European economies from abroad, with transfers within the company.

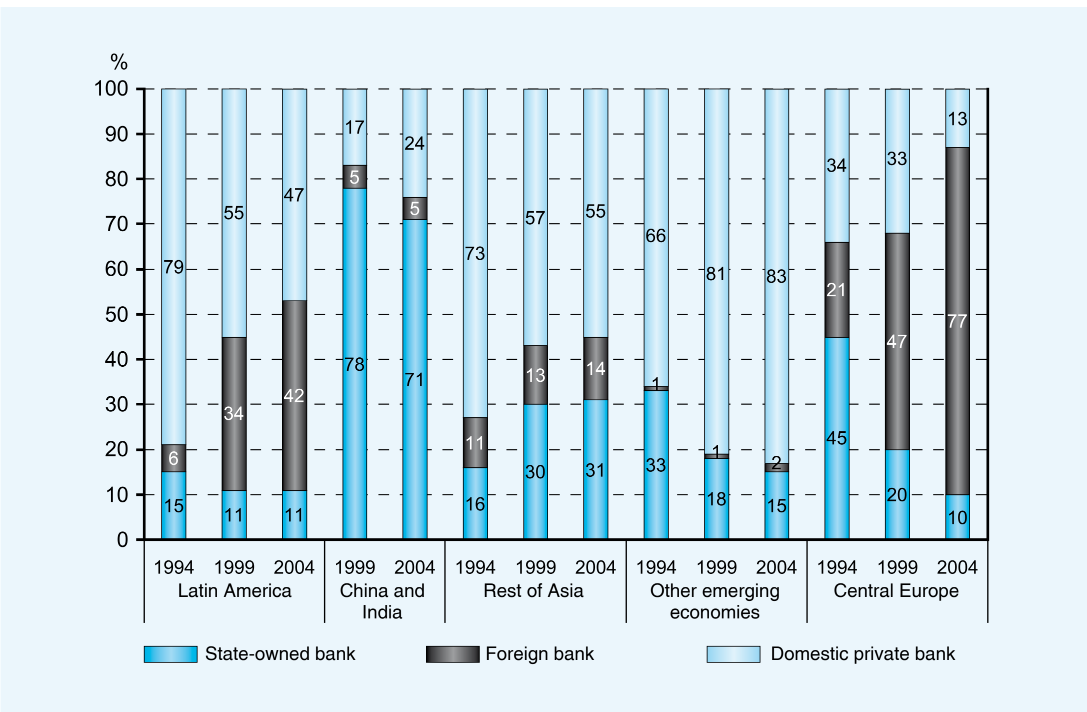
THE CENTRAL ELEMENT OF A DEPENDENT ECONOMY IS A DEPENDENT BANKING SECTOR

In a dependent economy, foreign corporations ‘bring with them’ the banking sector serving their needs, thereby, their financing is discrete from the domestic real economy and its institutions (Cornel, 2013). In these economies, it is not only the balance of outbound and inbound FDI that is disrupted, but also, as a result of this, the proportion of domestically owned and foreign owned actors in the banking sectors (Nölke, Vliegenthart, 2009). A foreign-owned banking system – because of its behavior in financial crises – will represent another mechanism of dependence in the model of traditional dependent economies (Cornel, 2013). This also manifests in the Central European financial systems being controlled from Western financial centers: this is the reason why Central Europe didn't see the development of any fully fledged international financial centers, *see Figure 1* (Gál, 2013).

Following the regime change, under the effect of the policy narrative of the Washington Consensus, a foreign-owned banking sector quickly – but in no way as a result of a natural progression – formed in Central Europe, *see Figures 1 and 2* (Gabor, 2010; Gál, 2016). By the 1990s, Western Europe saw the creation of capital surplus and intensifying, strong market competition, many banks therefore looked to Central European markets because of decreasing profit margins (Cornel, 2013; Vliegenthart, 2010). The available capital was welcomed with enthusiasm in the East, because based on neoclassical theories of modernization, they thought this was the factor required for the region to catch up economically (Vliegenthart, 2010). Many leading economists of the day thought that shifting ownership of the banking sector abroad would harden soft budget constraints, which should be considered a false narrative (Gabor, 2012). Those arguing in favor of bank privatization said that irresponsible lending by publicly owned banks to publicly owned companies needed to stop in order to prevent the resulting financial instability. They feared that publicly owned banks would end up being ac-

Figure 1

SHARE OF COMMERCIAL BANKS BY OWNERSHIP (SHARE OF ALL BANK LENDING)

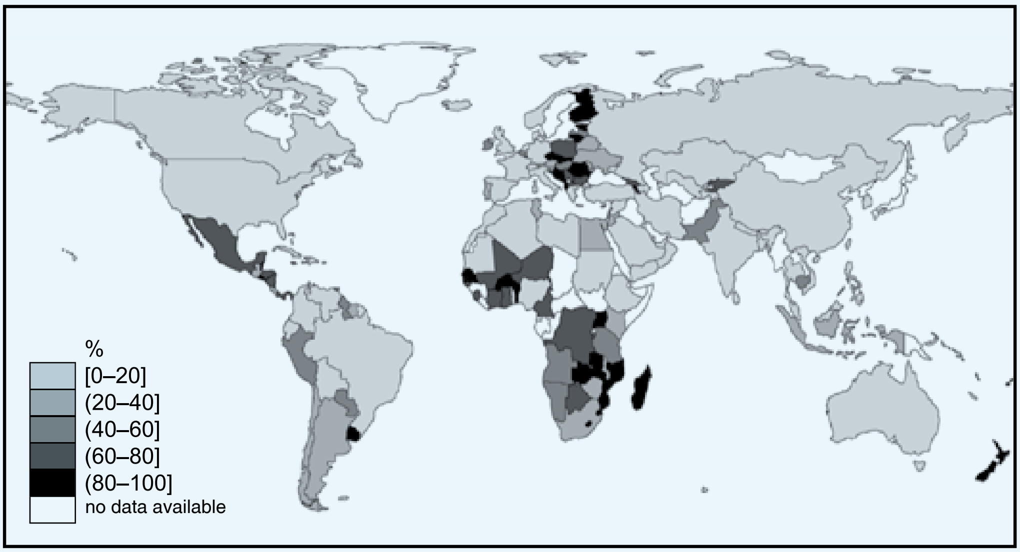


Note: Because of rounding, not all totals add up to 100.

