

# Corruption in Hungary Involving European Union Funds



**NETHERLANDS  
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# 1. Introduction

This paper presents information on corruption in Hungary involving European Union funds, gathered through desk research. The main source of this information is the *Black Book on Corruption in Hungary between 2010 and 2018* (referred to as *Black Book* in this paper), drawn up by the anti-corruption organisations Transparency International Hungary and K-Monitor, and issued in April 2018 by the Civitas Institute<sup>1</sup>. A 2015 paper by the Clean Air Action Group, *How EU Money has Contributed to the Dismantling of Democracy in Hungary*<sup>2</sup>, is also drawn on (referred to as *Dismantling of Democracy* paper). In addition, information is drawn from reports of the EU's anti-corruption agency OLAF, from academic studies and from investigative journalists.

Chapter 2 covers assessments of and comments on the general issue of corruption in Hungary and European Union funding. Chapter 3 describes a number of cases of (alleged) corruption in relation to European Union funds. Finally, chapter 4 presents a short discussion of possible steps for action by the EU and actors in other EU member states.

The paper intends to inform debates on fighting the descent into institutionalized kleptocratic governance that the world has witnessed in Hungary, accompanied by increasing disrespect for the rule of law, legislative procedures, fairness in elections and space for critical civil society and media. These phenomena, in differing degrees, are also plaguing other European Union countries. The paper's observations (in particular in section 2) and its recommendations (section 4) therefore have more general validity.

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<sup>1</sup> *Black Book, Corruption in Hungary 2010-2018*, <https://transparency.hu/en/news/ti-hungary-releases-black-book-corruption/>

<sup>2</sup> *How EU Money has Contributed to the Dismantling of Democracy in Hungary*, [https://www.levego.hu/sites/default/files/eu-budget\\_democracy\\_hungary\\_2015nov20-honlapra\\_0.pdf](https://www.levego.hu/sites/default/files/eu-budget_democracy_hungary_2015nov20-honlapra_0.pdf)

## 2. Corruption in Hungary and EU funds

*Introduction - 'an inverted version of state capture'*

A range of academic and NGO sources write about corruption on Hungary in alarming terms. The Introduction to the *Black Book* describes 'inverted version of state capture': "In contrast with the classic form of a captured state, where a weak public authority is controlled by influential economic interest groups, in Hungary the public authority, which is uniquely strong in the European Union, continuously maintains a close, non-transparent relationship with the business circles (oligarchs), in which the political actors usually have the final say. In the opinion of Transparency International Hungary, each of the institutions of the state implements the will of the Government, therefore they are an instrument of the government rather than a controlling force."

One of the writers of an acclaimed academic paper on corruption in Hungary<sup>3</sup> touches on the same matter: "In theory, corruption is a secret agreement that circumvents the existing rules, but now – by contrast – the rules and the structure of the state are tailored to fit the corrupt transactions. In the previous era [before 2010] the networks of strong economical and political actors were tied in into police organisations, the prosecution or the National Tax and Customs Authority, by which the controls could be switched off in some cases. Now that Fidesz has set the large controlling organisations and the 'independent' branches of power to manual control, they also switched this control completely off. There is no need to such 'arranging persons' or middlemen anymore, because the system itself is in an almost continuous switched-off state, and this fact imposes a huge risk of corruption."

As stated in the *Black Book*, "corruption is not only aimed at individual enrichment - although it obviously does have such an effect -, it is much more meant to ensure that those in power cannot be held accountable or replaced. It is a solution that can be used to reward members of the clientele selected on the basis of loyalty... Now corruption appears in Hungary not as a result of a malfunction in the operation of the power of the state, but rather as a central characteristic of the operation of the state."

*The political-economic system*

A number of authors use strong-sounding terms to describe the political-economic system: 'oligarchisation', 'kleptocracy', and 'mafia state'.

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<sup>3</sup> Interview with Dávid Jancsics, <https://english.atlatszo.hu/2014/09/20/fidesz-has-set-the-large-controlling-organisations-and-the-independent-branches-of-power-to-manual-control/>

An academic paper by the Corruption Research Center Budapest<sup>4</sup> says in its introduction, “The kleptocratic state has been developing and operating in Hungary since 2010. This can be considered as an extreme case of cronyism, when the resources of the country are no longer distributed to cronies selected by the political leader; instead, political leaders, their fronts and their families become the beneficiaries par excellence.”

Academic (and former Minister of Education) Balint Magyar, who coined the term ‘mafia state’, states<sup>5</sup> that “Hungary is unique in that it moved toward liberal democracy and joined the European Union before changing course and heading toward autocracy. The rest of the region’s mafia states, such as Russia, Azerbaijan, and other Central Asian former Soviet republics, either passed through a period of oligarchic flux, or took a direct path from communist dictatorship to criminal enterprise.”

“In these countries, oligarchs and the organized underworld have not captured the state; rather, an organized ‘upperworld’ of elites have captured the economy, including the oligarchs themselves. The result is a mix between a criminal organisation and a privatized, parasitic state. Most analyses of post-communist autocracies tend to focus on the political institutions and ideologies underpinning the state. But while these regimes make populist appeals, they are not driven by ideology. Their primary concern is to consolidate the ruler’s power and personal wealth through whatever means necessary. In today’s mafia states, key decisions are made through informal mechanisms created by the regime, instead of through formal institutions. In terms of structure and culture, these arrangements resemble an adopted family, which the regime creates by systematically replacing political and economic elites. In a democracy, these elites would be autonomous actors. But in a mafia state, their position is subsumed in a system of patron-client dependency, often through regime-led corporate raiding and rent-seeking. The classic mafia technique of physical coercion is thus replaced with a bloodless, ‘legal’ form of compulsion overseen by public authorities.”

Under the heading ‘The New Oligarchisation’, the *Dismantling of Democracy* paper emphasizes that, “the distribution of free funds irresistibly has attracted all those looking for a quick buck by illegal or semi-legal means. According to the scientific advisor of the Sociological Institute of the Hungarian Academy of Sciences, Imre Kovách, a new phenomenon in the relations between the political and business elite of Hungary has developed.” Introducing a new study of the Institute on the topic, he observed, “The main reason the business elite started to be involved in politics, and to side with political parties and persons, is the fact that Hungary joined the EU, from where thousands of billions of Forints started to flow to us. It was already worth influencing the allocation of this

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<sup>4</sup> István János Tóth and Miklós Hajdu, 2018, *How does the Kleptocratic State Work in Hungary?*, [http://www.crcb.eu/wp-content/uploads/2018/01/mgts\\_2018\\_paper\\_180126\\_.pdf](http://www.crcb.eu/wp-content/uploads/2018/01/mgts_2018_paper_180126_.pdf)

<sup>5</sup> Balint Magyar, 2017, *The EU’s Mafia State*, <http://www.mondialisations.org/php/public/art.php?id=41296&lan=EN>. The term is used by Magyar in several articles and papers, culminating in his 2016 book *Post-Communist Mafia-State: The Case of Hungary*, full text at [https://pds.ceu.edu/sites/pds.ceu.hu/files/attachment/event/773/magyarpost-communistmafia-state-case-of-hungary-final-2016\\_1.pdf](https://pds.ceu.edu/sites/pds.ceu.hu/files/attachment/event/773/magyarpost-communistmafia-state-case-of-hungary-final-2016_1.pdf)

money, and it became possible to get substantial financial resources as winners of applications for grants.”

