The role of the state in contemporary market economies

Edited by
Zoltán Ranschburg

REPUBLIKON INSTITUTE

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European Liberal Forum
Rue d'Idalie 11-13, boite 6, 1050 Ixelles, Brussels (BE)
info@liberalforum.eu
www.liberalforum.eu

Republikon Foundation
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Editor's note

From a liberal perspective, the approach to the state's role in market economy has always been defined by the principle of 'the less is more'. The market should be regulated by demand and supply, and free competition should control the prices to everybody's benefit. In an ideal world the role of the state is limited to the provision of the rules of free competition, and governments abstain from interfering with the market. The world, however, is never ideal, and it has been even less so over the last couple of years. Although crises of various natures had appeared from time to time in different states and continents throughout modern history, in our globalised economy and deeply interlinked societies the crises of the recent times, such as the COVID-19 pandemic, the emergence of armed conflicts (such as Russia's invasion of Ukraine, or the Israeli-Hamas conflict), or fuel price shocks created unprecedented circumstances, calling for new answers.

As successive crises shook the markets around the world, more and more governments and international organisations felt the need to increase their role in the economy. Lending a helping hand to those hit the hardest by most of the time unforeseen depressions, whether they are individuals in debt, or entire sectors drifting toward bankruptcy due to lockdowns, was always the reasoning behind interventionalist policies. Yet, it suddenly became visible that certain political actors took advantage of the crises and of the metaphorical 'fog of war' they brought along, and, under the banner of helping those in need, introduced measures supporting their own political and/or economic goals. Furthermore, either due to the urgency of taking steps, or simply because of policymakers' recklessness and a lack of proper consideration, several policies came into effect all around the world that weren't effective in mitigating the effects of crises or had serious unexpected side effects.

Although because of the challenges set by the recent years the liberal approach to the state's role in the economy is transforming, too, we cannot forget about the concerns related to state interference that have been characterising it from the beginning. In the future we will need solutions that enable the state's effective intervention but tie its hands strong enough to prevent it from upsetting the market's balance in the long run, and to make sure that public funds really end up at those who need them. For that end, it is necessary to look back and around, and draw the consequences from the era of 'permacrisis'.

In September 2023, Republikon Institute held an international conference in Budapest on the state's role during crises with the participation of excellent Hungarian and international economists and analysts. Although initially, the conference intended to focus on state interventions in the market economy, during the panel discussions it quickly turned out that the scope of the discourse had to be broadened: state interventions during crises cannot be examined and analysed in a "vacuum", without getting a deeper understanding of national level systems and mechanisms, political structures, and their relations to the market. As a result, we asked our conference's distinguished speakers who also honoured us by contributing to the present publication to elaborate not only on measures of state intervention taken in response to crises in the past years, but also on the underlying structures of the connection of state and market, which largely define a country's resilience to economic shocks.

The case studies included in this publication focus on Austria, Hungary, and Portugal – three countries of completely different economic and political backgrounds. The diversity of the cases sheds a light – at least partly – on the variety of economic and political structures within the European Union, and on the entirely different issues these structures may entail, from rent-seeking to the state's overpresence in the market, or to the implementation of counter-productive populist measures. While the studies are insightful and enlightening in themselves, we believe that as a collection, they raise awareness of the multi-layered and complex nature of the challenges EU member states and, consequently, the EU itself must face in connection with understanding and interpreting the state's role in the market, and they help us draw conclusions for the future that could contribute to the improvement of the resilience of national economies, and to the protection of the free European market.

Chapter 1

The two forms of modern capitalism: liberal and illiberal states

Péter Mihályi:

Introductory remarks

This short note operates with three basic hypotheses:

(1) Every society has some form of domination to keep the system working. With the benefit of hindsight, we can confirm that Max Weber (1920) was right. The dream of Marxists about a domination-free society and the "withering away of the state"[1] were not more than utopia, emotionally attractive to left and liberal-leaning intellectuals. Force and coercion must exist in every system, if for no other reasons but to keep criminals under control.

(2) Each country is a mix of various types of domination, and in each type of domination the nation-state guarantees a different degree of economic and political rights, and civil liberties. From a closer inspection every

[1] [1] This term was coined by Friedrich Engels in two important writings, the Anti-Dühring (1877) and the Origins of the Family, Private Property, and the State (1884

country exemplifies a hybrid regime[2] – not only the authoritarian ones as it is often understood in the literature (Diamond, 2002). Even the most progressive liberal democracies are not perfect "textbook" democracies. The concept of liberal democracy has several dimensions with measurable indicators, and there is no country where all these indicators reach the maximum value.

(3) There is no linear evolution from one type of domination to the next. Historical change is rather cyclical. Some liberal systems may become illiberal or autocratic, but at one point, the wheel can change directions and the country can return to liberalism (e.g., Poland in 2023?). The movement from one regime to another is not determined with certainty. It greatly depends on social struggles and international, global processes.

As it was first exposed in our earlier paper – Szelényi – Mihalyi (2021) – we distinguish six existing types of domination in the early 21st century:

[1] liberalism, [2] conservativism, [3] illiberalism, [4] autocracy, [5] dictatorship, and [6] despotism.

Liberalism and capitalism

During the 17th and 18th centuries, classical theorists of liberalism were not interested in the economic consequences of liberalism since capitalism hardly existed. By the 20th century, for Max Weber this became the single most important question. Weber believed that capitalist systems function effectively only under "legal-rational authority". While individual profit-seeking capitalist entrepreneurs can operate even in *traditional* and in exceptional cases in *charismatic authority*, a system integrated by the logic of profit-seeking capitalism was only conceivable under a legal-

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[2] At this point Weber's line of thinking goes parallel with Karl Polanyi, as we asserted in Szelenyi - Mihályi (2020b).

rational or liberal regime. His reasoning was simple: Capitalism needs a secure and predictable environment, a rule of law, which is only possible if the three major branches (legislature, executive and judiciary) of government are, at least to some extent, separated.

Varieties of capitalism

The idea that capitalism has had different forms is not new. Already Karl Marx considered a critical distinction between “productive” and “finance” capitalism. The first is capable for self-reproduction, while the second was thought to be self-destructive. Karl Polanyi (1957) – at least in our interpretation, see Szelenyi – Mihalyi, 2020b - could also imagine a self-correcting capitalism (correcting the destructive features of pure markets).

The golden age of liberal capitalism came to an end by the 1970s (especially triggered by two international oil shocks). The post-WWII fast growth, reduced inequality, and improvements in well-being all came to an end. The Scandinavian welfare state faced serious problems, given its high taxes to cover the generous welfare provisions. In the globalizing world, capital could move almost without restriction, so there was a capital flight from high tax countries into "tax havens". As Christian Joppke (1987) called it, the world moved into the neoconservative model[3] of capitalist growth, financial discipline, austerity measures and cutbacks in welfare expenditures. In a way, this is what *globalization* is mostly about. But it would be premature to bury the welfare state. Expenditures in social welfare – measured as proportion of GDP – are still much higher in welfare states than in liberal market economies and even in these societies political pressure to improve their welfare systems is increasing (see Bernie Sanders’ “democratic socialist” mass

[3] There is a difference between neo-liberal or neo-conservative political regimes. Neo-cons accept political programs (e.g., Western military interventions around the world) what neo-liberal philosophers may not support. In terms of economics, however, they are largely undistinguishable.

movement in the US). US-style liberal market economies, however, do have their own problems stemming from globalization. One result of globalization is the explosion of inequalities on the top of the social hierarchy, while in the bottom 30-50 percent incomes tend to stagnate. As a result, even liberal capitalist economies are vulnerable to illiberal, populist, anti-globalization rhetoric, what Donald Trump cashes in so effectively, and what Boris Johnson used to “get Brexit done”. The COVID-19 pandemic has only added more fuel to the anti-globalization hysteria (Mihályi – Szelenyi, 2022).

Thus, capitalism is most likely to flourish under liberalism (rule of law) and especially under liberal democracy. But dynamic growth is conceivable – and did occur – in *non-liberal or illiberal* capitalist states. In the “soft” version of illiberalism, while the independence of various branches of powers is undermined, regular elections are still held and they have a stake, even if the electoral rules are managed to favor the ruling party: Japan, Turkey, Russia (under Yeltsin), India, Hungary (since 2010), Singapore, Taiwan, and Poland (since 2015) are perfect examples. The same is true even in *certain dictatorships* as long as they guarantee some degree of law and order at least in the sphere of business (e.g., Russia under Putin, Chile under Pinochet, or the United Arab Emirates). Elections are held, but they have no

In the “soft” version of illiberalism, while the in-dependence of various branches of powers is undermined, regular elections are still held and they have a stake, even if the electoral rules are managed to favor the ruling party...

stake, although there is a relatively independent judiciary as far as the international business connections are concerned.

If, however, the ruler is *despotic*, where he can act as he or (rarely) she pleases, the capitalist system cannot be constituted, though profit-seeking firms owned by clients of the ruler may exist. By and large, this is the case currently Iran, in some Gulf monarchies, in several post-Soviet republics and China (1978-2012).[4] The drastically reduced separation of powers is typically accompanied by ethno-nationalist, anti-globalist, and mercantilist policies as well.