Source: Mihaljek (2007)

Figure 2

SHARE OF ASSETS OWNED BY FOREIGN BANKS (2012–2013)



Source: Cull et al., 2017

quired by the national classes of oligarchs at rates far below market value – like in Russia and Ukraine. They wanted to favor EU countries to accelerate accession talks; they were attempting to import a Western banking sector complete with fully new, modern technology; and finally, the wanted to put an end to the frustration of consumption from the time of state socialism with cheap and easily available consumer credit (Cornel, 2013). The most important criterion was that foreign capital lent legitimacy to national governments, quickly improving consumption levels (Gabor, 2012).

The tone of experts, however, changed drastically when the crisis deepened in 2009 (Gabor, 2010). At first, the IMF excluded the possibility that – instead of patient financing – short-term credit spread speculation practices by banks were what caused the crisis. At the same time, it became obvious that foreign financiers became a Central European group of annuitants, whose profits far exceeded Western levels (Banai et al., 2011). This 'extra' profit was due to foreign actors using weak regulations to make foreign currency consumer lending widespread, especially in Hungary (Gabor, 2010).[3] Obtaining foreign annuity was based on ownership rights being transferred from local societies to foreign owners (Gál, 2013).

The banking system becoming foreign owned resulted in multiple adverse effects: the dependent banking system was characterized by 'impatient financing', which caused a decrease in SME lending according to *Gabor* (2010).[4] Consumer and real estate bubbles started to build up, therefore, breaking away from the real economy, foreign bank subsidiaries were able to generate higher profits than their parent companies back home (Cornel, 2013; Vliegenthart, 2010). The relative underdevelopment of small and medium enterprises in multiple countries of the region can also be traced back to foreign funds not appearing in the (domestic) manufacturing sector: in the late 90s, foreign banks provided short-term loans mostly to governments or served exclusively the financing of transnational corporations' manufacturing needs. According to Gabor's data (2012), Romania's corporate lending volume in 2008 was the same as in 1994 to 1996, in the era of domestic, publicly owned banks.[5] And while in 2000, 56 per cent of loans went into industry, in 2008, only 20% did so, with corporate lending taking a backseat to consumer and real estate lending (Cornel, 2013). In the meantime, between 1994 and 2007, in the post-Socialist banking sector, foreign ownership went from nearly 0 per cent to 80 per cent in terms of bank assets (the average proportion was 25 per cent in the EU and 15.5 per cent in the eurozone) (Gál, 2013).

As such, a dependent banking system can have its drawbacks: *Prasad* et al. (2006) state that those non-industrialized countries that relied more heavily on foreign financing didn't grow faster on the long term than those that relied less heavily on it. In many cases, this foreign-owned banking sector – absent appropriate policies – created a risk-based competition instead of long-term investments aimed at improving capacity and efficiency (Badics-Szikszai, 2015). It financed speculative transactions (Vliegenthart, 2010) or investments implementing a low-wage model.[6] After 2008, the question of whether in a time of bank privatization crisis, this led to a deepened recession came to the forefront again (Fungácová et al., 2011).

THE SPECIFICITIES OF THE HUNGARIAN MODEL OF CAPITALISM

Stabilization: the deterioration of the domestically owned economy

The mainstream stabilization narrative considered it important to maintain a strict monetary policy and to limit the loans given to large enterprises previously owned by the state. The liquidity crisis thus created contributed to banks beginning to limit even short-term lending. Therefore, it was in the middle of the economic shock of the transition that the entire Hungarian entrepreneurial sector was left without financing (Katona, 2017). In 1999, in Hungary, 27 per cent of corporate loans were connected to small and medium enterprises, which is a quarter of the EU15 level at the time. By 2007, this had grown to 53 per cent, which was still low compared to the economic significance of SMEs (Árvai, 2002; Csubák, Fejes, 2014; Naaborg et al., 2003). Due to informational asymmetries and their weak bargaining positions, domestic SMEs were only able to access loans at a higher rate than foreign corporations, between 1995 and 2000, the Hungarian banking sector supported the domestic rise of foreign corporations (Csubák, Fejes, 2014). At the end of the 90s, half of Hungarian companies operated without loans (Várhegyi, 2002). A strict bankruptcy law, favoring foreign capital and strict financing terms together contributed to Hungary being the only country where the share of foreign corporations in the total value added exceeded 50 per cent by 2011 *(Table 6)*.

In the late 90s, Hungary was not tracking with middle-income countries in deepening its financial intermediation system and developed a financing model typical of low-income countries based on a high return on assets (ROA) and low penetration. Lending by domestic banking remained low by international standards, thereby creating an intermediation system that was based 'neither on banking nor on the capital markets'. Foreign corporations arriving in the country benefited not only from favorable loans by foreign banks, but were also granted tax exempt status (Katona, 2017). Domestic corporate lending remained low in the 90s even though the banking sector became foreign owned, thereby granting access to the abundant funding available in Western markets (Naaborg et al., 2003).[7]

In the 2000s, foreign banks achieved several times of their parent company's ROA in the Hungarian market. Interestingly, local, domestic banks had an information advantage: their tacit knowledge owing to their familiarity with local economic actors resulted in them providing more loans to domestic SMEs than foreign banks and their results were higher than those of foreign actors, because they had accumulated several decades' worth of knowledge (Banai et al., 2011). The excess earnings of foreign banks compared to their parent company could also be explained by the establishment in Hungary of an oligopolistic market pricing.[8] Domestic consumers were not price sensitive, therefore, instead of lower prices, banks tried to expand their clientele via higher marketing and network-building costs and risk-based competition (Banai et al., 2010).[9] As a result, the margin on consumer loans were double that of the eurozone, therefore – unlike Western Europe – Hungarian banks made most of their income from interests (Várhegyi, 2002).[10] Foreign banks transferred 30 to 40 per cent of their profits immediately back to their parent companies, investing the rest in order to expand the speculative lending boom.[11] The loan-to-deposit ratio of foreign banks in Hungary, contrary to domestically owned banks, was extremely high by international standards (Banai et al., 2011). In the 2008 crisis, foreign banks in Hungary continued to perform well by international standards: in several cases, foreign banking groups owed the entirety of their profits to the Central European market (Banai et al., 2011). The foreign owned pro-cyclical banking system became the primary source of macroeconomic risks and the deep-seated 2008 economic recession in Hungary (Banai et al., 2011).

