**Chapter 5: The Political Environment: Politics and Business Intertwined**

**Hungary finds political consensus elusive**

Hungary’s economic development since the fall of communism has rested heavily on FDI. But the country’s Socialist government, which came to power in 2002, presided over a period of economic downturn which eventually led to a political crisis, forcing the prime minister, Ferenc Gyurcsány, to resign in 2009. His government had overseen a period of uncontrolled budget deficits caused in large part by profligate public spending and corruption. Gyurcsány, a former communist youth leader who became a multi-millionaire businessman, had portrayed himself as a modernizer in terms of policy, welcoming foreign investors. He took pride in the decision of Daimler in 2008 to build a large factory in Hungary, winning out over Poland and Romania. However, government finances were spiraling out of control. He later admitted lying about the size of the deficit during the election campaign which his party won in 2006. As the crisis deepened, the public turned against not just the government but also the foreign owners who dominate much of the economy, including the banks. The main opposition party, the centre-right Fidesz Party was eager for the next general election, seeing the political tide turning their way. In the meantime, an interim, non-party prime minister, Gordon Bajnai was appointed, who was able to muster a majority in parliament made up of the socialists and two smaller parties.

When Mr Bajnai took over, Hungary’s economic position was precarious, having suffered in the recession. Its economy was expected to shrink 7% in 2009. He initiated drastic austerity measures, especially taking an axe to public spending. Social spending and public-sector pay were severely affected. These measures helped to bring the budget deficit down from 9.2% of GDP in 2006 to 3.4% in 2009. Hungary’s currency, the forint, seemed to recover, and the threat of a banking crisis receded by the time new elections were called.

Fidesz swept to power in the general election of 2010, giving the new prime minister, Viktor Orban, 53% of the vote, translating into 263 out of the 386 seats. By then Socialist support had evaporated, and they won only 59 seats. To the surprise of many, the far-right Jobbik party won 17% of the vote, giving them 47 seats. A new liberal-green party (LMP, standing for ‘politics can be different’) won 16 seats. With his big majority, Mr Orban promised reforms such as reducing bureaucracy and cracking down on corruption. The country’s ills, including unemployment (at over 11%) and crime, he blamed on the previous regime, in which the business allies of the socialists had flourished. Mr Orban is a vice-president of the centre-right grouping, the European People’s Party in the European Parliament, which has positioned itself as an upholder of democratic and European values. Nonetheless, the party espouses more nationalist values than its predecessors, and sought early on to renegotiate the terms of loans from the EU and IMF, as part of a ‘new partnership’. (*The Economist*, 1 May).

The electoral support for the far right revealed many of the tensions in Hungarian society. The plight of the Roma gypsies, mired in poverty and discrimination, is an issue which governments can help to alleviate, but during times of economic crisis, it is not uncommon for extreme nationalist parties to gain support. Extreme nationalism feeds on people’s economic anxieties, mixing anti-capitalist messages with a picture of a better life under the protection of the nation-state. The extreme nationalist Jobbik party has been perceived as tapping into veins of anti-Semitism and hostility to Roma people, who they blame for much crime. Although Jobbik has lacked the resources to mount media campaigns in the manner of the two main parties, it utilized the internet to put its messages to the electorate, touching in particular discontented young people. The strong electoral showing for the radical right could possibly affect Hungary’s future attraction for international investors. It was hoped by many, including socialist and liberal voters, that if Fidesz won a big enough majority, it would halt the apparently rising support for the extreme right. Mr Orban said on his election, ‘the better the performance of the government is, the weaker the far right will be in the future’ (Bryant, 2010).

Sources: Escritt, T. (2008) ‘Daimler picks Hungary for east Europe factory’, *Financial Times*, 19 June; Bryant, C. (2010) ‘Investment fears on election success of Hungary’s far right’, *Financial Times*, 13 April; *The Economist* (2010) ‘Orban’s triumph’, 1 May; *The Economist* (2009) ‘Gyurcsány goes’, 28 March.

**Questions for discussion:**

* What are the causes of political instability in Hungary?
* Why did Hungary’s Socialists see their support diminish so dramatically?
* To what extent will foreign investors be concerned about Hungary’s economic, social and political environments?