The approach embodied in this short note is not firm-centered, but state-centered. In the globalized world economy, the existing differences among firms' behavior reflected in

- industrial relations,
- vocational training,
- corporate governance,
- inter-firm relations and
- coordination with employees

on which the original "varieties of capitalism" (VoC) approach is based[5] are of secondary importance only. Furthermore, history has simply not justified the assumption of "increasing divergence between the

[4] During the post-Stalinist and post-Maoist system communism was moving into this direction of hard illiberalism. The case of fascist or Nazi systems is rather complicated. Mussolini and Hitler had substantial support from big businesses, though they did not offer the guarantee of security of property. Crown price Muhammed bin Zayed of Abu Dhabi, who claims to be the source of all laws, recognizes certain business interests and offers enough security to business to operate in a capitalist system. The classification of China after 2012 is a difficult task. See the present author's views in Mihályi – Szelenyi (2020).
[5] For this five-member list, see Hall-Soskice (2001) 68-page long introductory and summarizing study, pp. 6-7.

coordinated and liberal market economies".[6] If anything can be said about the direction of change after the 2008 international financial crisis and the ensuing institutional, as well as intellectual changes pertaining to macroeconomics, it is the opposite. The liberal democracies of the core OECD or EU countries became more similar than before. All the firm-centered differences between Germany and Britain, or France and the United States are insignificant, if compared to the differences between liberal states like this four on the one hand, and the illiberal capitalist democracies, like Japan[7], Russia, Turkey[8] or India on the other hand. If this were not the case, the European Union would have fallen apart long time ago. And in a similar way, the Brexit conflict or the trade war between the Trump presidency on the one hand, and the rest of the world on the other have very little to do with the differences between the so-called Liberal Market Economies and the so-called Coordinated Market Economies. The origin of all these conflicts is at the level of state-politics.

The Hungarian version of illiberalism

In 2014, the Hungarian Prime Minister, Viktor Orbán brought into the public discourse a new dimension (Bozóki, 2019, Kovács – Trencsényi, 2020). Orbán, a former radical liberal, spectacularly turned into a major critic of liberalism.[9] He was inspired by the widely known American

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[6] See Kathleen Thelen's (2001) clear-cut position in the above-mentioned Hall-Sockice edited volume, op. cit. p. 72.
[7] It is worth noting that the VoC approach does not question the liberal credentials of Japan. We do this, in spite of the ironical fact that the Liberal Democratic Party (LDP) was almost continuously in power since its foundation in 1955 (with the exception of a period between 1993 and 1994, and again from 2009 to 2012.)
[8] In fact, this is the real reason why the EU has become increasingly hesitant to open the accession talks with Turkey.
[9] In 1992, Orbán was elected Vice Chairman of the Liberal International (LI). In 2000, however, Orbán and his Fidesz party left the LI and joined the European People's Party (EPP). From this date, Orbán showed more and more signs of intellectual enjoyment of illiberal actions and statements. In 2021, Fidesz left the EPP, too. Scheppele – Bánkúti (2012).

Orbán (2014) with a stroke of genius turned "illiberalism" into a positive term (without referring to Zakaria) in a widely quoted public lecture after being re-elected as Prime Minister the third time.

political scientist, Fareed Zakaria (1997), who first introduced the notion of illiberal democracy. For Zakaria, the notion of illiberalism had negative connotations: a country which is illiberal could not be genuinely democratic. According to Heller (2019), in this sense, illiberalism was a new phenomenon. It is tyranny with a negative ideology: nihilism.

Orbán (2014) with a stroke of genius turned "illiberalism" into a positive term (without referring to Zakaria) in a widely quoted public lecture after being re-elected as Prime Minister the third time. In his interpretation, liberalism puts excessive emphasis on individual liberty and interests and does not sufficiently respect the national interest. But what is the national interest? He developed a strange logic to define it much earlier. When in 2002 Orbán lost unexpectedly the election with a small margin, he was factually correct and, in some way, self-critical. He said: our mistake was that we did not create during my government a loyal domestic bourgeoisie. After 2010, when Orbán and his Fidesz party returned to power, they did not make the same mistake: they fervidly supported with money their own loyal entrepreneurs in many sophisticated ways. After 2014, they realized that they also have to create a loyal intelligentsia. This seems to have been under way in the last couple of years as a "cultural war" against liberal intellectuals. Some time ago, Orban (2020) went so far that he even denied the existence of liberals: “there is no such thing as a liberal: *“a liberal is nothing more than a communist with a university degree”*.

However, illiberalism is far from just a Hungarian or Orbán phenomenon. What we observe now is nothing less than an all-*out ethno-nationalist, sovereigntist counter-revolution* against liberal democracies in 18 (!) EU Member States and on other continents as well. These illiberal counter – movements and political parties so far have not captured the majority votes in all recent national elections, but the support rate of these right-wing parties among the voters is already in the 11.0% (Latvia) to 49.3 (Hungary) range.[10] Often, this is enough to have the majority of parliamentary seats or to receive a few important ministerial positions in coalition governments. This counter-revolution calls for a potent executive, whose actions for the “national” interest are not blocked by institutional checks and balances. The essence of illiberalism is to overcome wishy-washy parliamentary paralyses and replace them with an executive, who is capable to act swiftly in all circumstances.

Illiberalism and capitalism

Can illiberalism co-exist with capitalism? In our definition *illiberalism* is a project to reduce the separation of powers and in particular to increase the power of the executive. This has major implications for political economy. Given the strength of the illiberal executive, the state interferes substantially in market competition especially in the process of public procurements. Competition is often limited either to cronies of the political decision-makers or to the family relatives of the political elite. Since competitors are thus eliminated (or at least their number is substantially reduced), certain businessmen can win such “competition” by asking higher prices for their products or services than what one could

[10] See a full list of the above-mentioned 18 illiberal national parties and their results in elections between 2015-2018. Önis – Kutlay (2019).

gain in open competition. They collect *rent* on top of the *profit* they earn. If rent-seeking becomes systematic, it reduces efficiency. If rent-seeking is manifestly widespread, it may even threaten the sustainability of the system (as it is documented in several African "failed states").

Some *rent-seeking* exists in all capitalist economies (Mihályi – Szelenyi, 2019). But in liberal states, it is less evasive, and it is usually not the outcome of direct government intervention. Rent in this sense is similar to what some 20th century Marxist economic textbooks called extra profit that monopolies or oligopolies generate. If the government limits competition in public procurement to *Strohmanns* or hidden frontmen in suspicious ways, public discourse labels this as corruption. If, in turn, politicians are caught in such activities they are prosecuted. In illiberal capitalist economies, such targeted government intervention is one of the most important goal functions of the system. Furthermore, the illiberal leaders are inclined to use selective criminalization through which they can eliminate their real (or suspected) opponents. In case *Strohmanns* are protected from the market competition that often serves the enrichment of the political elite (or their families). This is what Bálint Magyar has called mafia state since 1999[11].

But since illiberal regimes also have to claim that they are "democratic", they have regular elections, and these elections have some stake. In other words, the ruling elites must win the elections for their legitimacy. As a result, rent-seeking means much more than privileges guaranteed to *Strohmanns*, it is the single most important mechanism to recruit a broad enough group of clients to be successful at elections. The explanation is simple: political parties need money and a large portion of this money comes from the business entourage of the ruling party.

[11] For a recent English presentation, see Magyar – Madlovics (2020).

Can such a system still be called "capitalist"? Of course, it can. Our explanation is that the illiberal project cannot bring the whole economy under state control. Illiberal leaders need multinational capital; thus multinationals are treated extremely well by the state. And there is also a domestic sector of the economy, which remains competitive, where wages and profits are generated on the free market. In 2023, for instance, the fourth wealthiest Hungarian individual was Mr. György Gattyán, who made almost $1 billion wealth by opening a globally accessible adult webcam service. The money he made was pure profit, not rent.

It is important to see that elections do matter in illiberal regimes, hence party leaders pay a great deal of attention to winning elections...

The bottom line of our analysis is this: with 1989-91 communism as a world-wide challenge to capitalism ceased to exist, but especially after 2005 there is a trend towards illiberalism, the rule of a strong executive in combination with some electoral legitimacy. It is important to see that elections do matter in illiberal regimes, hence party leaders pay a great deal of attention to winning elections (even if it requires the manipulation of electoral rules, or, if necessary, election fraud[12]).

As we have already stated above, the essence of illiberalism is the weakening of the separation of powers and the strengthening of the executive

[12] See e.g. „Hungary: Election Was Free but Not Entirely Fair, Observers Say", The New York Times, April 9, 2018.

So, was Weber wrong? Today it seems to us that he might have overempha-sized the need for legal rational authority, but we are convinced that illiberal systems and dictatorships do have essential vulnerabilities

branch. It is supported by a desire for strong leadership and the defense of national identity. These are both vote-winners and can give strong representation in the legislature (even a two-third majority). This is working relatively well in established democracies, like the Brexit vote in Britain, or Donald Trump's presidency from 2017 to 2021. Unsurprisingly, illiberalism and even dictatorships often appeal to a very large group of voters (not a 50% majority though) in post-communist countries, without much or any democratic past and a deeply rooted nostalgia for strong leaders.
Just to return to Weber: in illiberal systems there is still some room for liberal capitalism and competition, hence room for capitalism. This is less the case in capitalist illiberal dictatorships, where there is no separation of powers, and the source of law is the ruler (prime examples are the United Arab Emirates or Saudi Arabia). Nevertheless, both are well functioning capitalist economies.

So, was Weber wrong? Today it seems to us that he might have overemphasized the need for legal rational authority, but we are convinced that illiberal systems and dictatorships do have essential vulnerabilities. One is, of course, the question of succession for the leadership position(s) of the state. The leaders of these countries do not like their possible successors. President Xi eliminated the term limit carved in the Chinese constitution in 2018; Putin went in the same direction in early 2020, when the whole world was occupied with the COVID-19 crisis. Donald Trump has been dreaming about his “dynasty” and or at least his own re-election in 2024, and thus turning his illiberalism into an absolute monarchy, just like his beloved Saudi Arabia.