As a result of early, radical stabilization measures that differed from other Visegrád countries, the Hungarian-owned portion of the economy, mainly small and medium companies suffered significant losses. It was Hungary where the dual structure of the economy became the most pressing issue, which is one of the traits of Hungary's 'extremely' dependent economy. Between 1992 and 1996, this number was 8640 in the Czech Republic, 21,759 in Poland, but 41,727 in Hungary. That means that in proportion to the population, we had five times as many companies that had to shut down as the Czech Republic and seven times as many as Poland (Antal, 2005). The fact that foreign banks only started providing loans to SMEs later, in the early 2000s, could have played a role, which resulted in domestic actors not getting any support during the long-lasting early period of the transition *(Table 2)*. While in the Czech Republic and Poland, in 2014, SMEs regularly made up more than 50 and 90 per cent of exports respectively, this number barely reached twenty per cent in Hungary, meaning that even after 2008, less than 1 per cent of Hungary's companies, mostly foreign owned corporations, accounted for four fifths of exports. Majority domestically owned companies' share of exports was also the lowest in Hungary in 2014 at 20 per cent, with the Czech Republic clocking in at 60 and Poland and Germany at 40 per cent (see Table 6). This imbalance was already present by the end of the 90s *(see Table 3)*. This is why the Hungarian model of capi-

Table 2

THE MAKEUP OF COMMERCIAL LENDING IN THE VISEGRÁD COUNTRIES, %

	Government			Corporate			Household		
	1999	2003	2004	1999	2003	2004	1999	2003	2004
Czech Republic	6	31	25	83	45	45	12	25	30
Poland	5	6	7	62	53	46	33	31	46
Slovakia	29	49	49	64	37	34	7	14	17
Hungary	43	13	9	49	57	57	8	30	32

Note: Because of rounding, not all totals add up to 100.

Source: Mihaljek (2007)

Table 3

SHARE OF FOREIGN COMPANIES IN INDUSTRY AT THE END OF THE 1990s, %

	Employment rate	Investments	Sales	Exports
Czech Republic	27	53	42	61
Hungary	47	82	73	89
Poland	29	63	49	59

Source: Berend (2009)

talism differs from other dependent Visegrád economies, representing a special case of those. The Hungarian dependent economy displays more unfavorable indicators than the V3 countries not just in the financial sense, but also in terms of its real economy.

Privatization: the creation of a foreign-owned, dual economy

'It is specific to Hungary – you will find few examples of this even in the developed countries of continental Europe – that in the course of privatization, the state divested a host of public utility services (natural gas and electricity providers, waterworks) to foreign investors' – *György* (2017) points out. This is well illustrated by the fact that, even by international standards, the Hungarian economic policy generated exceptional income from privatization: the cumulative income from privatization, in terms of GDP, was 30 per cent between 1989 and 2000 in Hungary, while in Slovakia, the Czech Republic and Poland, an amount equivalent to 10 to 15 per cent of the GDP was added to the budget by privatization (Zidek, 2014). As such, acting as a pioneer of privatization, Hungary gave an early and supportive welcome to foreign investors looking to acquire large Hungarian corporations (Myant, 2018).

On top of privatization representing twice the amount in terms of GDP, Hungary was also distinguished by the methods and means of privatization *(see Table 4)*. In V3 countries,

Table 4

COMPARISON OF PRIVATIZATION MODELS

	Primary privatization technique	Ownership rights in privatized companies typically exercised by	Country-specific characteristics	Benefits	Drawbacks
Czech Republic	Voucher privatization	Privatization funds and, indirectly, the banking system	Late privatization of the banking system, state ownership maintained for a long time indirectly	Fast privatization, widespread social acceptance	Opaque ownership structure, significant delays in changing structures
Poland	MEBO, voucher privatization, later sales on the market	'Insiders', privatization funds	Strong bargaining position of employees, early privatization of the banking system, privatization fund IPO's	Quick increase in efficiency, transparent privatization process	Lagging implementation, significant issues in agriculture
Slovakia	Voucher privatization, later sales on the market	Privatization funds, political interest groups	Foreigners staying away during Meciar's administration, enforcement of political preferences in privatization	Significant increase in inbound FDI's starting in 2000	Significant delays in the changing structures, uncertain legislative framework until the late 90s
Hungary	Sales on the market	Foreign investors	Early privatization of the banking system, the region's strictest bankruptcy law, significant role of income from privatization in macro-stabilization	Significant income from privatization, divested overwhelmingly to outsiders, rapid change of structure and increased efficiency	Uncertain social backing, suspicions of corruption
Slovenia	MEBO	Insiders	Low participation by foreigners, the privatization of the banking system didn't start until 2002/2003	Social backing, steady legislative framework, increase in efficiency	Extremely slow privatization process, costly consolidation of banking

Source: Baksay et al. (2003)

economic policy strived to prevent foreign actors from acquiring direct ownership in the privatized companies of strategic sectors. According to *Baksay et al.* (2003), Hungary was the only country typified by divestment to foreign actors despite slow, internal privatization having a similar effect in terms of increasing efficiency. Hungary is the only case where they mention uncertain social backing and suspicions of corruption.

The distinguishing characteristics of the dependent Hungarian economy

Hungary's peculiar stabilization and privatization created conditions that made it possible for an economic and ownership structure typifying dependent economies and an extreme type of a dependent economy to be established earlier than in other Visegrád countries. Starting in the second half of the 90s, Hungary counted as a leader in terms of attracting FDI in the region *(Table 5)*. FDI per capita grew to its highest value in the Visegrád countries, 4.5 times higher than it was in Slovakia. In terms of GDP, Hungary's inbound FDI in 1999 was three times higher than Slovakia's. This became possible because Hungary's economic policy made it its primary objective to improve the operating environment of FDI, the economic policy was based on devising a growth model driven by FDI in both the financial sector and the real economy.