He explains that, “this oligarchisation (i.e. the rise of influential business circles with a negative effect on political decisions) is extremely harmful for Hungarian society.” He also refers to other studies, which have proved that countries with strong oligarchies fall behind in innovation, and this leads to the economic and political downfall of these nations. In fact, as Kovách points out, in many countries all over the world, the availability of ‘free’ money is an enormous driving force for elite business groups to fight for that money, no matter what the cost is for society. “Present development policy is financed by non-transparent redistribution. It serves only to reward those who are close to the current political power, and it is a hotbed of corruption,” writes József Papp, Professor at the Budapest Corvinus University (university of economics) in his book, which he finished in 2009 (i.e. before the present ruling party, Fidesz came to government). According to his diagnosis, “It is not the market competition, the efficiency which directs the allocation of capital, but the embeddedness in [political] power.”

### Courts

The *Black Book* mentions that among the official bodies the courts stand out as they are “still autonomous actors independent of the power (here we mainly mean the decisions of judges and not the organisational set-up of courts).” With the introduction in 2018 of a new category of Administrative Courts, this assessment will likely be outdated soon. These courts will deal with the legal challenges of decisions taken by state authorities, including on public procurement, election outcomes and police action. The Minister of Justice will have a decisive role in the appointment of judges and many of them will probably come from the public administration sector.<sup>6</sup> A number of other EU member states have similar administrative court systems, which are used by the government to defend the introduction of the new system.<sup>7</sup> However since there were no efficiency and quality problems in the existing system to adjudicate administrative cases, political motives are suspected to underlie the changes.<sup>8</sup>

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<sup>6</sup> See descriptions and assessments by the Hungarian Helsinki Committee, December 2018, *Blurring the Boundaries: New Laws on Administrative Courts Undermine Judicial Independence*, <https://www.helsinki.hu/wp-content/uploads/Blurring-the-Boundaries-Admin-Courts-HHC-20181208-final.pdf> and Verfassungsblog, Jan 2019, *An Advanced Course in Court Packing: Hungary’s New Law on Administrative Courts*, <https://verfassungsblog.de/an-advanced-course-in-court-packing-hungarys-new-law-on-administrative-courts/>

<sup>7</sup> Zoltan Kovacs, Dec 2018, *Administrative courts established in Hungary amongst the sound of sirens and whistles*, [https://index.hu/english/2018/12/12/administrative\\_courts\\_minister\\_of\\_justice\\_unprecedented\\_powers\\_in\\_dependence\\_separation\\_of\\_power/](https://index.hu/english/2018/12/12/administrative_courts_minister_of_justice_unprecedented_powers_in_dependence_separation_of_power/)

<sup>8</sup> See e.g. scathing criticism by Amnesty International, Dec 2018, *New Law Adopted to Eliminate the Independence of Judiciary in Hungary*, <https://www.amnesty.hu/news/2557/new-law-adopted-to-eliminate-the-independence-of-judiciary-in-hungary>

The implementation legislation was part of a hotly contested package of bills that was adopted by parliament in December 2018 but most public and media attention at that time went to the so-called ‘slave law’ on employees’ overtime.

### *History – before and after 2010*

While the start of the current Fidesz government in 2010— with its continued majorities in parliament after elections in 2014 and 2018— is described in most of the reviewed literature as the start of systemic corruption, corruption definitely occurred beforehand.

The *Black Book* states, “Severe forms of corruption had been present in Hungary in the period before 2010 as well,” and, “TI Hungary pointed out in 2008 already that ‘corruption shows signs of becoming institutionalized,’ and determined that ‘the phenomenon of corruption in an institutionalized form is present in economic life with a non-negligible weight.’ The current corruption goes beyond the transactions, traditional bribery and kickbacks, and takes on a systemic nature. The most important risk of corruption is the distortion of the institutional system itself.”

Balint Magyar already saw the threat of the emergence of a ‘mafia state’ around the year 2000.<sup>9</sup> In his book *Post-Communist Mafia-State* he speaks about “alternating corrupt regimes” when describing the pre-2010 period and when categorizing the still-existing situation in neighbouring states. “The post-communist states that were admitted to the EU—with the exception of Hungary— can be described in varying degrees as the alternation of corrupt regimes. In their cases an electoral system that is proportionate—or only slightly disproportionate—guarantees the most secure institutional constraint on any political force gaining exclusive power. At the same time, this situation ensures the relative autonomy of the oligarchs appearing in the given society, and thereby their bargaining position against the various political forces aspiring to government. Therefore they can make deals with a number of rival political forces simultaneously, without the danger of any one of these forces subjugating them through pure political violence.”

As the foreword<sup>10</sup> to Magyar’s book says, this was also the pattern in Hungary until 2010: “Before the Orbán revolution, economy and politics were deeply intertwined in a novel arrangement that could not be described as state control of the economy (socialism) nor as the economic control of the state (state capture). [...] Economic and political tools were used in tandem to hold a governing elite in place in a system of mutual corruption. Economic power corrupted politics and political power corrupted the economy. But because the agreements among allegedly competing players were stable for a number of years, Hungary appeared to have made a model transition. [...] In 2010, this situation abruptly ended when Orbán’s constitutional majority allowed him to rewrite all of the rules in an aggressively anti-liberal direction. With his new powers, he cut all of his cross-party

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<sup>9</sup> According to this review of *Post-Communist Mafia State*, <http://hungarianspectrum.org/2016/02/19/balint-magyars-latest-book-post-communist-mafia-state-the-case-of-hungary/>

<sup>10</sup> By Kim Lane Scheppele, Laurance S. Rockefeller Professor of Sociology and International Affairs, Princeton University

partners-in-corruption out of their various secret joint deals. Orbán, in Magyar’s telling of the story, was then able to monopolize the benefits of corruption for himself and his party, using state power to choose his own preferred oligarchs and to provide endlessly ingenious ways of siphoning public assets into private hands.”