**2016 update:**

Hungary’s political leadership has moved further to the right since this case study first appeared. The ruling Fidesz party, under Prime Minister Victor Orban, won a second 4-year term in elections of 2014. With the help of coalition partners in government, Mr Orban obtained the two-thirds majority of seats in the parliament that he would need in order to alter the country’s constitution. It was feared that after the 2014 elections that Mr Orban would take steps to weaken constitutional institutions and mover closer to an authoritarian model. These fears have proved to be justified. He has become closer in political thinking to Russia’s president, Vladimir Putin, and Russian investment in Hungary has grown. Large Russian projects include a nuclear power station.

Mr Orban has shifted his political ideology considerably further to the right, reflecting his strongly-articulated opposition to western liberal democracy. His vision of Hungary is now a good deal closer to an authoritarian model, based on nationalist sentiment and against pluralism in society. His party is thus closer to the views of the extreme right Jobbick party, which is openly anti-semitic and hostile to the Roma people. There has been a deterioration in Hungary’s adherence to democratic values, including the tolerance of dissent, a free press, an independent judiciary and the rule of law.

Mr Orban has taken a strong stance against migrants entering Hungary. In 2015, the influx of migrants from the Middle East and beyond prompted Mr Orban to bring in harsh anti-immigration laws and to have fences erected along the country’s southern border, effectively preventing migrants from crossing into Hungary from Austria. This route through Hungary had been used by migrants and refugees hoping to make their way to western European countries. The EU has introduced a policy whereby each EU member state would take a quota of migrants, but Mr Orban has been fiercely opposed to the idea of welcoming any migrants in Hungary. A referendum on the issue was held in October 2016. Although the vote went in favour of banning migrants, the turnout was below the threshold required, and the result was of no legal effect.

**The politics of gas in Russia**

With claim to the world’s largest gas reserves, Russia has huge potential for wealth generation from energy exports. The strong state tradition of its vast territory, along with satellite territories over which it has historically exerted control, has made the exploitation of gas pivotal in the eyes of rulers in Moscow. This was true in the former Soviet Union, and remains true today. The break-up of the Soviet communist dictatorship in 1991 marked the start of a period of political and economic instability. The sale of former state assets led to the rise of powerful business oligarchs, the leaders of newly privatized industries. New democratic political institutions promised accountability of government, but became mired in corruption and infighting among new business and political powerbrokers. The election of Vladimir Putin as president in 2000 promised to restore order and refocus the economy. His nationalist message was clear, and he intended to reassert Russian influence in former Soviet territories. This was a message that appealed to the Russian populace, boosting the popularity of his United Russia party. His success would depend heavily on the country’s main source of wealth – its gas industry. Bringing energy under Kremlin control would be crucial to consolidating his political power. Political legitimacy and economic power seemed to go hand in hand.

Gazprom, the former Soviet gas ministry that had been privatized in the 1990s, was restored to state control, headed by a Putin associate. Other resource assets went the same way. Yukoil, the privatized oil company, was broken up and its owners imprisoned; the assets were awarded to Putin associates. In the Russia of Putin, Kremlin-linked individuals became the new oligarchs, able to gain rich rewards but on condition of loyalty to Putin. The economy became concentrated in the hands of these individuals, and, ultimately, under Putin’s political control. In addition, Gazprom bought out Russian media businesses, helping to consolidate Putin’s control of the media.

In a world of rising energy prices, the potential for wealth generation was seen as phenomenal. Russian optimists foresaw Gazprom overtaking companies like US giant, ExxonMobil. Global investors enthused, and Russia was branded a BRIC economy, along with the fast-growing emerging economies of China, Brazil and India. But Russia was different, with a history of industrialization dating from the Soviet era, when its energy resources were a source of its power. In the post-Soviet era, however, the exploitation of Russia’s gas has been dependent increasingly on partnerships with western oil companies. In particular, reserves in harsh locations, such as offshore and in Arctic locations, have seen the involvement of BP, Shell, ExxonMobil and the large service companies such as Schlumberger. In 2008, when Gazprom’s confidence was high, it was valued at $367 billion, but the deterioration in the economic environment by 2015 saw its value slip to just $51 billion (Burke, 2015). The fall in energy prices globally was a big factor. The price of oil had fallen from $100 a barrel to $50 by 2015. The other big factor affecting Russia was sanctions imposed by the western countries whose companies had been active in Russia.