Multiple indicators show that Hungary maintained the highest level of inbound FDI even later on. This is also what shows up in the net foreign assets as a proportion of the GDP (Novokmet, Piketty, 2018). In this regard, as in others, Hungary can be considered as being in an exception position *(Figure 3)*. Proportion of net foreign assets as a yearly average between 1993 and 2015: It was 23.1 per cent in the Czech Republic, 38.7 in Slovakia, 45.4 in Poland, but 81.9 in Hungary. The net foreign assets indicator is a good illustration of why the Hungarian economy is distinct from the Visegrád countries: on one hand, a more dual economic structure is created with a high share of foreign ownership, on the other, the debt of the economy's actors reached exceptionally high levels. The highest relative influx of capital in the region did not result in

Table 5

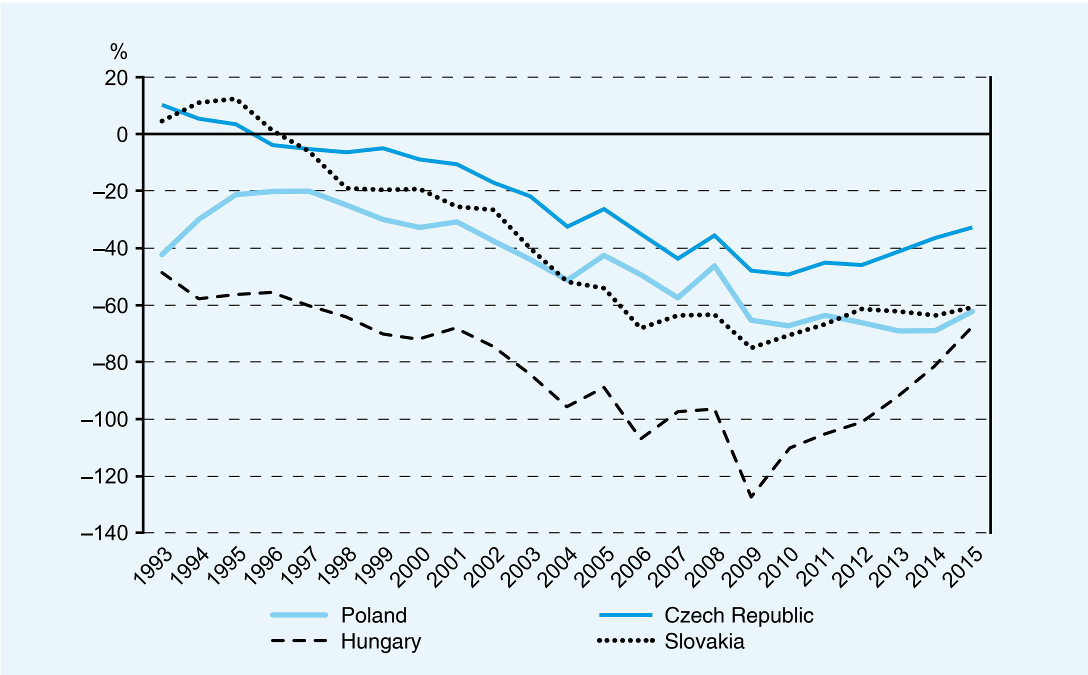
FOREIGN OWNERSHIP IN THE COUNTRIES OF THE REGION AT THE END OF THE 90s

Country	Total FDI between 1989 and 1999 (in billions of dollars)	Total FDI per capita (in dollars)	Total FDI as a percentage of the GDP in 1999	Number of banks	Of which: majority foreign-owned banks	Share of majority foreign-owned banks (%)
Czech Republic	14.9	1456	28	40	26	65
Poland	20.0	517	13	74	40	54
Slovakia	2.1	370	10	22	6	27
Slovenia	1.4	700	7	31	5	16
Hungary	18.1	1664	34	42	32	76

Source: Várhegyi (2001)

Figure 3

NET FOREIGN ASSETS AS A PROPORTION OF THE GDP (VISEGRÁD COUNTRIES, PERCENTAGE)



Source: Piketty, Novokmet (2018)

the highest increase in efficiency and did not manifest as the most significant annual GDP increase *(Table 6)*.

A characteristic of foreign-owned dependent economies is that compared to Western economies, a larger proportion of property income flows abroad. In 1993, the difference between the GDP and the GNI in terms of percentage points started increasing sharply: the spread grew by nearly 6 per cent in 1999, whereas it remained under 2 per cent in the V3 countries between 1994 and 2000 *(Figure 4)*. We see a similar image when it comes to net foreign property income: From 1995 to 2008, an average foreign property income equivalent to 6 per cent of the GDP left the Hungarian economy, while this number was only 2.9 per cent in the V3 economies (Novokmet, Piketty, 2018). As early as 1998, 6.1 per cent of the GDP was leaving the Hungarian economy, which was another sign that the Hungarian model of capitalism deviated significantly from the V3 countries (Figure 4).

Hungarian public debt exceeded the debt of V3 countries both in decades before and after the regime change. At the same time, Poland secured the cancellation of 50 per cent of its debt both with private and public lenders in the 1990s, thereby separating as early as the beginning of the 1990s the path of Polish and Hungarian net foreign assets, *see Figure 5* (György, 2017). While the difference was negligible in 1992, between 1993 and 2007, the proportion of Polish net foreign assets amounted to roughly half of the Hungarian value. This also contributed to net foreign property income being twice as high in Hungary as in Poland between 1995 and 2007.