The post-2010 development seems to follow up on the analysis Orbán already made in 1994, when reflecting on failures of conservative prime minister Antall, who had lost the elections: “[Antall had] neglected to cultivate personal contacts with the eight to ten big capitalists... What should have been done with them? Make it clear in front of the bankers that these eight to ten people are our people. (...) These people could have been helped in the investment funds, in the calls for tenders...”<sup>11</sup>

### *Research into corruption*

As in other countries, investigative journalism significantly contributes to knowledge about corruption. In Hungary, journalist collectives *Atlatszo*, <https://english.atlatszo.hu/>, and *Direkt36*, <https://www.direkt36.hu/en/>, are the main producers of corruption-related information. Their name will appear a number of times in the case descriptions in Chapter 3 of this paper.

In the NGO sector, K-Monitor, <http://k-monitor.hu/home> and Transparency International Hungary, <https://transparency.hu/en/>, are the main researchers and advocates.

In academia, several approaches are being entertained. Some researchers are looking at organisational processes facilitating corruption, and how power in organisations can be used to ‘legalize’ corruption and deactivate external and internal controls, trying to go beyond viewing corruption as an individual act based on greed.<sup>12</sup>

Other studies use large data sets and statistics to analyse primarily public procurement procedures and the likelihood of favouritism and overpricing of politically well-connected tenderers. Research that compares average companies with companies owned by persons with close ties to politics (identified by their owners’ surnames as MGTS) shows that “prices for tenders won by MGTS companies exceeded real market prices and thereby resulted in a maximum social loss.”<sup>13</sup> The most extreme figures were obtained for Lőrincz Mészáros (childhood friend of Orbán) and István Tiborcz (son-in-law of Orbán).

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<sup>11</sup> Page 35 of *Orbán: Hungary’s Strongman* by Paul Lendvai, 2018; Lendvai quotes from an earlier biography by József Debreczeni

<sup>12</sup> Istvan Javor and David Jancsics, *The Role of Power in Organisational Corruption: An Empirical Study*, link at the bottom of this interview with Jancsics, <https://english.atlatszo.hu/2014/09/20/fidesz-has-set-the-large-controlling-organisations-and-the-independent-branches-of-power-to-manual-control/>

<sup>13</sup> István János Tóth and Miklós Hajdu, 2018, *How does the Kleptocratic State Work in Hungary?*, [http://www.crcb.eu/wp-content/uploads/2018/01/mgts\\_2018\\_paper\\_180126\\_.pdf](http://www.crcb.eu/wp-content/uploads/2018/01/mgts_2018_paper_180126_.pdf)



The letter S corresponds to Lajos Simicska who after 2014 came into conflict with Orbán;<sup>14</sup> “as a result Simicska’s people in the government have been replaced by those of other oligarchs with close relations with Orbán, and EU funds started to flow to other oligarchs close to Orbán,” as the *Black Book* states.

### *Corruption and EU funding*

The nature and scope of money flows from the EU Structural and Investment Funds<sup>15</sup> make them susceptible to fraud and corruption.

The *Black Book* states: “Annually, Hungary receives a support of more than one thousand billion forints from the budget of the European Union. 50 to 60 % of all public procurements in Hungary are co-financed by the European Union. In the Union budgetary cycle for 2014-2020 Hungary is receiving almost eight thousand billion forints (25 billion euros) in financial support; at an annual level this constitutes 3 to 4 % of the Hungarian GDP on average (however, in 2016 and 2017 it was approximately 6 to 7 %).

This increase in 2016 and 2017 seems to provide support for a thesis put forward in the *Dismantling of Democracy* paper, that EU fund expenditure is used to boost government support ahead of elections. The paper argues that economic ‘growth’ was achieved in 2013 and 2014 by much higher spending than before from EU funds, ahead of the 2014 elections. “Now”, the paper says, “Fidesz is planning to repeat the same trick, and distribute in 2017 most of the EU money available for the funding period 2014-2020 (the next national elections will take place in 2018).”

The *Dismantling of Democracy* paper is very critical about EU funds in general: “The purpose of this money is in principle to contribute to the achievement of the economic, social and environmental goals of the country set forth in various EU and national documents. However, there is little or no evidence that the vast amount of EU money inundating Hungary during the previous period (2007-2013) improved the general situation of the country in any of these fields. On the contrary, the competitiveness of the economy has been reduced, the educational system has greatly deteriorated, the health care system is in ruins, innovation has been stifled, environmental problems have worsened in many aspects, social inequalities have substantially increased, and democracy has been undermined.”

The paper talks about an ‘enormous market distortion’: “It is in itself a serious problem that EU grants land in highly disproportionate numbers at persons and companies with close relations to the ruling political party, but even if this phenomenon would not exist, the way EU funds are being distributed would still be making a mess of Hungary’s economy, and would contribute to the dismantling to democracy. A large part of EU funds is given directly to individual companies.

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<sup>14</sup> See e.g. *Inside the fall of the oligarch who turned against Viktor Orbán*, <https://www.direkt36.hu/en/feltarul-simicska-bukasanak-titkos-tortenete/>

<sup>15</sup> [https://ec.europa.eu/regional\\_policy/en/funding/](https://ec.europa.eu/regional_policy/en/funding/)

Generally, this occurs according to a scheme in which companies submit applications in order to gain public funds, and public officials decide which companies will obtain grants from such public funds, and how much. This method of the allocation of EU money seriously distorts the market and makes the prospects of any business unpredictable. Just one example, to clarify the situation. A substantial amount of EU money has been spent to support the construction of new hotels. This can clearly be interpreted by all persons and companies which had invested into the hotel business earlier with their own money and their own risk, that they made a mistake: it is not worth competing on the market for the costumers by better products and services, but they should vie for public funds instead. Moreover, such funding often leads to unnecessary spending of the taxpayers' money. In the given case, even the Hungarian Hotel Association expressed strong criticism of state subsidies for hotel construction, emphasising that existing hotels are often struggling for survival. Such results of EU funding are characteristic not only for the hotel industry but practically all sectors of the Hungarian economy.”

Several leading Hungarian economists have warned about the distorting effects of EU funds. For example, Attila Chikán, professor at the Budapest Corvinus University and former Minister of Economy (during the first Orbán government, in 1998-1999) recently stated in an interview: “We use EU funds with very low efficiency ... EU money is not valued, and not only in the public sphere: entrepreneurs often buy machines for which they have no or little need, and when we ask why they purchased them, they answer that it was for free.” All this has led to a situation, where practically no business circle or company steps up (at least not openly) against the new oligarchisation and the dismantling of democracy. The reason is obvious: all companies already either received or hope to receive in the future some public money some time, either directly or indirectly (as subcontractors of other companies).