But let us not end this essay on a negative note. If we take the long-run view, we have a robust argument for being optimist. As Zakaria (2007) noted, at the beginning of the 20th century there were no free countries on Earth meeting the standards of today: universal suffrage was limited everywhere to some extent. But today, in 2023, the number of free countries stood at 84 according to the Freedom House metrics.

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Chapter 2

Portuguese State intervention(s) in the country market economy

Ricardo Silvestre

1. Introduction

When studying the interventions of the Portuguese State in the national market economy, in a comparative analysis with other Member States of the European Union (EU), it may look like Portugal is always going through a crisis. Not that is not completely false. In fact, since the country became a full-fledged democracy after the Carnation Revolution of 1975, which deposed a far-right dictatorship, several economic bailouts were needed to keep the economy afloat (1977, 1983 and 2011). This adding to the global economic crisis of 2008, the COVID-19 pandemic, the insolvency of several key national banks, and more recently, the energy and inflation crises.

However, there is a deeper problem when thinking about what the role of the Portuguese

State in a contemporary market economy should be: it isn't that there is a revival of State interventionism with recent crises, but that interventionism is continuously hard to diminish. It is deeply rooted in Portugal thinking, from societal to political, that the State should be a nanny-state, protecting and providing for its citizens. This has been something progressively abandoned with the inclusion of Portugal in the EU and in a modern globalisation of markets, capitals, and labor. However, it is still a work in progress.

In this chapter we analyse historical conditions in which the resistance of the State to assume a minimal role in markets and economic issues is rooted; what are some of the measures, both internal and external, that may contribute to less interventionism in the market economy; and some liberal solutions that could help speed-up and consolidate the process. The methodology consists of performing qualitative research and collection of information in a way to produce a constructivist narrative to develop a theoretical generalisation, starting with specific facts and empirical observations, and advancing to the construction of the theory.

2. Portugal economy functioning: (recent) past and present

After the 25th of April 1975, also known as the Carnation Revolution, when the forces of democracy deposed the dictator António Salazar, there was a period of negative economic growth due to the chaos, lack of structure, and political turmoil. This was compounded by the nationalisation of industry and farms, while the country was decoupling from the former colonies and their resources. This scenario affected, among others, manufacturing, mining, agriculture, and fishing, resulting in the country having the lowest growth rate in Europe, including several years of negative growth. Fortunately, this was inverted with the entry of Portugal in the then European Economic Community in January 1986, which helped create the conditions for a stable economic growth, based on increased trade, but importantly, from the influx of European funds for the development of the country. In the 1990s, Portugal followed economic policies that were determined by the Economic and Monetary Union's convergence criteria[1]. After a successful completion of the process of nominal convergence, Portugal was integrated in the Eurozone in 1999, which brought along the need to accommodate the free flow of capital, goods, and services. The Portuguese market economy underwent then a transformation, with an increase in the dominance of the services sector, more private investment, and the liberalisation of some key markets.

However, due to the political view and installed culture that were dominant until 2010, Portuguese governments, both in the center left (Socialists) and center right (Social-Democrats), incurred in over-expenditure and ill-advised investment plans, particularly in public-private partnerships, a way for the State to be part of the economic market[2]. This led also to waste, corruption, mismanagement of funds, and duplication of State structures, which caused hesitance in international investors to move capital to Portugal. For almost four decades, the Portuguese economy was damaged by high-risk credits, public debt creation, and mismanaged European structural and cohesion funds, to the point that Portugal needed an economic bailout from the EU, International Monetary Fund, and the International Fund. Such happened in the period between 2011 and 2014[3], causing a severe increase in taxes over work, a decrease of salaries, the privatisation of key public companies, such as the national air carrier, mail services, the selling of State holdings in the electric market, and the liberalisation of the housing market (among others). These measures had a

[1] C. de Sousa (1997), ' EU convergence criteria set framework for pay guidelines in Portugal', Eurofound, 27 September, https://www.eurofound.europa.eu/en/node/15596

[2] Diário de Notícias (2011), 'Conheça o verdadeiro peso do Estado', Diário de Notícías, 7 January, https://www.dn.pt/tv-e-media/media/conheca-o-verdadeiro-peso-do-estado-1750097.html

[3] International Monetary Fund (2019), 'Political consensus at the heart of Portuguese recovery', IMF, May, https://www.imf.org/en/Countries/PRT/portugal-lending-case-study

negative impact on the economy, causing decreased consumption, investments scarcity, and businesses closings[4]. Portugal entered an economic recession, which only saw an inversion in 2014.
Getting into the 2020s, the most important economic sectors in the country are wholesale and retail trade, transport, accommodation and food services (20.8%), public administration, defence, education, human health and social work activities (20.7%), and industry (17.4%)[5]. Apart from the steady revenue of the State from tourism, which accounts for 6.4% of the country's gross domestic product (GDP)[6]], Portugal also depends on exports like machine tools, textiles, clothing, footwear, paper pulp, wine, cork, plastic moulds (among others)[7], while energy sale can also become a major player in revenue growth.

Positively for the country's economic development, there has been a significant improvement in the standards of the manufacturing industry due to modernisation: a departure from the dependence on traditional activities towards a more technological environment. The automotive and components sector, electronics, energy, pharmaceutics and information and communication technologies are examples[8]. The overall regulatory framework is deemed to be efficient,[9] there are set rules for forming and

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[4] P. Pedroso (2014), 'Portugal and the global crises', Friedrich Ebert Stiftung, April, https://library.fes.de/pdf-files/id/10722-20220207.pdf
[5] European Union (2023), 'Portugal, overview', https://european-union.europa.eu/principles-countries-history/country-profiles/portugal_en
[6] Pordata (2023), 'Travel and tourism accounts as a % of GDP', Fundação Francisco Manuel dos Santos, https://www.pordata.pt/en/portugal/travel+and+tourism+ac-count+as+a+percentage+of+gdp-2632
[7] Britannica (2023), ' Portugal, resources and power', Britannica, https://www.britan-nica.com/place/Portugal/Resources-and-power
[8] Permanent Mission of Portugal to the United Nations (2023), 'About Portugal, economy', Ministry of Foreign Affairs, https://onu.missaoportugal.mne.gov.pt/en/about-portugal/economy
[9] Heritage Foundation (2023), '2023 Index of Economic Freedom, Portugal', Heritage Foundation, https://www.heritage.org/index/country/portugal

operating in the market economy, but in certain cases, as it often happens in a country with a history of excessive regulations, they can be burdensome and costly. The financial sector, dominated by banking, after overcoming some serious problems, which will be detailed later, has regained stability, and offers a range of financial services[10].

In 2018, there were some positive signs of major investments without public subsidies, for example in renewable energy production and distribution, which was particularly noteworthy in a country that is used, in the 50 years of democracy and modern market economy, to being State subsidy dependent. Even with the liberalisation of several markets: energy, water, investments, funds, goods and services, the weight of the State is still relevant, and hard to diminish. This also extends to EU funds. The current framework for Portugal (the PT2020) has financing for 164,736 investment projects[11]. In 2023 further projects are expected to be financed via the European Regional Development Fund, the Cohesion Fund and the European Social Fund. Portugal occupies the third place in a ranking based on the number of projects supported among the 27 Member States, just behind Germany (283,599), and Italy (739,673)[12], not even counting all the financing from the NextGenerationEU fund, which will be discussed next. On the other hand, these mechanisms of support have been, undoubtably, essential to support economic, social and territorial cohesion[13].

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[10] See footnote above.
[11] European Commission (2023), 'Kohesio: discover EU projects in your region', https://kohesio.ec.europa.eu/en/
[12] Agencia para o Desenvolvimento e Coesão (2022), 'Portugal é o terceiro pais com mais projetos financiados pela EU', AD&C, 21 March, https://www.adcoesao.pt/portugal-e-o-terceiro-pais-com-mais-projetos-financiados-pela-ue/
[13] M. Alves (2019), 'De 1986 até 2018 Portugal terá recebido 130 mil milhões de fundos comunitários, Jornal Económico, 11 March, https://jornaleconomico.sapo.pt/noticias/de-1986-ate-2018-portugal-tera-recebido-um-valor-acumulado-em-torno-de-130-mil-milhoes-de-fundos-comunitarios-428371/

3. From crises to crises

As mentioned above, a decreased State intervention in the market economy is complicated when there is successive bad management of public finances, leading to economic bailouts, either internal or external. The economic adjustments from 2011 to 2014, which resulted from the international financial help are one of those cases. Other examples are worth mentioning.

One of them is the banking system, which cost the State (therefore, tax payers) more than 22 billion Euros from 2008 to 2021, according to the Court of Auditors to the State General Accounts[14]. These interventions were justified by the banking sector, and by the members of (successive) governments, with the moniker that the bailed-out financial institutions were too big to fail, and that their insolvency would cause economic depression. It is not within the scope of this chapter, but such justifications were, and still are, received in Portuguese society with suspicion due to the evidence of mismanagement of bank resources, deregulation that allowed the banks to create what are know as toxic assets[15],

One of them is the banking system, which cost the State (therefore, tax payers) more than 22 billion Euros from 2008 to 2021, according to the Court of Auditors to the State General Accounts

[14] A. Machado (2022), 'Banca custou ao Estado 22 mil milhões entre 2008 e 2021', Observador, 4 October, https://observador.pt/2022/10/04/banca-custou-ao-estado-22-mil-milhoes-entre-2008-e-2021/

[15] S. Jessop, A. Khalip (2016), 'Fund firms sue Portugal's central bank over Novo Banco debt', Reuters, 5 April, https://www.reuters.com/article/funds-lawsuit-novo-banco-idUSL5N1781TN

and political connections that created the conditions for abuses of the governance system[16].