Table 6

THE MOST IMPORTANT CHARACTERISTICS OF THE HUNGARIAN DEPENDENT ECONOMY

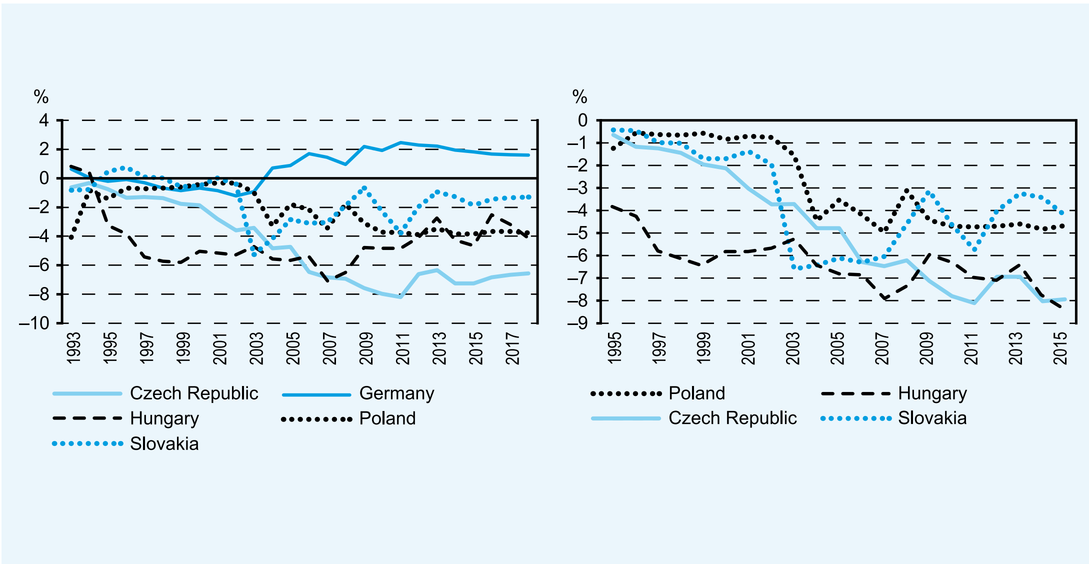
	Hungary	Poland	Slovakia	Czech Republic
Financial characteristics				
Proportion of foreign currency loans as a percentage of loans to the private sector (2008, %)	65	34	19	9
Loan-to-deposit (2008, %)	156	115	83	83
Proportion of foreign funds as a percentage of the balance sheet total (2008, %)	26	7	5	10
Share of FDI going to the real estate, rental and commercial services sectors (by year, %)	30.7 (2010)	17.6 (2009)	10.9 (2008)	16.2 (2009)
Net interest rate spread (2000–2007)	4.50	3.90	3.52	2.99
ROA (2000–2007, %)	1.73	0.64	1.26	1.27
ROE (2000–2007, %)	19.37	4.37	16.54	17.32
Financial deregulation (2000–2005)	0.96	0.85	n.a.	0.90
GDP–GNI spread (1993–2007, % of GDP)	– 4.4	– 1.4	– 1.3	– 2.8
Net foreign assets (1993–2007, % of GDP)	– 73.5	– 35.6	– 24.4	– 13.2
Interest expenditure on public debt (1995–2007, % of GDP)	5.7	2.7 (2000–2007)	2.6	1.0
Net foreign property inc. (1995–2007, % of GDP)	– 5.9	– 1.9	– 3.2	– 3.2
Non-performing loans (2008–2016, %)	11.4	4.5	4.9	4.9
Properties of the real economy				
GDP growth (GDP per capita, PPP, as a percentage of the EU average, growth in percentage points, between 1995 and 2002)	8	4	6	–3
GDP growth (GDP per capita, PPP, as a percentage of the EU average, growth in percentage points, between 2002 and 2008)	4	8	17	11
Share of foreign corporations in total value added (2011)	51.9	35.1	38.2	42.9
Export share of SMEs (%, 2014)	17.19	85.72	N/A	53.66
Export share of majority domestically owned corporations (%, 2014)	19.79	40.00	N/A	59.00
Wage rate in the manufacturing sector (Change as a percentage point of the GDP, 1995–2015)	– 17.73	– 11.48	3.27	– 0.92
Wage rate premium of domestic corporations (difference between wage rate of foreign corporations and domestic corporations)	– 12.53	– 2.82	2.83	0.2
Average wage (in 2016 dollars, PPP-based, as a percentage change between 1995 and 2010)	40.34	48.35	81.25	68.28
Participation rate (ages 15 to 64, average of 1994 to 2007)	59.87	65.48	69.44	71.28

Note: We indicated in parentheses when we specified data specific to a given year or the average of the values of a given time period.

Sources: Based on Central Bank of Hungary (2014), World Bank, Piketty and Novokmet (2018), IMF, Ameco, Eurostat, OECD, Podkaminer (2013) and Myant (2018)

Figure 4

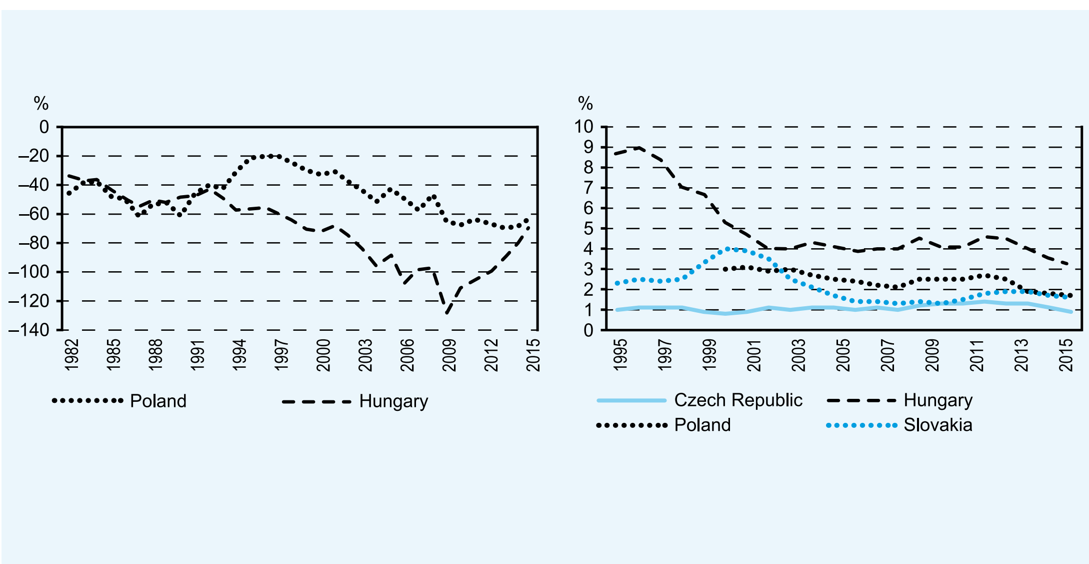
GDP–GNI SPREAD AND NET FOREIGN PROPERTY INCOME (DATA AS A PERCENTAGE OF THE GDP)