The *Black Book* refers to 2015 research by Transparency International Hungary that showed that, “the abundance of resources creates a risk of corruption in and of itself, since each government in power after the accession of Hungary to the European Union has had the primary goal of spending all of the funds it had available as fast and as completely as possible. Given the pressure to spend, the planning of the projects, and the utility and substantiation of the selected projects were of secondary importance. The auditing of the projects has not been a priority either, since it would only prevent the utilization of resources.”

“The organisations deciding on the beneficiaries of European Union resources and those that control the spending of the funds and plan the supported projects are, in fact, parts of the same managing authority, i.e. they are under the same political leadership (the authority of the Deputy State Secretary, and ultimately of the Minister). Therefore the controlling bodies have a vested interest in not regulating the projects, since regulation would, on the one hand, slow down the utilization of the resources, and, on the other hand, could incriminate the Government by exposing that the relevant beneficiary was not selected with proper care if deficiencies or irregularities were discovered as a result of the audits.”

“Since the Government intends to spend this huge amount of money as quickly as possible, it is common that the individual projects are over financed, i.e. much higher sums are authorized than would be necessary. This is further compounded by insufficient control. These two factors have highly contributed to the overpricing of European Union projects becoming a general phenomenon. According to the 2015 research cited above, based on the expert estimate of TI Hungary relying on interviews with public figures and beneficiaries, overpricing may affect over 90 % of the projects, with an average rate of overpricing of 25 %.”

#### *OLAF: European Anti-Fraud Office*

The European Anti-Fraud Office (OLAF) is the EU body mandated to detect, investigate and stop fraud with EU funds. Investigations by OLAF cover only a tiny fraction of EU funded projects<sup>16</sup>, but investigations are usually launched when there is reason to suspect irregularities, e.g. after journalistic reporting. As a result of its investigations, OLAF can issue financial as well as judicial recommendations. The latter category applies to situations where criminal law may have been violated. Information is transmitted to national prosecution services who are responsible for pursuing the case (or deciding to dismiss it).

In this category, in 2017, ten investigations relating to Hungary were concluded by OLAF, seven of them ‘with recommendations’ (about possible violations). In 2016, 13 investigation were concluded, 11 with recommendations. OLAF also provides data on the follow-up by the prosecution office. Over the period 2010-2017, an indictment had been issued in eight cases, while nine cases had been dismissed. On a total of 20 cases, no decision had yet been taken.<sup>17</sup>

Of the cases where a decision has been taken, the indictment rate is 47%. This places Hungary slightly above the EU average of 42 %. OLAF is not satisfied with the over-all follow-up rate and looks forward to the creation of the European Public Prosecutor’s Office that will be mandated to investigate and prosecute fraud and corruption involving EU funds, presumably building on work already done by OLAF. Currently, “in numerous Member States, after receiving the OLAF final report, prosecutors carry out all the investigation activities once again in order to acquire admissible evidence. Sometimes, despite considerable investigative efforts deployed by the Office, its limited investigation powers and practical possibilities do not allow to collect conclusive evidence of a criminal offence.” Hungary, however, has not agreed to join EPPO until now.

Information about the cases in which OLAF has issued recommendations does not automatically become public. In March 2018, the Hungarian Prosecutor General sent a letter<sup>18</sup> in response to criticism about his office’s follow-up practices of OLAF recommendations (see Chapter 3 of this

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<sup>16</sup> The *Black Book* says that in the seven-year budgetary period from 2007 to 2013, over 60,000 projects funded in part or fully by Union resources were implemented in Hungary alone

<sup>17</sup> The *OLAF Report 2017*, [https://ec.europa.eu/anti-fraud/sites/antifraud/files/olaf\\_report\\_2017\\_en.pdf](https://ec.europa.eu/anti-fraud/sites/antifraud/files/olaf_report_2017_en.pdf)

<sup>18</sup> [in Hungarian] <http://ugyeshseg.hu/wp-content/uploads/sajto2/2018/03/dr.-polt-peter-legfobb-uegyesz-levele-ingeborg-grasse-reszere-hu.pdf>

paper, section on the Elios affair). The letter, sent to MEP Ingeborg Graessle, head of the Committee on Budgetary Control of the European Parliament, contains a list of all cases since 2009. The total number of cases and of cases pursued and dismissed are in line with OLAF's 2017 report. The list includes a brief description of the subject of each case; investigative journalism group Atlatzso has started to follow them<sup>19</sup>.

### *Political reaction*

Over the course of the years, several political figures have quit Fidesz over their rejection of corrupt practices. In 2013, Prof. Dr. József Ángyán, Member of Parliament at that time, left Fidesz, declaring that he is not willing to support any more the unfair practices of the party. Ángyán, who is also a renowned and highly respected university professor, said that “Out of the about 70 Members of the Government (Ministers, State Secretaries) 8 or 10 were appointed by the Prime Minister, all others were in fact appointed by organised crime groups.” He underpinned his statement with concrete examples.<sup>20</sup> He had been Member of Parliament since 2006, and served as Secretary of State for Rural Development from June 2010 till January 2012. He resigned over disagreement on state land lease policies and raised shady relations between the government and some Hungarian ‘oligarchs’.<sup>21</sup>

Later, Ángyán unsuccessfully ran for a parliamentary seat during the 2014 parliamentary election as a candidate of the Human Chain for Hungary.

A second high profile case was Ákos Hadházy, a local Fidesz politician from Szekszárd. He left Fidesz in 2013 in rejection of corruption and favouritism (see Chapter 3, The Elios affair). He joined opposition party LMP (Politics Can Be Different), and became a Member of Parliament in 2016. He led LMP in the 2018 elections but, after a disappointing performance, stepped down as party leader, and subsequently left the part altogether. He has his position continued as an independent Member of Parliament.<sup>22</sup>

Hadházy uses his parliamentary position as a platform for anti-corruption campaigning, and has embarked on the collection of 1 million signatures calling for Hungary to join the European Public

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<sup>19</sup> The first article, dated 20 Jan 2019, reports about a case of embezzlement of EUR 140.000; the main culprit was (on appeal) served a 1 year and 10 months suspended prison sentence; <https://english.atlatzso.hu/2019/01/20/olaf-cases-in-hungary-first-defendant-in-fake-dog-fitness-case-given-suspended-prison-term/>

<sup>20</sup> From *Dismantling of Democracy*, [https://www.levego.hu/sites/default/files/eu-budget\\_democracy\\_hungary\\_2015nov20-honlapra\\_0.pdf](https://www.levego.hu/sites/default/files/eu-budget_democracy_hungary_2015nov20-honlapra_0.pdf)