A more recent example, at the writing of this chapter, are government-led solutions to the soaring property prices. While the State is one of the biggest owners of properties, it has a legacy of under-investment in public housing. The crisis in the housing sector, due to multiple factors like speculation, inflation, or gentrification, caused the government to invest 2.4 billion Euros in public housing until the end of 2026. In the past, public subsidies and tax incentives were made available to encourage people to purchase properties (not State owned), giving the country the highest level of home ownership in western Europe, at more than 75 per cent[17].

However, a lack of economic purchasing power, in conjunction with increases in interest rate by the European Central Bank, make the option of buying a house much less viable, particularly to young generations. A government program called More Housing (Mais Habitação in the original) was presented, but immediately drew protests due to intrusive actions on private property, like the enforced rental of vacant habitable properties, and a suspension of new licences for housing to short-term rentals, commonly known as the Airbnb market[18].

Another example, taking place against the backdrop of the vicious and illegal invasion of Ukraine by the Russian Federation, are measures aiming to reduce wholesale electricity prices by lowering the input costs of fossil fuel-fired power stations. Equally, buyers in the wholesale electricity market were exempted from paying adjustment costs until the end of 2023.

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[16] P. Ames (2021), 'Portuguese court orders ex-PM Sócrates to stand trial for money laundering', Politico, 9 April, https://www.politico.eu/article/portugal-former-prime-minister-jose-socrates-trial-money-laundering/

[17] B. Jopson, V. Romei (2023), 'Spain and Portugal tackle property crisis by embracing public housing', Financial Times, 18 April, https://www.ft.com/content/abd093f1-0a36-4989-bd38-e7cc3ea6bfca

[18] Visit: https://www.airbnb.com/a/stays/Portugal

4. The promises of (truly) making structural reforms

Being that a market economy is the economic system in which economic decisions, and the pricing of goods and services are results of the interactions between market players, and where the government intervention, or central planning should be minimal, how can Portugal become a more economic free environment, and less of a nanny-state? How can such transformation take place despite the decades of dictatorship that assumed a paternalistic attitude towards the citizens, and a political system that over-regulates and intervenes in the industrial and enterprises sectors?

At the time of this writing some positive signs are present that can create the conditions for such changes. The European Commission's latest economic forecast for Portugal[19] expects a 1.8% increase in gross domestic product (GDP), and a decrease in the gross public debt (to 103,1%, as a percentage of GDP) by 2024. In case of the latter, this will be a declared improvement when compared to the 106,2% projected to 2023, and, most notably, to the 113,9% of 2022. This is compounded with an expectation that households' real disposable income will increase, and with that private consumption[20]. Investment growth is also expected to improve, with the normalisation of the global supply chains, and the application of the European funds from the Recovery and Resilience Facility[21]. It is also expected that an increase of government revenue will be attained due to a strong economic rebound, favourable labor market developments, an increase in tax revenue, and a general government deficit to improve 0.1%

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[19] European Commission (2023a), 'Economic forecast for Portugal', 15May, https://economy-finance.ec.europa.eu/economic-surveillance-eu-economies/portugal/economic-forecast-portugal_en

[20] European Commission (2023b), 'The Recovery and Resilience Facility', https://commission.europa.eu/business-economy-euro/economic-recovery/recovery-and-resilience-facility_en

[21] See footnote above.

> Portuguese companies, according to Forbes Global 2000 rankings, are banks that have extended to other Member States, energy companies, food retail and telecommunications services.

of GDP in 2024[22]. Tourism will continue to play a crucial role[23], which has been a constant for Portuguese economy.

The country stands 50th in the world by gross domestic product[24], exporting vehicles (11.8% of total exports), mineral fuels, including oil (8.6%), electrical machinery and equipment (8%), machinery, including computers (5.9%), plastics and plastic articles (5.2%), paper and paper items (3.7%), knit or crochet clothing and accessories (3.3%), articles of iron or steel (3.2%), furniture, bedding, lighting, signs, prefabricated buildings (2.8%), and footwear (2.6%)[25]. Some of the leading Portuguese companies, according to Forbes Global 2000 rankings, are banks that have extended to other Member States, energy companies, food retail and telecommunications services[26].

However, the promise of truly structural reforms may not come just by political will, or from EU guidelines, but as a response to what was, at the same time, an economic, health and societal

[22] See footnote 19.
[23] Agência Lusa (2023), 'Travel and tourism worth a fifth of Portugal GDP', The Portugal News, 18 July, https://www.theportugalnews.com/news/2023-07-18/travel-and-tourism-worth-a-fifth-of-portugal-gdp/79633
[24] Visit: https://www.worlddata.info/largest-economies.php
[25] D. Workman (2023), 'Portugal's Top 10 Exports', World's Top Exports, https://www.worldstopexports.com/portugals-top-10-exports/
[26] A. Murphy, H. Tucker (2023), 'The Global 200', Forbes, 8 June, https://www.forbes.com/lists/global2000/

crisis: the COVID-19 pandemic. We won't go into detail in this chapter, but tourism is one of Portugal's key sources of revenue, and to not have tourists due to the shutting down of free circulation had a devastating effect on the country's economy. Therefore, it was with great anticipation that the NextGenerationEU fund[27], part of the EU Recovery and Resilience Facility[28], was received in Portugal.

As a part of the process of accessing NextGenerationEU funds, Portugal, as the other Member States, created its national Recovery and Resilience Plan (RRP)[29], focusing on longstanding structural changes, improving labor skills, and companies' competitiveness[30]. The RRP translates into financial benefits in the range of EUR 13.9 billion in grants, and EUR 2.7 billion in loans, to be used in a time span of five years. This creates an enormous opportunity for the country to recover, together with the rest of the EU. The RRP is expected to have a wide-ranging effect in the country, starting with badly needed changes at governmental institutions and policies. Some are of a structural nature, while others will focus on necessary investments in digital and climate transition[31]. This need for State reforms was acknowledged by the European Commission, reflected in 'extensive set of mutually reinforcing reforms and investments that contribute to effectively addressing all or a

[27] R. Silvestre (2023), 'The Portuguese Plan for Recovery and Resilience: Contribution for a comparative analysis between EU Member States on effects in governmental institutions and policies', in G. M. Bovenzi and O. Łabendowicz (eds.), NextGenerationEU, Taking Stock (Brussels, European Liberal Forum), p.105.
[28] See footnote 20.
[29] European Commission (2023c), 'Portugal's recovery and resilience plan', https://commission.europa.eu/business-economy-euro/economic-recovery/recovery-and-resilience-facility/country-pages/portugals-recovery-and-resilience-plan_en
[30] International Monetary Fund (2022), 'Portugal: policies for a strong economy', IMF, 1 July, https://www.imf.org/en/News/Articles/2022/06/30/CF-Portugal-Policies-for-a-Strong-Economy
[31] See footnote 27.

significant subset of the economic and social challenges'[32]. Apart from the recovery from the economic shock due to the pandemic, the ambition is to place Portugal on the path of sustained growth, and to make it less dependent on subsidies and external financial help.

The Portuguese government, naturally, boasts about playing the most important role in this transformation through the introduction of a governmental plan to stimulate the economy[33] called Agenda More Growth (Agenda Mais Crescimento in the original)[34]. After the disastrous management of Portuguese finances by the State (including socialist governments), the current Prime Minister, António Costa makes repeatedly the case that his is an administration where 'the accounting is right'. However, it is more of a political slogan message than a true economic message. It is true that accounting is more well done, but this is mostly so because most of the financial processes are guided by EU institutions. The other possible criticism of the government's success messaging is that the accounts are balanced (good for the market economy) because of a lack of investment in basic social programs (hampering economic growth).

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[32] European Commission (2023d), 'NextGenerationEU: European Commission endorses Portugal's €16.6 billion recovery and resilience plan', Press corner, 16 June, https://ec.europa.eu/commission/presscorner/detail/en/ip_21_2985
[33] Portuguese Government (2023), 'Growth in GDP is a consequence of the Portuguese economy's structural transformation', 16 June, https://www.portugal.gov.pt/en/gc23/communication/news-item?i=growth-in-gdp-is-a-consequence-of-the-portuguese-economys-structural-transformation
[34] Portuguese Government (2023a), 'Agenda mais crescimento começa a 14 de junho', 13 Junho, https://www.portugal.gov.pt/pt/gc23/comunicacao/noticia?i=agenda-mais-crescimento-comeca-a-14-de-junho

5. Liberal solutions for significant problems

If we assume a continued economic recovery, a fiscal consolidation needs to rebuild fiscal space, facilitating the needed public investment, while alleviating risks from high public debt[35]. Tax revenue will continue to be the engine of growth, particularly via indirect taxation. Expenditure is projected to continue to expand, albeit at a lower pace than revenues, and upward pressure on current spending is expected to persist mostly due to social benefits and the public wage bill[36]. Downside risks are associated with the contingent liabilities arising from State guaranteed credit lines, and financial rebalancing of public-private partnerships[37].

With these scenarios, what could be liberal solutions to decrease the State's intervention in the market economy, while also making it smarter and effective? Some examples are reforms to strengthen insolvency regimes, which will allow non-viable businesses to cease operation more easily. Reforms to reduce differences between permanent high, and temporary low-value jobs, along with improvements to labor training under the Recovery and Resilience Plan[38]. Fiscal incentives can be included for private enterprises that wish to invest in the Portuguese market, with, for example, a reduction on the company income tax, and a more streamlined process for installation and operation for new companies. This will promote the celerity of processes, with an increased swiftness for stakeholders and enterprises[39] to set in the market.

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[35] See footnote 30.

[36] See footnote 19.

[37] See footnote 35.

[38] See footnote above.