Source: Piketty-Novokmet (2018)

Figure 5

NET FOREIGN ASSETS (LEFT) AND INTEREST PAYMENTS (RIGHT) IN TERMS OF GDP



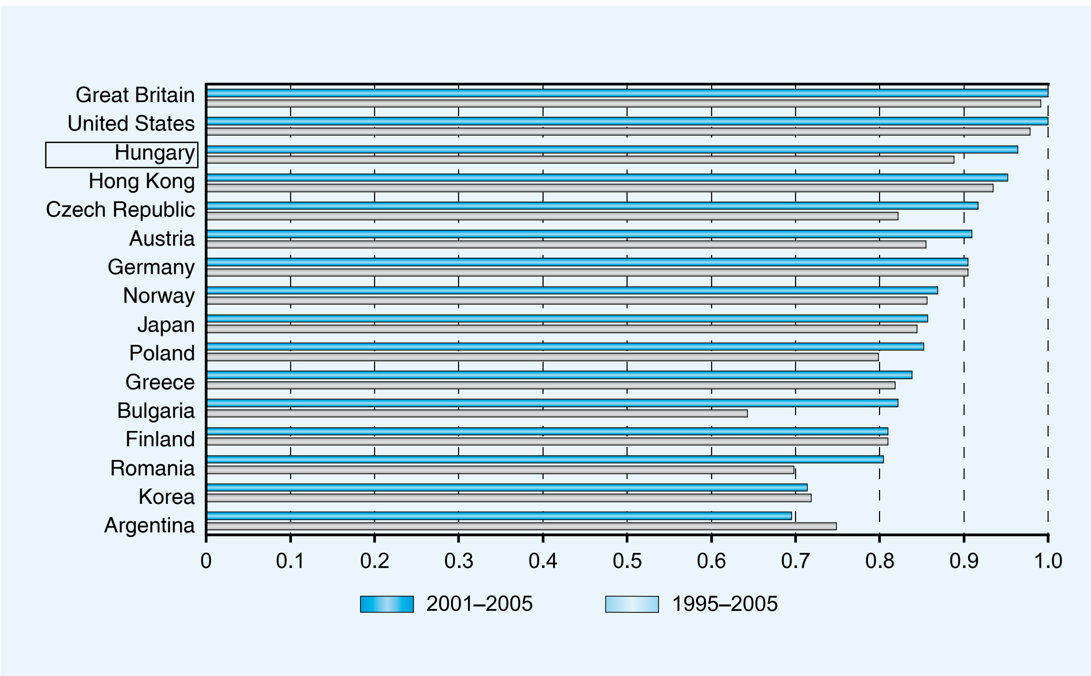
Source: Piketty, Novokmet (2018), Eurostat

Hungary's early and radical privatization served the otherwise avoidable purpose of using that income to repay its previous loans. After the temporary effects on the financial markets of Polish debt relief, Poland's international perception and credit rating remained sustainably identical or nearly identical from the end of the 1990s all the way to the 2008 financial crisis, while Hungary had already built the foundation of its own dependent economic model. In terms of GDP, the Czech Republic's debt servicing to its lenders was 3 percentage points lower, while Poland's was 2 percentage points lower after 1995 for nearly 15 years (György, 2017). In terms of GDP, compared to the Czech economy, Hungary had to produce 4.05 percentage points more to service debts between 1995 and 2015. In Hungary, between 1993 and 1999, interest expenditure exceeded education, culture and healthcare spending, thus, Hungary's dependent economic model also had an unfavorable effect on the most important growth factor, the regeneration of human capital (György, 2017).

The uniqueness of the Hungarian model of capitalism within the Visegrád countries is also reflected by the management of the financial sector and public finances and the policy prerogatives afforded to it. The Hungarian banking sector was the first to become foreign-owned and Hungarian economic policy performed the largest deregulation in the newly foreign-owned banking system. The IMF's financial liberalization index between 1995 and 2005 in Hungary displayed an average indicating a higher degree of liberalization than not only the Czech Republic and Poland, but also several developed countries *(see Figure 6)*. Hun-

Figure 6

AVERAGE VALUE OF THE INDEX OF FINANCIAL REFORMS BETWEEN 1995 AND 2005 (0–1)



Source: IMF Database of Financial Reforms gary engaged in more drastic deregulation in the financial sector than Greece, plunged into a financial crisis in 2008, or than South Korea known for its miraculous dynamic growth, but also surpassed Central Europe's Romania, Bulgaria and Poland.

Under the effect of financial deregulation, Hungary become the most financially vulnerable economy of the region (for a summary of the characteristics of this dependent Hungarian economy, see Figure 6).[12] Following the turn of the millennium, Hungary was the only one of the Visegrád countries where the share of foreign currency loans reached 65 per cent, with Poland displaying a share that was half of this value, Slovakia one third and the Czech Republic one sixth. As a result of the risk-based competition that emerged in Hungary's oligopolistic banking market, the loan-to-deposit ratio grew to twice the level of Slovakia and the Czech Republic. The credit expansion therefore manifested mainly in foreign currency loans, which increased the vulnerability of the Hungarian banking system via three separate channels: the mechanisms of (1) currency mismatch, (2) increased financing risks and (3) maturity mismatch (Central Bank of Hungary, 2014). The domestic foreign currency funds were not sufficient for the expansion of foreign currency lending, which is what increased the reliance on other, including foreign, sources of foreign currency. The weight of foreign funds thus grew from 17 to 25 per cent between 2003 and 2008, which corresponded to 30 per cent of the GDP (Central Bank of Hungary, 2014).