Russia sits on the world’s largest reserves of shale oil, which make up 25% of its total reserves. The US has seen a boom in shale production, and Russia, which has greater shale reserves than the US, hoped to duplicate its success. Exploiting these resources, however, involves fracking technology, in which western companies have developed expertise. In the days of the Soviet Union, all the equipment used in the energy industries was Soviet manufactured. Nowadays, western oil-service companies hold the key, in fracking as well as in the technology to explore and tap resources offshore and in the Arctic regions. Without these companies, Russia’s energy sector is vulnerable to dwindling production. These companies’ activities were restricted by sanctions imposed on Russia when Putin ordered the annexation of Crimea in Ukraine in 2014. Although appealing to Russian nationalist sentiment, the move was damaging economically, and Ukraine became politically destabilized, with violent conflicts between Ukrainian and pro-Russian forces. Russian pipelines that had been delivering gas to European customers were vulnerable to disruption, and the volume of gas flowing through these pipelines declined rapidly. Gazprom’s sales and profits were thus affected by the sanctions.

Gazprom has devised alternative plans for serving energy markets, but all seem to involve huge initial capital expenditure. Northern pipelines to avoid Ukraine are among these projects designed to serve European markets, but the new pipelines would be far more costly than the one through Ukraine. New customers for Russian gas are emerging in China, and, for these customers, too, a new pipeline can be built, but, again, the building of the new pipeline will add hugely to the costs for Gazprom. These costs would look more justifiable in an environment of high global energy prices, but if low prices persist, Russia’s energy dependence creates risks for the economy, and for its political leadership.

It is often observed that the economic and political power concentrated in Putin and his circle of associates has created a system in which the institutions designed to be democratic have become transfigured into mechanisms to support what is effectively an authoritarian regime (Hille, 2015; Thornhill, 2015). Opposition politicians have little voice, and little scope to organize freely. Elections take place, but, in the eyes of one opposition campaigner, they are ‘imitations of democratic institutions’ (HIlle, 2015). The demise of the Soviet Union was seen as ushering in ‘free speech, free markets and a free press’ (Thornhill, 2015). Russia today seems to have none of these.

Sources: Hille, K. (2015) ‘Russia’s elections show Putin-style democracy in action’, Financial Times, 10 September, at www.ft.com; Burke, J. (2015) ‘How Russian energy giant Gazprom lost $300 billion’, The Guardian, 7 August, at www.theguardian.com; Thornhill, J. (2015) ‘Tsar quality’, Financial Times, 7 February; Farchy, J. (2014) ‘Between a rock and a hard place’, Financial Times, 30 October.

**Questions for discussion:**

* In what ways is Gazprom an example of subservience of a company to political leadership rather than business decision-making?
* How has the global political environment affected the Russian energy sector?
* What are the risks faced by western companies when working with Russian companies?
* How stable is Putin’s rule in terms of political and economic conditions?

**The consolidation of presidential power in Turkey: what are the risks?**

Turkey presents a picture of an emerging economy with global ambitions, driven by a political leader, Recep Tayyip Erdogan, who aspires to consolidate his hold on the reins of power. However, the democratic political system which has framed Turkey’s economic development and party politics now seems to be under threat from the forces of the country’s strong-minded president and his Islamist political party. These developments would threaten not just its democratic institutions, but also the secular values that are established in its constitution of 1982. Turkey’s constitution establishes a parliamentary system, in which the government is in the hands of a prime minister, with a non-partisan president as a figurehead. Mr Erdogan and his Justice and Development Party (the AKP) have enjoyed remarkable electoral success since 2002. Having served three terms as prime minister, which is the legal maximum, he shifted his ambitions to the office of president, which he wished to see transformed into a more active executive role – a role in which he would wield executive power. Winning the presidential election of 2013 gave him the political platform for a campaign to change Turkey’s constitution to a presidential one with a strong executive. Changing Turkey’s constitution would require the support of 330 out of the 550 members of Turkey’s parliament in order to authorize holding a referendum. Would the country back the AKP to this extent, impliedly giving the voters’ blessing to a new presidential framework?