[39] Portuguese Government (2021), 'Um Estado para ser forte tem de ser ágil e leve', September, https://www.portugal.gov.pt/pt/gc22/comunicacao/noticia?i=um-estado-para-ser-forte-tem-de-ser-agil-e-leve.

A more simplified labor code would also be beneficial for the collective agreements between employees and employers, responding to specific needs of businesses' operation, location, or even internationalisation. Simplification is also a need to fight against centralised bureaucracy. In Portugal, this tends to be a default system, something that was observed, for example, when the government created the laws for the management of the Recovery and Resilience Plan[40]. In lockstep with the previous need, market rules and regulations need to be transparent, not only to gain the trust of market economy actors and stakeholders, but also to avoid fraud and mismanagement[41]. This will then create incentives for domestic and foreign investors to look at the Portuguese market as a limited risk liability, something that hasn't been a reality in the previous years. In addition, the functioning of the judicial system has to be streamlined and expeditious, respect the rule of law, defend property, and protect investments.

The country, its government and the market economy itself face multiple challenges. This is a crucial time, as Portugal is recovering from the COVID-19 pandemic, boosted with the return of the precious help from the tourism sector, with the Recovery and Resilience Plan, and with all the structural changes included in Agenda More Growth. Still, there is much more to be done regarding State intervention in the market economy, either by necessity, culture, or political convenience. Portugal has shown in the recent past to be capable of adapting to complicated and challenging circumstances, something seen from crises to crises. Now there is the opportunity to make a difference when better conditions are set.

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[40] Recuperar Portugal (2022), 'Presidência do Conselho de Ministros. Decreto-lei n.º 29-B/2021 de 4 maio, Sumário: Estabelece o modelo de governação dos fundos europeus atribuídos a Portugal através do Plano de Recuperação e Resiliência', https://recuperarportugal.gov.pt/wp-content/uploads/2021/10/Governacao-PRR.pdf, p. 11-(3).

[41] Brussels Times (2021), 'Investors concerned about lack of transparency and legal protection in EU recovery', The Brussels Times, 23 June, https://www.brusselstimes.com/news/eu-affairs/174877/investors-raise-concerns-about-lack-of-transparency-and-legal-protection-in-the-eu.

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Chapter 3

Government interventions since the Covid-19 pandemic: The good, the bad, and the ugly

Lukas Sustala:

The state's role during current crises has expanded in many European countries, not only in providing healthcare, but also in economic policy. Citizens can expect three things of their government regarding any crisis of such a scope.

The first thing is preparation. Going into any crisis, we should have learned lessons from past experiences to alleviate their repercussions. This is true for a health emergency as well as for any other issues. Many government agencies exist because of a crisis in the past. But their efficiency varies widely.

Secondly, citizens can expect crisis management. We do expect our government and its political representatives to follow some basic rules of crisis management and communication, to inform the public about current evidence, precautionary measures or to alleviate unnecessary fears.

Thirdly, we should expect political leadership in any crisis. Trust in government and institutions is a consequence of actions taken, measures communicated, and help provided. And after three years, it is rather obvious that there is growing evidence that trust in many institutions has fallen due to political infighting, largesse regarding interventions, and populism in communication.

1. The Indispensable Hand of Government: Economic Policy during the 2020/2021 Pandemic

The 2020/2021 global pandemic, caused by the novel coronavirus (COVID-19), brought unprecedented challenges to countries around the world. Governments were thrust into the spotlight, faced with a dual crisis: a health emergency, and an impending economic downturn as international commerce came to a halt. As the virus travelled continents, infecting millions, economies teetered on the brink of recessions and depressions, with industrial activity dropping at unprecedented pace. Economic policy in many areas reacted swiftly, but at a cost. And often, high public spending in the short term was not due to efficient and swift action taken in response to the crisis, but was caused by inefficient and long lockdowns, and thusly large government aid programmes in response during the pandemic.
This paper will focus on the economic interventions enacted and the costs incurred.

Economic Policy in recent times

Traditionally, economic policy has been a tool that governments wield to ensure the stability and growth of their economies, employing measures that either stimulate economic activity during downturns or cool down overheated economies. Unfortunately, many governments fail to run balanced budgets during good economic times. In times of crisis, fiscal and monetary stimuli increase the state's role in the economy: central banks in advanced economies have accumulated vast amounts of holdings since the start of the financial crisis in 2008. Fiscal policy has increased public spending and the overall public debt to new record levels in many economies. However, the 2020/2021 pandemic presented unique challenges, blending public health with fast and far-reaching economic considerations in ways previously uncharted.

Immediate Economic Shock:
As the virus spread, many governments implemented lockdowns and social distancing measures. While these steps were crucial from a public health perspective, they also led to an almost instantaneous economic shock. Demand plummeted in sectors such as travel, hospitality, and retail, while global supply chains were disrupted, leading to widespread business closures and skyrocketing unemployment rates.
The speed and magnitude of the economic collapse was without any modern precedent.

With the onset of the pandemic, numerous special regulations were introduced on the European level. The Stability Pact was suspended – and following the outbreak of the war in Ukraine, the suspension was extended for another year until the end of 2023. This means that EU member states are allowed to deviate from the stipulation to reach budget deficits of a maximum of 3 percent of economic output (GDP). Consequently, higher debts than in regular times became, and still are permissible.
Moreover, the Commission significantly relaxed the European aid framework to allow member states more flexibility in providing economic aid.

Fiscal Policy Responses:
Governments around the world introduced large-scale fiscal measures to support their faltering economies. These ranged from direct financial assistance to individuals, wage support schemes that allowed businesses to retain employees, grants and loans for businesses facing liquidity crises, to more broad-based measures like tax deferrals and increased public investment. The magnitude of these fiscal packages, in many instances, surpassed those seen during the 2008 financial crisis.

If we take an overall view of the crisis years from 2020 to 2023, the following picture emerges (due to the data on Corona aid, this comparison is only possible for the Euro countries): Luxembourg ranks highest in this list, followed by Austria. There, almost 7,000 Euros per inhabitant were spent on Covid and energy aids between 2020 and 2023. This is followed by Germany with about 6,700 Euros, although this figure would be significantly lower if announced measures were to be utilized less fully.

On average, countries in the Eurozone spent around 5,000 Euros per inhabitant. Major economies like Italy and Belgium are roughly in line with the Eurozone average, while France is slightly below it. A thorough analysis of the crisis of 2020/2021 and 2022 showed that the size of fiscal measures did not at all correlate with the economic losses incurred. Rather, different policy choices lead to highly different outcomes.

Economic Policy: Not Without Controversy
While the aggressive economic policies arguably helped prevent a total economic meltdown, they were not without problems. Concerns about rising public debt, a push for higher inflation, and the moral hazards of bailing out businesses became central to economic and political discourse. Thus, we want to provide an analysis about the virtues and vices of recent public interventions.

2. The good, the bad, and the ugly

Others deepened the crisis or prolonged the huge economic costs by providing crisis-relief instruments for long times.

It is obvious, that no government could ignore the pandemic when conducting economic policy. But the scope and scale of interventions have varied and showed that big government need not translate into smart government. Countries like Denmark with big welfare states have been seen as role models whereas similar sized welfare states like the Austrian have been seen as inefficient. The reason behind their differing outcomes is that not all government interventions are created equal. Economies were resilient to a varying degree. Some provided true short-term relief for an external shock that few firms and households could prepare for. Others deepened the crisis or prolonged the huge economic costs by providing crisis-relief instruments for long times. The same is true for the energy crisis since 2022: some governments provided immediate relief to support hard-hit households, while others started a new binge of new state aid.

From a liberal perspective, the efficiency of government interventions comes down to a number of points. 1. Were they successful at reducing the human or economic cost of the crisis they were fighting against? 2. Did they allow some adaption to changing environments, or were they merely focusing on conserving the current economic structure? This is of particular importance for the energy crisis. If government subsidies are mostly used to prop up demand for energy consumption of oil or gas from Russia, but prices for these goods remain elevated, companies might be lured into technologies that prove to be expensive down the road. 3. Do we need to fund these aid programmes and measures because of risky behavior in the past or due to unfortunate circumstance? To give you an example: Subsidies during the covid-pandemic were particularly high in countries like Austria or Germany because of long and far-reaching lockdowns, which for a prolonged period of time have challenged various industries, from hotels to services. Also subsidies for gas consumption were particularly high in these countries, as they were among the ones that were most reliant on Russian gas and had to diversify sources more than many other European economies.

The good

1. Prioritizing vulnerable groups: Many European governments recognized the importance of supporting those most affected by the economic downturn caused by the pandemic. By focusing on these vulnerable groups, governments ensured that the immediate fallout of the crisis did not disproportionately impact those least equipped to handle it. This approach not only provided immediate relief but also contributed to long-term social stability.

2. Supporting SMEs: Small and Medium-sized Enterprises (SMEs) form the backbone of many European economies, often accounting for a significant portion of employment and economic activity. Recognizing their importance, their vulnerability to economic shocks and less access to capital markets, some governments implemented measures to ensure their sustainability. These measures ensured that the engines of local economies could continue to function and adapt to changing economic landscapes.

3. Enhancing Labor Market Flexibility: The labor market is one of the most critical facets of any economy, and its adaptability determines how quickly an economy can rebound from a shock. Some governments introduced measures that aimed to maintain the link between employers and employees, even in challenging times.

4. The "Kurzarbeit" Scheme: One of the standout measures in this respect was the "Kurzarbeit" or short-term work scheme. Adopted by several European countries, notably Germany and Austria, this approach allowed employees to reduce their working hours, with the government compensating for a portion of the lost wages. The dual benefit of this scheme was that it provided immediate relief to employees while also allowing companies to retain their workforce, thereby avoiding the long-term costs and disruptions of mass layoffs. While taxpayers bore the immediate cost of these programs, the long-term benefits in terms of economic stability and continuity justified the expenditure.