It is due to these processes that the Hungarian economy ended up in a public financial crisis earlier than other Visegrád countries, as early as 2006 (Matolcsy, 2015). Between 2002 and 2006, the primary balance can be identified as being the cause of increasing debt (Kicsák, 2015). Growth slowed beginning in early 2006 even though the global economy grew by 5 per cent in 2007 and German growth fed – thanks to the mechanisms of dependent economies – the growth of other dependent Visegrád economies. But the Hungarian economy's growth was already below the EU average at this time (Parragh, 2014). Beyond the unsustainable budgetary policy, it was the extremely high level of foreign currency based mortgage debt of households that made it so that by the time the global financial crisis came around, Hungary was considered the most vulnerable economy in the region (Baksay, Palotai, 2017). The processes, which were reminiscent of Latin America's dollarization, had a very significant impact on Hungary compared to other Visegrád countries, which demonstrates that radical differences can be identified between the Polish economy, which weathered the global recession while maintaining its growth – but which literature states is dependent – and the Hungarian model of capitalism, which experienced a downturn as early as 2006. Hungary was the second country to request the assistance of international organizations in 2008 (Baksay, Palotai, 2017). As early as the fall of 2006, Hungary had to revise its 2005 convergence program, because its authenticity had been questioned by the Council of Finance Ministers of the EU (Political Capital, 2006).[13]

One of the reasons the profitability of banks exceeded Czech and Slovak rates was because the deregulated banking market saw conduct that seriously distorted competition as early as the middle of the 2000s. The OECD (2010) and the European Commission (2007) both pointed out that Hungarian banks made it difficult to change banks to achieve annuities and earnings that were high even by international standards. Foreign banks also distorted competition by product tying, while worsening informational asymmetry: the costs, charges and commissions of bank products became opaque to consumers. Concentration and instability grew in tandem: a macroprudential and a consumer protection problem arose at the same time, because the risks were passed onto the consumers by an under- and de-regulated banking system (Pawłowska, 2015). Because of this, between 2008 and 2016, the share of non-performing loans in Hungary is double the value found in other V3 countries (OECD, 2010). At the end of 2017, the Hungarian banking system still achieved the highest return on assets (ROA) within the EU, while loans to the private sector in terms of GDP in Q1 2018 was only higher than in Romania (Banai, Nagy, 2018).

THE ROLE OF FOREIGN CAPITAL IN THE REAL ECONOMY

According to *Andrianova et al.* (2010), between 1995 and 2007, public ownership of banks displayed a significant, positive correlation amongst the countries of the world with long-term economic growth rates. A good example of this is Hungary, where an early application of the principles of the Washington Consensus still only provided a small-scale and temporary benefit in terms of catching up with EU economies (Table 6). One of the possible reasons for this positive correlation is that in economies with weak institutions and informational asymmetry, the state must take on a decisive role in developing the economy (Andrianova et al., 2010). *Degryse* et al. (2009) reveal in their analysis that (1) at first, foreign banks in Poland only gave loans to transparent, i.e. mostly foreign corporations; (2) the country's greenfield foreign banks provided more foreign currency loans than domestic banks, (3) foreign banks provide shorter-term loans than domestic ones. As a result, foreign banks present a higher credit risk and can significantly limit lending in times of crisis.

The production-improving effect of foreign ownership can be misconstrued due to the fact that foreign investors mostly buy the most productive and profitable companies. Once you control for these investors appearing in industries and companies with the highest potential of productivity, the positive effect of FDI's on the target country's productivity can be refused (Fons-Rosen et al., 2012). *Fons-Rosen* et al. (2012) only found FDI-related productivity ripple effects in Western European economies and not in Central European countries, but only in corporations that are not direct competitors of foreign investors. In order for the positive effects of the influx of foreign capital to manifest, man other conditions must be met [technological development of the recipient country, health status of the population, the properties of market competition or regulation policies (Fons-Rosen et al., 2012)]. Contrary to industry investments, it is difficult to justify expecting a positive effect from domestic service sectors (water provision, trade, financial sector, apartment rentals) becoming foreign-owned, because this can result in wage rates decreasing in service sectors (Podkaminer, 2013).

It is easier to measure the effect of foreign capital on the income situation than its effect on productivity. In the Hungarian dependent economy, the excessive role of foreign capital compared to other Visegrád countries entailed a drastic decrease in wage rates (Table 6). Between 1995 and 2015, the wage rate of the manufacturing sector decreased by 17.7 per cent in Hungary. The cause lies in the dismantling of the SME sector and the prevalence of foreign investments in production structure: while in Slovakia and the Czech Republic, domestic corporations' wage rates are higher than those of foreign corporations, in Hungary, domestic corporations' wage rates are 12.5 percentage points lower than foreign corporations. This demonstrates that in a dependent economy, the potential productivity-improving effect of foreign capital only presents in real wages to a limited extent, because these effects can be negated by the strengthened bargaining power of foreign capital ownership on the market. What made debt-driven consumption in Hungary a necessity was that GDP growth and improvements in productivity only had a limited impact on household wage growth, an economic policy that favored foreign capital resulted in the evolution of productivity and real wages separating, while the return rates of the financial sector were the highest in the region. This also contributed to participation rates in Hungary being over five percentage points lower than in Poland and more than ten percentage points lower than in the Czech Republic (Table 6).

Hasan et al. (2014) say that economics still don't have a grasp of the relationship between bank ownership and lending to SMEs. In light of this, the Hungarian banking sector becoming foreign owned in the 90s can be considered premature. Hasan et al. (2014) state that local cooperative banks provide more loans to domestically owned SME actors of the economy than large foreign banks. They refer to the interviews of *Haas* and *Naaborg* (2006) made with foreign bank executives in Central Europe, which revealed that these banks provided almost the entirety of their loans to the foreign corporate sector and to a more limited extent to local large corporations in the 2000s. Foreign banks only began to lend to the local SME sector after a long period of integrating into the local institutional environment, but they continued to focus on local households to a larger extent than domestically owned banks (De Haas et al., 2010). *Gormley* (2010) in turn showed that when foreign banks entered the local Indian markets, SMEs' access to loans deteriorated: while the volume of loans increased, the new loans were provided to the most profitable corporations. According to *Mamatzakis et al.* (2017), the best results on the Chinese market are achieved not by the foreign- and state-owned banking system, but the domestically owned private banking system.