Historically, Turkey stands at a cultural crossroads between east and west. Many of its inhabitants look more towards Europe, as evidenced by the fact that Turkey applied for EU membership in 1995. But Turkey today is far from leaning towards the values of democracy and freedom that the EU stands for. Culturally and politically, Turkey is highly divided. The majority party, the AKP, has a broad base in the Muslim population, and has been the force behind Erdogan’s popularity. Its business leaders, many of whom are close to the president, have been the main drivers of Turkey’s economic growth, which reached a high of 8.8% in 2011. Since then, growth has weakened, as export markets for the many consumer products that it produces have stalled.

Turkey has a large westernized population, concentrated in Istanbul. They lean towards more individualistic and liberal thinking, and they tend to see Mr Erdogan as a threat to democratic values, freedom of speech and the rule of law. They also fear that the president is introducing more conservative Islamist policies, despite the constitutional guarantees of secularism. Mr Erdogan has a record of suppressing the activities of the opposition parties and other dissidents, as well as curtailing freedom of speech. Another important cultural grouping in Turkey is the large Kurdish population, linked to the Kurdish militarist group known as the PKK (the Kurdistan Workers Party). A destabilizing factor in Turkish politics has been the civil war raging in neighbouring Syria. While Mr Erdogan has taken a stance against the Islamic State (ISIS) terrorists that are fighting to topple Syria’s government, he was slow to come to the aid of Kurds being overrun by terrorists near the border in 2015. This event had the effect of alienating many of Turkey’s Kurdish people.

Parliamentary elections in June 2015 were inconclusive, and new elections were then called for November, the AKP hoping for a big majority for changing the constitution. The AKP won 317 seats, representing 49.4% of the vote, but this was not sufficient in itself to call a referendum on the constitution. Importantly, the pro-Kurdish party gained 13.2% of the vote, and its members expressed willingness to consider a new constitution. Worryingly, the international monitors for the electoral process reported violent intimidation and arrests of opposition supporters. Mr Erdogan professed satisfaction with the result, and hopes to unite the country behind a new presidential constitution. But, in truth, the country remains highly divided. Polls show that some 57% of Turks prefer to keep the parliamentary system (Cengiz, 2015). Many opponents of constitutional change view the real motive behind Mr Erdogan’s constitutional reform as wanting to increase his power over the system. His plans are for the president to be given powers to issue executive and legislative decrees, and to appoint half the members of the higher courts. It is usual in a presidential system to have separation of powers, along with a system of checks and balances. By contrast, Mr Erdogan seems to be planning to consolidate his power over all branches of government. The vision of Turkey’s future projected by its president is one of strong national will and security. He is confident that his core Muslim electoral support will remain solidly behind him, but other groups in Turkey fear that democracy will suffer.

Sources: Shaheen, K. (2015) ‘Turkey election campaign unfair, say international monitors’, The Guardian, 2 November, at www.theguardian.com; Toksabay, E. and Aslan, M. (2015) ‘Turkey’s Erdogan calls for new constitution as EU frets about rights’, Reuters, 10 November, at www.reuters.com; Cagaptay, S. (2015) ‘Turkey’s divisions are so deep they threaten its future’, The Guardian, 18 October, at www.theguardian.com; Cengiz, O. (2015) ‘Turkey’s path to dictatorship’, Al-Monitor, 12 November, at [www.al-monitor.com](http://www.al-monitor.com).

**Questions for discussion:**

* How has democracy lost ground in Turkey?
* To what extent has Turkey turned its back on possible EU membership?
* How is the rule of law being jeopardized in Turkey?
* How would a new constitution along the lines that Mr Erdogan envisages affect Turkey’s business environment?