It can be seen as a clearly positive measure that insured that short-term shocks did not lead to an unnecessary loss of qualified workers and employees. It also provided some time for firms to adapt to work-at-home-schemes. All in all, short-term work played an important and mostly positive role in the short-term. However, in countries where it was prolonged due to longer lockdowns it burdened taxpayers with additional debts and kept people in firms that were not able to operate normally and worsened the labor shortages in other sectors.

In conclusion, the good economic measures taken by some European governments during these challenging times demonstrated a balance between immediate relief and long-term strategy. A number of countries swiftly bounced back after the Covid-19 pandemic. By prioritizing the vulnerable, supporting SMEs, ensuring labor market adaptability, and implementing innovative schemes like "Kurzarbeit," these governments showcased a pragmatic approach to economic management.

The bad

1. Inadequate Preparation: The onset of the pandemic underscored a significant lack of preparedness among many European governments. While contingency planning is a staple of good governance, many of the existing pandemic prevention plans were rendered ineffective when faced with real-world scenarios. This deficiency meant that when the crisis hit, governments were scrambling to react, which often led to hasty and less-than-optimal decisions.

2. Inconsistent Data Collection and Measures: Countries like Austria and Germany exhibited a lack of standardization in their responses. Instead of a unified national approach, measures varied at state and even communal levels. This inconsistency likely resulted in confusion among the public, difficulties in enforcement, and challenges in assessing the effectiveness of different interventions. Such a patchwork of policies can also create inefficiencies, as resources might not be optimally allocated and duplicated efforts could arise. Countries like Denmark, on the other hand, benefitted from an already-established data infrastructure that allowed health and economic policy makers to deal with the challenges in a more evidence-based way.

3. Costly Populist Measures: In the face of crises, governments often feel compelled to take action, any action, to appease public sentiment. However, these measures can sometimes be more about optics than efficacy. Implementing costly populist measures without thorough analysis can strain public finances, potentially leading to long-term economic challenges. While these measures might earn short-term political points, they can have lasting economic repercussions.

4. Counterproductive Economic Stimulus during the Energy Crisis: Economic stimulus packages are typically introduced to invigorate a flagging economy. However, during the energy crisis, the massive economic stimuli introduced by some European governments inadvertently exacerbated inflation. Instead of stabilizing the economy, these measures further inflated prices, intensifying the very economic strain they were designed to alleviate.

5. Misaligned Claims and Actions: Politicians often made claims about aiming to reduce the very issues they were exacerbating through their policies. This disconnectedness of political rhetoric and policy outcomes can erode public trust and confidence in government, leading to skepticism about future interventions and their potential effectiveness.

In essence, the challenges presented by the pandemic and the energy crisis illuminated several weaknesses in the economic decision-making processes of many European governments. The lack of preparation, inconsistency in measures, hasty populist actions, and counterproductive stimulus packages all contributed to economic measures that, in many instances, did more harm than good.

The ugly

1. Lack of Coordination and Strategy: One of the most glaring issues was the absence of a cohesive strategy among European governments. The urgency of the pandemic and the energy crisis necessitated swift and structured responses. However, rather than collaborating or developing unified approaches, governments often found themselves in competition. The race to secure essential supplies like masks, health equipment, and LNG from the US showcased a fractured and uncoordinated approach in the beginning, which likely drove up costs and hindered effective distribution.

2. Influence of Lobbying and Corruption:
The intertwining of political interests and economic decision-making often results in policies that may not be in the best interest of the broader public. Lobbying by vested interests can skew priorities and delay or even obstruct necessary measures. The Austrian or the Hungarian government's response to the challenges in the gas market serves as a pertinent example. Their close ties with Russia, possibly influenced by lobbying and geopolitical interests, meant that there was a lag in adapting to the evolving energy situation. Such relationships can distort economic decisions, making them less about the welfare of citizens and more about maintaining political and economic alliances.

3. Short-sightedness: Instead of planning for long-term resilience and adaptability, the focus often seemed to be on immediate remedies. This myopic approach meant that while immediate concerns might have been addressed, the foundational issues that could lead to future vulnerabilities were often neglected. Many countries that saw their data infrastructure fail during the Covid Pandemic, have yet to improve it, because of a failure to improve crisis responses in the medium term.

In summary, while the immediate challenges of the pandemic and the energy crisis were unprecedented, the response by many European governments showcased a series of missteps. The combination of a lack of coordination, opportunistic behaviors, undue influence of lobbying, and corruption, as well as short-term thinking, resulted in economic measures that were less than optimal.

Conclusion:

The 2020/2021 pandemic and the energy crisis of 2022 can be seen as stress tests of how governments enact policy in times of many unknowns and challenges to the society and the economy at the same time. It underscored that in times of profound crisis, passive economic stewardship can be detrimental, but also that sizeable government interventions can worsen situations. Smart rather than big government is of the essence. The pandemic, in highlighting vulnerabilities, also provided a chance to reimagine economic policies for a more resilient future.

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Chapter 4

The State and the market in Viktor Orbán's Hungary

In summary, while the immediate challenges of the pandemic and the energy crisis were unprecedented, the response by many European governments showcased a series of missteps. The combination of a lack of coordination, opportunistic behaviors, undue influence of lobbying, and corruption, as well as short-term thinking, resulted in economic measures that were less than optimal.

Zoltán Pogátsa

The historical beginnings

Both markets and states had existed prior to the beginnings of capitalism.
This fact might sound quite trivial, were it not for the conventional, received definition of capitalism as being a system of 1.) the dominance of private property and 2.) markets as a coordinating mechanism of the economy. In fact, such widespread definitions fail the test of empirical evidence when examined in the face of prior socio-economic historical periods.

According to economic history, capitalism is a system that has been in existence for a couple of centuries. In comparison to the thousands of years of human history, this is a rather short interval. In fact, if we think of all of human history as a day, capitalism has only been around for a few brief minutes.

The question then arises: was there private property, had there been markets prior to the beginnings of capitalism, in previous socio-economic epochs? The answer is obvious: yes.

It is enough to visit a museum to see that in the Middle Ages, as well as in antiquity, private property was in fact the dominant form of ownership, and markets existed to coordinate volumes. In fact, it was from the medieval agricultural market that the "father of economics", Adam Smith took the metaphor of "markets".[1] Thus private property and markets cannot serve as the basis for the definition of capitalism. They simply do not provide a conceptual differentia specifica.

It goes without saying that states had also existed before capitalism. The above museums clearly demonstrate the powers of the medieval Holy Roman Empire or the ancient Upper and Lower Egyptian state.

The above challenge to the traditional definition is hardly altered by the fact that, as it is well documented, earlier economic systems relied heavily on redistributive systems operated by the state. This just proves that the market system was never the only economic coordinating mechanism. It was always complemented by some degree or other of redistribution. Conversely, even the most redistribution-based systems (such as the Soviet style economy, see later), are complemented to some degree by market mechanisms.[2]

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[1] The Hungarian expression, „piac", comes from the Italian name for the venue of the market, the piazza

[2] As demonstrated by the works of János Kornai, who has famously shown that failures of the planned economy, the economy of shortage, is in itself a form of market mechanism, which leads to queues and the persistence of the black market.

Capitalism had to be created. By the state.

Although the concepts of the state and the market are more often than not posed as antagonistic, in reality, right from the very beginning of capitalism they remained intimately intertwined. As the great economic historian Karl Polányi reminds us, "capitalism had to be created", in the forms of markets for capital, land and labour, and the key agent that created it was in fact none other than the state.[3] None of these markers had existed prior to the creation of capitalism. There had been no capital markets, due to a religious ban on the lending of capital, shunned as usury. There had been no market for land or labour either. Land had belonged to the king and was granted to and revoked from landlords. Labour went with it, tied down through serfdom, absent any market mechanism.

Businesses take certain legal forms (partnerships, limited liability companies, etc.), which are defined by law. They sign contracts with each other, and in case of breach, these are guaranteed by the legal system of the state, in courts run by the state. Although initially currency had been private, it soon transpired that a state legal system is better suited to commerce. In addition to the above, the state specifies standards, measurements, health, safety and environmental regulations, all to ensure trust in the markets, ensuring the smooth functioning of manufacturing and commerce.

As can be seen from these simple examples, the very functioning of markets is dependent upon the state.

States versus markets

By the end of the nineteenth century, however, it became more and more apparent that states will increasingly play a more active and pervasive role

[3] (Polany 1944)

than simply guaranteeing the smooth functioning of markets by providing a legal framework. They increasingly took on very interfering functions.

Central banks

Money creation in the era of free private money was carried out by whoever wished to undertake this task, or to be more precise, whoever proved themselves successful at having their money accepted by others in the economy. However, this system proved to be chaotic and inflationary. Almost all states eventually drew the right of money issuance to themselves, in the form of central banks, beginning in the nineteenth century. By the middle of the twentieth, effectively all states in the global economic system had monopolised money issuance, enabling them to implement effective monetary policy. This is a significant strengthening of the state, as monetary policy constitutes one half of economic policy. Of the western states, this process was most conflictual in the United States.