CONCLUSIONS

While the category of dependent economies established in 2009 by Nölke and Vliegenthart pointed out facts regarding the transition of the Visegrád countries that had previously been ignored – foreign ownership defining social-economic-institutional structures –, the transition of the Hungarian economy was implemented with a significantly different timing and practices compared to other Visegrád countries. This unique economic policy, which executed privatization too prematurely, to an extent too large, with too little strategic outlook and regulation, can be held liable for the Hungarian economy becoming dependent and being the only one of the Visegrád countries to require international assistance in 2008. In a manner that is peculiar in the region, the banking system, rather than being an institutional system managing and allocating risks, became the main cause of risks.

The concept of dependent economy also refers to the fact that the Hungarian economy is a model with low added value and based on low wages, which can also be considered subordinated to Western countries in value chains, but also because of its growth dynamics being based on debt. In our study, we have pointed up the connection points between financial variables and the dual real economy as the two dimensions of a dependent economy: a crisis of the first deepened the crisis of the domestically owned real economy, decreasing wage rates.

Domestic and international organizations and literature often had a more favorable opinion of the Hungarian transition than of the region, while the external exposure and issues of the economic structure showed a different image. This contradiction makes it necessary to introduce the new concept of a dependent economy in Hungary's case. After 2010, Hungary can attempt to create the institutional system of a new model of capitalism from a much tougher starting position than Visegrád countries, since Hungary's dependent economy can be considered a special, extreme case of a dependent economy. As a matter of policy conclusion, one might ponder how to increase the sovereignty of this dependent economy and converge institutionally towards the dependent economies of the V3. This, however, is also partly a matter of political science, because other than abandoning the growth model of a dependent economy, the state building work that was not done in the 90s must also take place.

Notes

[1] The first generation of VoC literature called 'classical school' was created by Hall and Soskice (2001) to describe developed countries. To this day, they classify Central European economies as export oriented liberal market economies, belonging to the same category as developed Western economies (Hall, 2017). Analyses of intermediate models of capitalism were encouraged by the increasing visibility, starting in 2005, of the differing dynamics of Visegrád countries attempting to catch up with the West and of Hungary grinding to a halt. This previous typology approached the East from a Western perspective, that's why it omitted foreign capital from its model as the most important factor from the point of view of the Visegrád region, even though it had been featured in multiple analyses penned by Central European pairs of authors (King, Szelényi, 2005; Bohle, Greskovits, 2012; Drahokoupil, Myant, 2010, 2011).

[2] Gereffi and Evans (1981) pointed out, through the example of Mexico and Brazil, that a dependent path of development carries with it increased external vulnerability and is less resistant to crises.

[3] The economic transition led by international organizations was based on the neoclassical-monetarist approach followed by the IMF, which considered establishing free market pricing its main priority, because it assumed that this would lead to an efficient allocation of resources. Kornai's soft budget constraint became a cornerstone of this narrative. Conversely, representatives of the Post-Keynesian school, considered neglected, thought the primary objective of the transition to be full employment (Gabor, 2012).

[4] The dependence is well illustrated by the fact that in 2001, Austrian banks derived one third of their profits from Central European countries, while only investing ten per cent of their assets there (Vliegenthart, 2010).

[5] In the Czech Republic, by 2004, only 15 per cent of loans went to the manufacturing sector, less than those given out to households and the government (Gabor, 2012).

[6] The dependent banking system based catch-up strategy attempts to replicate the successful catch-up of East Asian countries, but using tools that are the exact opposite of their models (Gabor, 2012). In emerging Asian countries, in developed Western countries and in Japan, financial systems continue to be domestically owned. Furthermore, certain service sectors – such as the retail network – are also retained by domestic interests (in order to be able to absorb less skilled domestic labor). In Central Eu-

ropean countries, however, these sectors were ceded in their entirety to foreign interests. In the influx of foreign capital, a difficult-to-justify double standard was leveled: for instance, in many cases, the influx of Russian capital was limited (Podkaminer, 2013).

[7] The shift of ownership abroad started in the second half of the decade, because up until the middle of the 90s, a special permit was required for foreign ownership of a Hungarian bank to exceed 25 per cent (Zídek, 2014).

[8] Especially when it came to retail loans. In 2007, the European Commission determined, that the foreign-owned banking sector in Hungary was maintaining high prices artificially by anti-competitive collusion, abusing its market position and making changing banks more difficult in order to achieve higher profits. In a closed market, there is a high barrier to entry and the system of products, charges and commissions is opaque. According to the analysis, the frequency of changing banks is a good indicator of strong competition, but this was very low (OECD, 2010; European Commission, 2007).

[9] An aggressive market penetration strategy meant that banking subsidiaries were offering far riskier products to their customers than in their home countries (Somai, 2016). What's more, they often flouted regulations in their home countries: Austrian authorities, for instance, cautioned strongly against foreign currency lending practices (Banai et al., 2010).

[10] In 2000, net non-interest income made up 26 per cent of all banking income in Hungary, whereas the EU average was more than 40 per cent (Várhegyi, 2002).

[11] In 2010, 30.7 per cent of FDI went to the real estate sector and commercial activities in Hungary. In the Czech Republic, this number was 16.2, in Poland 17.6 and in Slovakia 10.9 per cent (Podkaminer, 2013).

[12] This Hungarian model of capitalism, which was extremely dependent compared to other Visegrád countries can be designated as a 'subprime economy'. Subprime lending meant providing loans to low-income, risky people, often with a bad credit history, which sets households on a financially unsustainable path. The expression can be used in reference to the entirety of the Hungarian economy because of the foreign currency lending issue (which only took on a defining role in Hungary out of all V4 countries) and an unsustainable growth based on debt, which created a public financial crisis as early as 2006. Hungary was the only country that needed to request the IMF's assistance because of the 2008 crisis. As such, the designation can also be used in reference not only to households, but also to public finances.

[13] Multiple Hungarian macroanalysts have put forward that 'the downturn in Hungary started as early as 2006' and that 'if the international crisis had occurred in 2006, the country probably wouldn't have been able to stay afloat and there wouldn't have been a shred of doubt that only the state (the overspending government) was responsible for the consequences (including a significant devaluation of the currency, large-scale capital flight and the increase in forint-based interest rates)' (Mellár, 2013; Oblath, 2009).

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