<sup>21</sup> See *Hungary: “Oligarch” is the New Buzzword of the Hungarian Net*, <https://globalvoices.org/2012/05/09/hungary-oligarch-is-the-new-buzzword-of-the-hungarian-net/>

<sup>22</sup> Ákos Hadházy, [https://en.wikipedia.org/wiki/%C3%81kos\\_Hadh%C3%A1zy](https://en.wikipedia.org/wiki/%C3%81kos_Hadh%C3%A1zy)

Prosecutor's Office, a position that is widely supported according to opinion polls, but is not supported by the government.<sup>23</sup> By the end of 2018, 380,000 signatures have been collected.<sup>24</sup>

From outside the political establishment, the Momentum movement has recently gained significant attention. Formed as an ad hoc group in early 2017 to oppose Budapest's bid to host the Olympic Games, they have since continued on to form a political party. They claim to represent a new political generation, stating "We founded Momentum because we believe that we have to do something about the current political situation in Hungary. Our leaders mismanage our already limited resources: corruption, the institutionalized role of oligarchs, lack of democratic decision making, and the state capture of formerly independent institutions are all a drain on Hungary's economic and political development."<sup>25</sup>

In the 2018 elections Momentum failed to reach the threshold for entering Parliament, but they continue activities, contributing in late 2018/ early 2019 to continuous street protests against government policies including the so-called 'slave law'. Their demands include the continued independence of the courts and joining the European Public Prosecutor's Office.<sup>26</sup>

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<sup>23</sup> See Ákos Hadházy, *Earlier, Soviet Tanks sustained a Dictatorship, now EU Money Does*, <http://hungarianspectrum.org/2018/10/30/akos-hadhazy-earlier-soviet-tanks-sustained-a-dictatorship-now-eu-money-does/> and [Dutch] Hadházy de Galliër, <http://sargasso.nl/hadhazy-de-gallier/>; on government rejection, see <http://hungarianspectrum.org/2017/01/29/an-eu-prosecutors-office-would-be-a-heavy-blow-to-viktor-orban/> and <http://hungarianspectrum.org/2016/12/11/not-on-viktor-orbans-christmas-list-a-european-public-prosecutor/>

<sup>24</sup> [https://index.hu/belfold/2018/12/20/europai\\_ugyeszseg\\_korruptcio\\_alairasgyujtes\\_hadhazy\\_akos/](https://index.hu/belfold/2018/12/20/europai_ugyeszseg_korruptcio_alairasgyujtes_hadhazy_akos/)

<sup>25</sup> <https://momentum.hu/momentum-hungary-new-political-generation/>

<sup>26</sup> See five point program included in this media report, <https://www.euronews.com/2018/12/18/why-are-people-protesting-in-hungary-euronews-explains>

### 3. Cases of corruption involving EU funds

Part II of the *Black Book* provides a short description of thirty corruption cases, attempting to provide insight into different types of corruption, but not aiming to be comprehensive. A number of cases, with varying characteristics relating to the use of EU funds are described here. The first one started before the current Fidesz government. Its description sheds some light on the difficulties in prosecuting for alleged corruption and on the highly politicized atmosphere in which they take place. The other cases occurred after 2010. The descriptions below are based on information from the *Black Book*, if additional sources are used, this is specifically mentioned.

#### *Budapest no. 4 subway*

In 2003, Gábor Demszky, the (liberal) mayor of Budapest at the time, signed a contract with the Government on the expansion of the no. 4 subway line. In order to receive funds of 260 billion forints (814 million EUR) from the European Union, the return on investment indicators of the feasibility study had to be over-estimated. A total cost of 480 billion (1.5 billion EUR) forints was indicated as necessary for the implementation of the first and the second stage. The European Commission authorized aid for the support of the first stage of the no. 4 subway line, but instead of the expected sum of 260 billion forints (814 billion EUR), the EU granted 181 billion forints, the lower sum was granted on the grounds that financial support for 11 out of the 50 contracts was not permissible. These contracts had been concluded without an open tendering. Most of these funds were provided by the European Investment Bank.

In 2009 DBR, the company in charge of implementation, announced the costs of the first stage alone would be as high as 365.5 billion forints (1.4 billion EUR), and the completion of the project could drag on until 2013. Eventually, in 2012 the Government set the total budget of the first stage, of which 181 billion (567 million EUR) was paid by the EU, 193.7 billion (607 million EUR) by the State of Hungary and 78 billion (244 million EUR) by the Municipality of Budapest. The metro line was delivered in March 2014. The tunnels were drilled by Bamco Consortium made up of Vinci of France, subsidiaries of Strabag of Germany and Hídépítő Zrt. In addition to them, Swietelsky Építő Kft. also participated in the construction of the stations. The subway cars were supplied by Alstom of France.

Atlatszo reported in 2013 that, “the project has also been dogged by persistent rumours of corruption. An investigation was launched into the ever-growing budget as part of one of the ongoing lawsuits involving Attila Antal, former head of the Budapest public transport company (BKV). Antal accused erstwhile Budapest deputy mayor Miklós Hagyó of accepting bribes from the rail construction company Swietelsky, which prompted police searches at the metro project directorate (DBR). Antal later apologised to Hagyó, but the state audit office (ASZ), the government



supervisory office (Kehi) and an independent supervisory engineer of the metro also probed the investment's legality. The ASZ then pressed misuse of funds charges in 2010.”<sup>27</sup>

Hagyó, a member of parliament until the 2010 elections, was detained the day after he left parliament, suspected of organizing criminal activities including bribery and extortion. In addition to the accusations by Antal, the testimony of former BKV senior manager Zolt Balogh played a role in his arrest and subsequent prosecution. Balogh had made allegations about Hagyó demanding 15 million forints (47,000 EUR), which he then transferred to him in a Nokia mobile phone box; this story was published in March 2010 and was used extensively by Fidesz in the election campaign of that year.

Hagyó's detention and prosecution became the subject of major public controversy and accusations of politicized decision-making on the pre-trial detention (for which the European Court of Human Rights found Hungary to have breached Hagyó's rights<sup>28</sup>) and on the transfer of the case to a presumably pro-Fidesz judge.<sup>29</sup> During the trial, both Antal and Balogh retracted their testimonies, and most of the prosecution's charges fell apart. Ultimately, in September 2017 Hagyó was convicted for instigation to embezzlement and sentenced to a suspended prison sentence of one and a half years, a sentence criticized by Fidesz for being “outrageously light.” Co-defendants Antal and Balogh also received suspended prison sentences.<sup>30</sup>

Accusations of direct abuse of EU funds did not play a role in this episode. OLAF started investigating the case in 2012 and finalized its report in November 2016. The government then, exceptionally, made it public in January 2017,<sup>31</sup> using it as a showcase to denounce corruption in the pre-2010 period.<sup>32</sup> The OLAF report explored a damage of about 167 billion forints (523 million EUR) in the no. 4 metro investment project, therefore the European Commission may impose a fine of 76.6 billion forints (240 million EUR) (87 billion forints according to other sources) on Hungary. According to István Tarlós, the present (Fidesz-supported) mayor of Budapest, ultimately the amount to be refunded may be about 59 billion forints (185 million EUR), which may have to be paid by the Government.