Anti-trust

Another area where states became active was anti-trust, breaking up cartels. Here the famous Standard Oil case or the name of Louis Brandeis will suffice as indications of the beginnings. Throughout the twentieth century, states remained very active in ensuring competition through preventing or eliminating cartels. It was only with the neoliberal state capture by large corporations that trust busting was effectively given up by governments, due to counter-interests by politicians, whose primary financiers became the very same ever larger corporations they were supposed to police and break apart.[4]

Demand management

With the advent of Keynesian economics, states began to take on the role of stabilising the economy. Previously, neoclassical economists had believed that the economy would stabilise itself through lower wages and

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[4] (Tepper and Hearn 2018)

After the more conservative German and the liberal British Models, Western European Welfare states culminated in the Scandinavian Model, the most successful and just form of capitalism to date.

lower prices, inducing rehiring and a rebound of purchases. Keynes proved for them that this was not happening to uncertainty pervading the business sector. He proposed that the state was needed to reignite the multiplier effect by inducing demand through public spending. Keynesian demand management was the default mode of economic policy from the 1930s to the 1970s. It went out of fashion during the neoliberal period but re-emerged after the Great Financial Crisis of 2008.[5]

Welfare states

In overlap with Keynesian demand management, but not identical to it, the Western European models of the welfare state developed from the 1920s onwards. The goal of these models was to ensure social justice. They were all built on sizeable redistribution, taxing, and spending on social mobility. After the more conservative German and the liberal British Models, Western European Welfare states culminated in the Scandinavian Model, the most successful and just form of capitalism to date.

Industrial policy: the developmental state

Another role that states took on, especially in more peripheral, less developed parts of the global capitalist system, was industrial policy. Industrial development by the state was key to the success of all successful economic

[5] (Tepper and Hearn 2018)

convergences to the core of the global economy after WW2, including Japan, Taiwan, South Korea, Singapore, Hong Kong, early Israel, and Ireland. This function culminated in the highly successful Far Eastern Development State Model[6], which even China adopted, starting with Deng Xiaoping.[7]

The omnipotent Soviet state: Bureaucratic State Capitalism

The Soviet-style political and economic system of the Twentieth Century is most often referred to as a.) Communism or b.) Socialism, with the assumption that the latter represented some sort of halfway house towards the former. It is also assumed that Communism as an end goal is defined by the ideology of Karl Marx.

In fact, on closer investigation, the Soviet system cannot be said to be a Marxist political economic entity. As it is relatively well known, Marx had predicted that in his form of Communism both 1.) markets will disappear (along with money, prices, commodity production, etc.), and 2.) the state will wither away.

Awareness of the actual reality of Soviet style systems will reveal that none of this actually transpired in real existing socialism. Not only did the state not wither away, but it became omnipresent and omnipotent. Not only did money not disappear, but it became the central coordinating mechanism of the system. As (Pravilova 2023) demonstrates, Lenin simply could not eliminate money and prices, and so chose instead to make it the central coordinating element. Commodity production remained, as did shops and contracts.

It is true, of course, that the Bolsheviks attempted to eliminate markets as much as possible. Initially, they were even successful, but it soon became evident that a system based entirely on the plan is unviable (as

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[6] (Johnson 1994)
[7] (Vogel 2011)

is, incidentally and conversely, a system based entirely on the market). As early as 1921 Lenin had to resort to reintroducing market mechanisms in the form of the New Economic Policy. This became the blueprint for numerous waves of later rationalisations of the soviet style system, including such notorious attempts as Yugoslav 'self management', the Hungarian 'new economic mechanisms', Gorbachev's 'perestroika, or Deng Xiaoping's 'reform and opening'.

The failure of the planned economy notwithstanding, the Soviet style system cannot be considered a Marxist system. Marx's description of capitalism rested on the notion of 'exploitation', workers not being in control of their means of production. It would have been unfounded to claim that workers in fact controlled their means of production in the Soviet style political economic systems. They clearly did not. This type of a system is best described as bureaucratic state capitalism, as a wide literature has elaborated. (Tamás 2021) is right to call attention to the fact that such a system is closer to developmental, modernisational forms of state capitalisms such as Atatürk's Turkey, Chiang Kai-shek's Taiwan, or early independent India and Israel, than to the original Marxian utopia.

It is also significant, that as (Tamás 2021) also emphasises, as soon as workers in Soviet style regimes realised that neither did they really rule as a class, nor did they control their means of production, the regime had to look for alternative sources of legitimation. In some cases, this meant nationalism (such as in Ceausescu's Romania or Mao's China), in others it consisted of an adoption of the Western European welfare state model (most obviously in Kádár's Hungary, but for a revealing contrast not at all in Mao's China, for instance).

The State and Market in Viktor Orbán's Hungary

Successive governments after the political and economic transition of 1989 chose to run a rather passive state. In terms of ownership structure, privatisation was on the agenda, especially through sales to foreign direct investors, a method Hungary had pioneered in the late eighties, when most other countries were still attempting to create a domestic ownership class. In terms of financing the most crucial redistributive systems (education, healthcare, social policy, public transport, etc), these remained underfunded compared to Western European welfare states, and unequal in terms of access and quality of service. This has led to Hungary having the lowest social mobility in all the European Union. The lack of a proper welfare state has resulted in waves of disappointment amidst the voting population, who had persistently preferred a proper western-style welfare state but had to be disappointed over and over. This process has been especially instrumental in the rejection of the Hungarian political Left, and the rise to power of Viktor Orbán.[8]

When in 2010 Orbán came to power for the second time, there was suddenly an abrupt change. This was observable not in terms of redistribution – Orbán continued to underfinance the subsystems that enhance social mobility. At least he was honest about it.
He claimed – quite contrary to evidence – that the welfare state had failed, and was a thing of the past. He preferred “the workfare state”, a concept from the US Republican South, with roots in Mussolini’s Italy. In fact, Scandinavian welfare states continue to lead almost all international listings, from employment to wages, lowest levels of corruption, social mobility, sustainability, freedom of the press, etc.

Where Orbán’s Hungary suddenly began to use the state was the changing of the ownership structure of the economy. It was rightfully claimed that Hungary had overprivatised towards western multinationals, and previous governments had continued to favour these entities more than the

[8] There is an entire literature on this process by now. See (Éber 2020; Fabry 2019; Gerőcs 2021; Pogátsa 2016; Scheiring 2020; Sebők 2019; Szombati 2018)

domestic ownership class of small and medium sized enterprises.
It was therefore a valid point that the pendulum should now swing back towards more domestic ownership. It could even be claimed that this would bring Hungary more in line with Western European varieties of capitalism, which are not as foreign direct investment dependent (Nölke and Vliegenthart 2009).

Orbán's post 2010 governments made use of the state in various ways to influence the ownership structure of the economy:

- By shaping tax policy in such a way that it would squeeze foreign ownership
- By shaping government regulation to favour domestic owners
- By shaping public procurement (including EU cohesion policy support) to strengthen the domestic ownership class
- By using state owned banks (as well as banks that are closed to the government, often themselves created with the help of the state (Várhegyi 2023)) to provide loans to the domestic ownership class
- By nationalising certain assets, in order to transfer privatise it to other domestic actors.

It is important to stress at this point that the state here is not used the same way as it had been during the Soviet style era. This is important to emphasise because in Hungarian domestic discourse one often finds that narrative that the private competitive market is threatened by the interference of the state. There is even a frequent allusion that the Orbán regime has somehow "returned" to the statist practice of the Kádár era of pre-1990. This narrative is inspired by the fact that many observers – in fact the dominant part of the Hungarian economics profession and many journalists – had been socialised during the latter half of the Soviet-style era. For these observers, the contest is not between different interest groups in the economy, but between the market (always stipulated as being efficient) and the state (always stipulated as being inefficient).

It is therefore important to emphasise that the practice of the Orbán governments is not similar to that of the Kádár regime. The latter's end goal was public ownership, which was maintained throughout the existence of the regime, even if effective control was exercised by the party. In the case of the Orbán regime, public ownership has never been the end goal. In fact, ideologically Viktor Orbán is starkly against public ownership. Nationalisation and other uses of the state are instruments of transfer privatisation, whereby certain private interest groups are being helped into position over others.

Various interpretations of this strategy include:

- Bálint Magyar's thesis that what we are seeing is a "mafia state", whereby a very narrow "family" is usurping state and private resources in the economy for its own use (Magyar 2016). This interpretation insists that Orbán's policies amount to nothing else but de facto corruption.
- A diametrically opposite interpretation by András Lánczi, a leading ideologue of the Fidesz party has famously stated[9] that "what they call corruption is effectively the main policy of Fidesz". He claims that the aim of this policy is to "develop the domestic ownership stratum".
- Other authors, such as (Gerőcs 2021; Scheiring 2020; Sebők 2019) have been critical of both of the above interpretations.
  They deconstruct Lánczi's narrative of a "domestic ownership stratum" by showing that it has not been domestic owners in general who have benefitted from Orbán's policies, but specifically those entrepreneurs who have been close to government circles. In fact, it can be shown that many of the policies of the Orbán government have negatively affected most small and mid-sized Hungarian domestic entrepreneurs, as well as many larger ones. Yet these authors also disagree with Magyar in that Orbán represents some kind of narrow mafia state. If the only beneficiary

[9] https://www.magyaridok.hu/belfold/lanczi-andras-viccpartok-szinvonalan-all-az-ellenzek-243952/

> were Orbán's narrow family, or even a few other families, as in a mafia, these authors argue, then the overwhelming majority of Hungarians would feel disappointed and would turn against Orbán. This, however, is far from the reality. Orbán has repeatedly won election after election: 2010, 2014, 2018 and 2022, not to mention Fidesz-KDNP's success in municipal and European Parliament elections. It is naïve to put this down simply to his control of state media. Much more is behind this success. As these authors show, wide social strata in Hungary have been beneficiaries of Orbán's policies, in terms of ownership, higher employment rates, higher salaries and so on. In fact, Orbán's continued rule is based on the fact that the majority of Hungarians still see Orbán's governance as being more beneficial for them than that of the previous Left-Liberal coalitions (in which Magyar himself was a prominent player). Thus, transfer privatisations and other benefits are clearly much more politically biased than Lánczi admits, but the circle of beneficiaries is decidedly wider than Magyar's mafia image would suggest. In fact, as (Scheiring 2020) emphasises, what we are seeing is a case of an accumulation state. Deeper awareness of previous economic Gründungszeiten would reveal that they all involve a considerable degree of non-competitive interplay between victorious political forces and their cronies, or outright state capture. A handful of telling examples would include the US Guilded Age of the Robber Barons, who also captured state and federal level authorities, as well as the South Korean economic miracle with the creation of the chaebols (holding companies such as Samsung, Daewoo or LG) by the dictator, General Park.