Almost all of the ‘irregularities’ found by OLAF occurred in contracts signed by six large firms: Siemens AG, the largest manufacturing and electronics company in Europe; Swietelsky, an Austrian construction company from Linz; Strabag, the largest construction company in Austria; a Hungarian

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<sup>27</sup> From <https://atlatszo.hu/2013/11/27/atlatzo-hu-compiled-a-selection-of-budapest-corruption-stories-to-mark-the-140th-anniversary-of-the-citys-foundation/>

<sup>28</sup> See <http://hudoc.echr.coe.int/eng?i=001-118647>

<sup>29</sup> See e.g. information contained in [https://en.wikipedia.org/wiki/Mikl%C3%B3s\\_Hagy%C3%B3](https://en.wikipedia.org/wiki/Mikl%C3%B3s_Hagy%C3%B3) (not updated till end of trial), <http://hagyofiles.blogspot.com/>, <http://www.hagyomiklos.com/en>

<sup>30</sup> <https://dailynewshungary.com/former-budapest-deputy-mayors-sentence-embezzlement-reduced/>

<sup>31</sup> [https://index.hu/assets/documents/belfold/budapest/olaf\\_final\\_report.pdf](https://index.hu/assets/documents/belfold/budapest/olaf_final_report.pdf)

<sup>32</sup> See e.g. <https://hungarytoday.hu/government-official-m4-construction-corrupt-case-hungarys-13-year-eu-membership-56433/>,

company called Hídépítő Zrt., which builds bridges and roads; the BAMCO consortium (Vinci CGP, Strabag, Hídépítő Zrt); and Alstom, the French multinational company operating worldwide in rail transport, including the manufacture of metro trains.

In regard to Alstom, OLAF reached out to Péter Medgyessy, Prime Minister in 2002-2004, who received EUR 600,000 in 2007-2008 from Alstom for two years of consulting. This payment occurred after Alstom won the tender with what was apparently the worst offer. Medgyessy naturally claims that his consulting firm had nothing to do with the Alstom case, adding that it is a well-known fact that his relationships with Prime Minister Ferenc Gyurcsány and the liberal SZDSZ leadership of the City of Budapest were strained.<sup>33</sup>

OLAF did not ask Alstom for a response on this point, as they would normally do before publishing a report, at the request of UK prosecutors who were working on the prosecution of Alstom on their actions in securing contracts for the Budapest metro. The UK case against Alstom led to a judgment in December 2018. While Alstom executives were found guilty on charges relating to other countries, allegations on bribes paid to public officials in Hungary to secure contracts to supply rolling stock to the Budapest metro ended with not guilty verdicts for the company and for three directors.<sup>34</sup>

#### *The Emergence of Lőrinc Mészáros*

Lőrinc Mészáros is a Hungarian entrepreneur, and mayor of the village of Felcsút since 2011, with the support of Fidesz and KDNP. Felcsút is the village from which Orbán originates. The fast enrichment of Mészáros, originally a pipefitter, induced significant political debates, due to his accumulation of massive wealth with little to no financial resources within a few years. By 2018, he had become the richest person in Hungary. Many observers name the political support of the Government and his personal connection with Viktor Orbán as the cause, but according to the parties of the opposition Mészáros is in reality the “front man of Viktor Orbán.”

The bias related to the allocation of public procurement contracts contributed in a major way to the staggering enrichment of oligarchs associated with the government. While in 2016 the net wealth of Mészáros ‘only’ amounted to 35 billion forints (110 million EUR), which earned him the 28th place on the Forbes list of the richest Hungarians, in 2017, he was ranked at 8th place with a new wealth of 105,7 billion forints (331 million EUR) and in 2018 he rose to 1st place with a net wealth estimated at 381 billion forints (1.2 billion EUR).

Public procurement data indicate that various companies, in which Lőrinc Mészáros or his close relatives hold stake, won public procurement contracts totalling 476 billion forints (1.5 billion EUR) from 2010 to 2017. A large majority of this sum, 83 %, i.e. a net amount of 396 billion forints (1.2

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<sup>33</sup> Taken from discussion of the OLAF report at <http://hungarianspectrum.org/2017/02/06/metro-4-the-largest-case-of-hungarian-fraud-and-corruption/>

<sup>34</sup> *Three Alstom executives guilty of conspiracy to corrupt*, <https://www.theguardian.com/law/2018/dec/19/alstom-executives-found-guilty-of-conspiracy-to-corrupt>



billion EUR), came from the European Union. Most of these amounts were realized in the year 2017, with a total of 310 billion (1 billion EUR), of which 251 billion (780 million EUR) (80 %) originated from EU funds.<sup>35</sup>

In 2017, Mészáros's business empire embarked on buyouts in a fast pace: in the span of six months he increased the assets of his companies by 45 billion forints (141 million EUR). He completed most of these transactions through OPUS Globál (formerly Opimus and Konzum) Nyrt., today a company floated in the stock market.

In January 2019, investigative website Atlatzso reported analysis which showed Lőrinc Mészáros “became the richest person in Hungary.” “The former gas pipe fitter and Viktor Orban’s childhood friend from his home village is increasing his wealth miraculously,” stated the website.<sup>36</sup> Atlatzso elaborated, “However, his riches might have more to do with EU funds and taxpayer money than magic. His companies won the most taxpayer-funded public tenders last year. The contracts were worth 265.18 billion Hungarian forints (EUR 826 million at today’s exchange rate) and 93 percent of that money came from the European Union.”

The name of Mészáros appears in a lot of reporting about corruption in Hungary. Most attention has been paid in international media<sup>37</sup> to the development of football facilities in Felcsút. A youth training centre, established next to the Prime Minister’s home in Felcsút and owned by Lőrinc Mészáros, has received substantial support to a special corporate tax scheme (TAO); of the budget of 3.1 billion forints (9.7 million EUR) of the stadium in Felcsút, 2.55 billion (8 million EUR) were covered by the TAO support.

The TAO scheme put in place by the Fidesz government allows corporate tax payers to offer funds for preferred aims, such as the support of cinematographic work, organisations of performing arts, or certain team sports. The aims of support (e.g. the selection of the individual sports) were hand-picked by politicians, and the lack of transparency in the system has created severe corruption risks.

According to critiques of the TAO system, companies that were awarded high-value contracts in public procurement, then purchase the goodwill of policy-makers by giving billions of forints of support to sports clubs. Owing to the funds available in the system, the sports clubs are not motivated to operate on a market basis, and they also apply various tricks in order to obtain the TAO funds.

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<sup>35</sup> Figures from Atlatzso website, March 2018 [Hungarian] <https://atlatzso.hu/2018/01/15/tulnyomoreszt-unios-forrasokbol-gazdagodtak-meszaros-lorinc-csaladi-cegei-az-elmult-het-evben/>

<sup>36</sup> <https://english.atlatzso.hu/2019/01/17/the-meszaros-empire-won-public-tenders-worth-e826-million-last-year-93-percent-of-which-came-from-european-union-funds/>

<sup>37</sup> See for example this article in De Volkskrant [Dutch], <https://www.volkskrant.nl/nieuws-achtergrond/in-het-dorp-van-zijn-jeugd-koesteren-ze-orbans-streken~b9e91af8/>; see also <https://www.boell.de/en/2017/05/03/how-hungarian-zuckerberg-keeping-orbans-system-alive> for extensive information on ties between Orbán and Mészáros

According to a report of Transparency International of October 2015, in the space of four years, spectator sports received a support of 200 billion forints (626.5 million EUR) in a non-transparent way. According to the authors of the study—and in contradiction to the statements of the Government—the funds paid out in the TAO system are not private donations, and instead are indirect state aid; therefore, they are subject to the rules applicable to public funds. The European Commission and the judgment of the Kuria (Supreme Court) adopted in October 2017 also confirms this opinion.

Of the 200 billion forints ((626.5 million EUR) determined to have been paid at that time, 75 billion (235 million EUR) went to football. 12 percent of that sum was paid to Felcsúti Utánpótlás Nevelésért Alapítvány (Youth Training in Felcsút Foundation), while altogether these funds were distributed among roughly 1100 clubs.

Volleyball is another case demonstrating the importance of political connections. The proposal for the expansion of the TAO system, to benefit volleyball, was submitted by Erik Bánki (Fidesz), whose wife is the president of the Beach and Leisure Volleyball Committee of the Association. Soon after that, the Association authorized a budget of 1.1 billion (3.5 million EUR) forints for a company associated with the family.

Despite criticisms of the TAO system, according to a law amendment submitted with urgency by the Ministry of National Economy and voted into effect in the autumn of 2016, it comes under the heading of tax secret. Tax secrets incorporate who receives a tax benefit for what, and all offered tax-deductible funds. Despite the conclusive sentences of public interest data lawsuits initiated in order to make TAO funds transparent, to this day it is not known who are the supporting companies. Additionally, in 2017 a draft law was prepared that would have made access to TAO data even more difficult to obtain. By the end of 2017, after a long legal battle, the Kuria decided that documents on the finances of the training centre should in fact be made public.<sup>38</sup>

In 2015, by a targeted grant the Government awarded 600 million forints (1.6 million EUR) of EU-support to FUNA for the construction of the light railway of Felcsút, declared a key investment. The press reported that the plans anticipated an unrealistically high number of passengers, 7,500 persons per day, while published documents indicated a passenger count of 10,000 per year.

The utilisation rate of the light railway in reality is closer to the latter figure: from the opening in the spring of 2016 until July 2017, there has been an average of 30 passengers per day, including 53 days when the light railway carried no passengers at all. At the beginning of 2015, the tender was awarded to the Foundation For the Youth Training of Felcsút, which was the author of the idea and the only bidder, and construction was performed by Swietelsky Vasúttechnika Ltd., where Zsolt Homlok, who later became the son-in-law of Mészáros, was the managing director at the time. The company

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<sup>38</sup> See *Financing of Hungarian Sports: Court Rules it Must be Transparent*, <http://hungarianspectrum.org/2017/11/17/financing-of-hungarian-sports-court-rules-it-must-be-transparent/>

of the mayor of Felcsút, Mészáros és Mészáros Kft. worked on the project as a subcontractor, while project management was the responsibility of Provital Zrt. with Aditus Zrt., companies often involved in tenders awarded to Mészáros.

In September 2017, the Budgetary Control Committee of the European Parliament visited the light railway of Felcsút in addition to several other projects supported by the EU, although at first the government strongly protested against the idea.<sup>39</sup>

A scheme involving EU funds of a much greater financial impact in which Mészáros's name also appears is a framework agreement of 420 billion forints (1.3 billion EUR) for public utility construction. This tender is the largest EU-financed (EEEOP) programme in Hungary, an infrastructure development programme of four years in the period 2014 to 2020, which was published by the National Development Programme Office. The announcement of the results in October 2017 showed that several companies belonging to cronies were included in the framework contract, from which contractors for individual projects will be selected by “a competitive procedure”.

This high-value framework agreement of four years restricts competition and carries a significant danger of price-fixing among the four parties selected for each of the four regions of Hungary. Consulting companies involved in carrying out the tender include enterprises related to Mészáros and Tiborcz (see below) and companies subject to an investigation by OLAF (Provital Zrt., CUE-Tender Zrt.). Consulting orders for the tendering process of 5 billion may have been heavily overpriced (therefore the EU auditors recommend a 100 percent adjustment concerning the consulting tender).

The European Commission and OLAF have investigated this tender from the beginning. According to the auditors of the European Commission, of the 69 valid bids, 62 should have been excluded under the public procurement contract notice because they failed to complete the sample task accurately. Failure to exclude them is an infringement. Only four companies won on the basis of valid tender, therefore most of the framework agreements were composed based on invalid bids. In the summer of 2017 the Government received the draft audit report from the European Commission. Owing to the irregularities, it is expected that some of the EU aid will have to be repaid. The suspicion of mismanagement and restriction of competition may arise, therefore MEP Benedek Jávor, a politician of Párbeszéd, asked the Chief Prosecutor's Office to start an investigation;<sup>40</sup> in the Prosecutor Office's opinion, however, there is no indication of any crime having been committed.