The implications of the above debate are cardinal. Any opposition strategy, for instance, which aims to topple Orbán's government, must be aware what its electoral success is based on. Any suggestion that a post-Orbán era would consist of a return to 2010 politics in terms of policies of personalities is doomed to failure, as it has been proved over and over.

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Conclusion

Although the European Union is a strong alliance of 27 member states, it is an extremely diverse community of nations from societal, political, and economic aspects as well. Each member state has its unique social structure, political system, and economic environment, therefore it is only natural that when a crisis hits the EU's common market, national governments come up with their individual answers to address it. These national level policies, however, exist within the larger European context, and have significant effect both on other member states, and on the EU as a whole. Understandably, national governments prioritise the well-being of their respective countries, including the sectors with the highest local relevance, national businesses, or state service providers. While some governmental measures attempt to provide support to those in need (sectors, companies, or individuals alike), it must be seen, too, that in certain cases decision makers use the opportunity created by the crises to strengthen their political positions, and give further economic advantage to affiliated market actors, even if such practices further erode trust in politics, worsen the relative position of more vulnerable players in the market, and endanger the proper functioning of the free market.

Beyond introducing how certain EU member states responded to the challenges posed by the economic crises of the recent past, the case studies of this publication also shed a light on the deeper interconnections of the state, the structure of political power, and market economy. It is fair to conclude that crisis situations function as searchlights, too: they find and implacably highlight the flaws of a political and economic system, moreover, when managed poorly, crises can further deepen those flaws, and vice versa: the flaws can further deepen the crises. If centralised bureaucracy is an obstacle to the effective operation of businesses, as we saw in the case study on

Portugal, for instance, its negative effects multiply when a crisis requires urgent adaptation.

The lack of proper systemic preparedness, and a lack of consistent data collection and use, as we saw in Austria's case, can reduce the effectiveness of measures, and encumber the optimal allocation of resources. A government that considers the state to be its vessel by which it can strengthen the economic position of certain private interest groups, like the Hungarian one, can take advantage of crisis situations, and can further distort the market in favour of its own preferred and prioritised economic circles.

The conclusions we may draw are two-fold: there are lessons both for national governments and for the EU to be learned. While it is tempting to lay back in relief once pressure on the economy appears to be easing at least temporarily, after a wave of the COVID pandemic, for instance, we live in an age of 'permacrisis', and national governments cannot afford that luxury. The relative calm of mid-crisis, or mid-peak periods must be utilised to increase the resilience of state systems in preparation for another economic challenge. Examples, including the ones detailed in this publication's case studies, have shown that it's not the state's size, or, more precisely, it's not the extent of the state's involvement in the economy that matters from an effectiveness point of view, but it is its smartness, and its ability to address the root causes of the crisis, and to properly target its measures. The policies to adopt may differ from state to state, depending on the already existing political, economic and social structures, but there are certain generic considerations that should be taken into account by every decision maker.

First, in line with the principle of subsidiarity, local knowledge and expertise should be prioritised over centralised solutions. Local actors (such as local civil society organisations, businesses, local governments, the local offices of state authorities, etc.) should be encouraged, empowered, and enabled to be effective parts of a national crisis strategy. This, of course, doesn't mean that there is no need for state level coordination, state funding, or nationwide programmes, but the involvement of local actors as key partners is inevitable for an effective crisis response.

Second, both the short- and the long-term consequences of state interventions must be taken into account during strategic planning because flawed measures, even if they may seem to support certain economic actors in need during a time of crisis, can severely damage the functioning of the free market. Improperly targeted measures, such as indiscriminate support schemes may only incentivise rent-seeking behaviour and provide undeserved and unnecessary advantages to certain market actors.

Third, national crisis strategies should include as many checks and guarantees as necessary to prevent governments from attempting to use crisis situations for political purposes. In Hungary, for instance, the constitutional 2/3 majority of the governing parties in the National Assembly declared a state of emergency due to mass immigration in 2016 (extended ever since in every 6 months); a health emergency due to the COVID pandemic in 2020 (which was in effect in different forms until 2022); and a state of emergency due to the war in Ukraine in May 2022 (extended ever since in every 6 months). This effectively enables the government to govern by decree, even further excluding every other political, economic, or other actor from decision making processes, creating legal and political unpredictability. This, needless to say, has several consequences beyond the economic dimension, but it also carries fundamental threats to the free market. Hungary's case is quite unique due to the excessive and almost uncontrolled power of the governing parties, but it should serve as a lesson to other states why it is necessary to strategically prevent the malicious political use of opportunities created by crises.

As we stated earlier, the conclusion are two-fold: not only states, but also the EU as a whole should learn from crises of the past. National governments may have several reasons not to take the steps described above in preparation for the forthcoming economic challenge: political actors have vested interests in the existing systems; changing deeply rooted mechanisms, even if they are evenly deeply flawed, may come at a political price decision makers are unwilling to pay; or the measures needed to prepare national systems for crises would simply divert funds, energy, and public attention from projects policymakers consider to be more easily convertible to votes in a national election. Political power in the EU, however, is not directly dependent on its member states' national systems, and even if a leading European political actor has some personal political or economic reason to be reluctant to urge the amendment of their home country's structures or mechanisms in order to make them more resilient, there are always other member states whose representatives are not bound by the same circumstances. The EU's primary responsibility is to incentivise member states to increase their national systems' preparedness for crises.

Similarly to, and extrapolating from our argument about the necessity of prioritising local knowledge and expertise over centralised solutions at the national level, the EU should not attempt to resolve the issues of state systems – it would hardly have the legal means to do so anyway. National decision makers are much more aware of their respective countries' vulnerabilities to crises, and of the systemic problems that would need to be resolved (such as extensive bureaucracy, underdeveloped communication among local actors, the lack of proper channels between the state and market actors, etc.). Yet, the EU has the means to push national governments in the right direction.

The Recovery and Resilience Facility (RRF), which is the core of NextGenerationEU, the EU's temporary recovery instrument to support the economy after the COVID pandemic, paves the way: the funds raised by the Commission are intended to be spent by the member states in a way that they make their economies and societies more resilient, and prepared for future challenges. REPowerEU, the plan that was born in response to Russia's unprovoked and unjustified military aggression against Ukraine, is similar in its nature: by incentivising saving energy, accelerating clean energy transition, and diversifying energy sources it directly contributes to reducing the risk factors to European economies. However, these are both reactive measures: they were taken as reactions to the crises Europe – and the rest of the world – had to face. The further EU level mainstreaming of the idea of incentivising EU member states to reform their national systems and structures in a way that they become more resilient to economic shocks, while preventing the states' overpresence in the economy to protect free market competition could largely contribute to the future success of the Union.

The crises of the past years have presented a major challenge to the global economy, and have brought along countless of economic dilemmas, political struggles, and human suffering. One doesn't need to be pessimistic to assume that the series of shocks is not over: armed conflicts around the world, climate change, or mass migration (all interlinked, of course) can affect the global economy in unexpected ways. If we want to make the most out of the crises we have been through, the best we can do is to learn from them, and to prepare for the unexpected.

Authors of the volume

Professor Peter Mihályi

Professor Peter Mihályi (b. 1953) served in Hungary as Deputy Government Commissioner for Privatization in 1994/95 and played a major role in the largest transactions in energy and banking. In 1997/98 he was promoted to Deputy State Secretary in the Ministry of Finance. His portfolio included the pension reform, the preparation of the healthcare reform and municipal financing.

Professor Mihályi has more than two decades of experience in teaching at BA, MA and PhD level. Before his retirement in 2023, he taught in the Institute of Economics at Corvinus University of Budapest. Since 2012, Prof. Dr. Mihályi serves as the Editor-in-Chief of Acta Oeconomica, an English language academic quarterly with an impact factor. His main fields of research are currently linked to the economic aspects of the post-communist regime changes, such as privatization, healthcare – and pension – reforms. His latest book – co-authored with Ivan Szelenyi – is entitled Varieties of Post-Communist Capitalism (2020).

Ricardo Silvestre

Ricardo Silvestre is the Senior policy researcher and International Officer at the Movimento Liberal Social (Social Liberal Movement) think tank in Portugal. He holds a Ph.D. in Philosophy from the University of Connecticut and a master's degree in international Relations from University Lusófona in Lisbon. He is an Associate Fellow, and host of the Liberal Europe Podcast, at the European Liberal Forum, the think tank associated with ALDE Party in the European Parliament. Ricardo's main focus of interest, and published work, are the future of democracy, digital solutions for societal problems, energy transition and the European Union security dilemma.

Lukas Sustala

Lukas Sustala is Political Director of NEOS and Head of the Thinktank at the NEOS Lab, the party's foundation. An economist and journalist by training he previously worked as editor and editor-in-chief for Austrian media companies and as a Deputy Director for the liberal economic Thinktank Agenda Austria.

Zoltán Pogátsa

Zoltán Pogátsa is a professor at the Alexander Lámfalussy Faculty of Economics, University of Sopron. His research interests include the economics of European integration, as well as developmental economics. He has published seven books and numerous professional articles. He is also a frequent commentator in the Hungarian and international press.

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