Other cases in which the *Black Book* mentions Mészáros are as follows:

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<sup>39</sup> *Felcsút: the Forbidden Village for EP “Bureaucrats”*, <http://hungarianspectrum.org/2017/09/09/felcsut-the-forbidden-village-for-ep-bureaucrats/>

<sup>40</sup> [Hungarian] <https://mno.hu/belfold/420-milliardos-gigatender-miatt-tettek-feljelentest-2420228>

- MKB bank: After being purchased in 2014 by the State to make it financially viable, the bank was privatized in 2016. After opaque shifts of ownership, in mid-2017 it turned out that Mészáros had obtained a controlling interest.<sup>41</sup> “The fact that associates of Orbán and Matolcsy, central bank chairperson, are in control of the bank enabled the funding of such media purchases as the acquisition of Origo or TV2,” states the *Black Book*.
- The termination of Népszabadság: The publication of the most renowned quality newspaper was suspended by its owner, Mediaworks in October 2016. The paper had been writing about scandals involving high-level Fidesz officials and because of that it was widely believed that the suspension and termination of the newspaper was motivated by political retribution. Mediaworks was later sold to Optimus Group, which is related to Lőrinc Mészáros. After the change in ownership, significant advertising funds started accruing from the state to press publications of Mediaworks. Heinrich Pecina, an Austrian businessman and owner of Mediaworks did not leave the Hungarian media market. At the end of 2017 he used a newly established company-- also taking advantage of the loan by MKB Bank, which is related to Mészáros --, to purchase Russmedia, considered the largest local media publisher of Eastern Hungary.

The *Black Book* links the shutdown to the “intention of a complete rearrangement of the media market, which was actually implemented by Fidesz step by step.” This assessment turned out to be true in a quite peculiar way, when in November 2018 the owners of a majority of Hungary’s pro-government media outlets donated their companies to a foundation, the “Central European Press and Media Foundation”. Both Mészáros and Pecina are among the donors. In total the new Foundations controls 476 media outlets.<sup>42</sup>

#### *The Elios affair*

Elios Innovatív Zrt. was established in 2009. In its first year of operation the company generated sales of 8.4 million forints, but by 2011 this amount had exceeded three billion forints (9 million EUR). The company (and its legal predecessor) was founded, among others, by István Tiborcz, the son-in-law of prime minister Viktor Orbán, who held various positions in the company until May 2015. In 2014, when István Tiborcz acquired a share of 50% in the company, Elios once again won public procurement contracts in the value of over three billion forints. A majority of Elios revenues came from projects financed by the EU, and their core activity was the implementation of public lighting systems using LED technology. The first major tender, which later on served as a reference for Elios, was awarded in March 2010 to the company called ES Holding Zrt. at the time, in the city of Hódmezővásárhely.

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<sup>41</sup> [Hungarian] [https://nepszava.hu/1139156\\_meszarose-lett-az-mkb-bank-tobb-mint-fele](https://nepszava.hu/1139156_meszarose-lett-az-mkb-bank-tobb-mint-fele)

<sup>42</sup> See *The Central European Press and Media Foundation*, <https://theorangefiles.hu/the-central-european-press-and-media-foundation/> and *Hungary: new pro-government media conglomerate threatens pluralism*, <https://www.ifj.org/media-centre/news/detail/category/press-freedom/article/hungary-new-pro-government-media-conglomerate-threatens-pluralism.html>

In 2012 an audio recording of a meeting, revealing improper behaviour in the mayor's office of the town of Szekszárd, caused a scandal in regards to public procurement procedures. The recording contained discussions of contacts between Elios and the municipality, and discounts being offered by the company.<sup>43</sup> The actual tenderer, the company then owned by Tiborcz, won a tender to rebuild the town's public lighting system in May 2014. The tender had only been issued two months before, suggesting that the company was not supposed to know about it until then. The recording was made secretly by a council member, Ákos Hadházy, who later quit Fidesz and gained a seat in the parliament after joining LMP, an opposition party, and made the fight against corruption a major part of his political activity (see Chapter 2, section Political reaction).

In March 2015 the police began investigations into four public procurement projects against Elios Zrt. OLAF also began auditing the KEOP 5.5.0/A/12 and KEOP 5.5.0/K/14 programs for the funding of reconstruction of public lighting systems, which were announced "customized to Elios" according to industrial sources.

The success story of the company is a clear demonstration of the Hungarian practice of the misuse of EU resources. It is also illustrative of the nature of public procurement projects in Hungary, where projects are tailor-made to a particular bidder. In public procurement projects announced between 2009 and 2014 on the support of public lighting from EU funds, the criteria of suitability were deliberately defined in such way that only the company in question could meet them. In addition, in each of the processes under examination by the contracting authorities, i.e. the local governments, were assisted by consulting companies. Meaning that the suitability criteria were formulated by consulting companies that can be proven to be associated with the party that later won the contract, i.e. with Elios Zrt., through the shared ownership background.

This is a clear violation of the rules governing acts on public procurement, as it relates to conflict of interest, which dictates that "persons or entities on behalf of the contracting authority [...] unable to perform their functions in an unbiased and objective manner for whatever reason, in particular due to economic or other interests or any other common interest with an economic operator participating in the procedure, shall not participate in the preparation and the execution of the procedure, for that shall qualify as a conflict of interest." In addition, it is likely that the projects were overpriced, there was tacit collusion with the competitors -- Tungsram-Schröder, which also had been a bidder earlier, and later appeared as a supplier to the winning bidder --, and that documents may have been falsified (concerning the rate of return of the bulbs).

In January 2018 the investigation of OLAF (which was much more in-depth than that of the Hungarian police) was leaked to the media<sup>44</sup>. OLAF suggested that the European Commission

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<sup>43</sup> *Company linked to PM's son-in-law got involved in public project years before winning the tender, secret recording shows*, <https://www.direkt36.hu/en/hangfelvetel-bizonytja-hogy-a-tiborcz-ceg-mar-akkor-targyalt-egy-projektrol-amikor-meg-ki-sem-irtak-ra-a-palyazatot/>

<sup>44</sup> See [Hungarian] <https://24.hu/belfold/2018/02/07/igy-csalt-orban-vejenek-cege-megszereztuk-az-olaf-jelenteset/>; see also OLAF's Annual Report's text about the case, <https://ec.europa.eu/anti->

should withdraw a EU support of EUR 43.7 million, (approx. 13 billion forints), concerning the tenders awarded to Elios Innovatív Zrt. OLAF found a series of irregularities in public procurement, its report contains findings on the manipulation of procedures as well as the suspicion of conflicts of interests among the participants and suspicion of fraud. According to the information publicly available until now, OLAF assessed the Elios contracts of 35 municipalities, and found each of them affected by abuses; concerning 17 municipalities, it found that organized mechanisms of fraud had been built up.

The OLAF report also confirms the suspicion that the staff of the company may have influenced the public lighting tenders already in the preparatory stage. The external consulting companies may have played an important role in the organisation of fraud: the studies prepared by them were used to determine how much money would be available for the renewal of public lighting, i.e. how much the winner will receive. In the majority of the cities that later awarded the implementation contract to Elios this expert was Sistrade in 12 cases (involved in preparations or as a project manager), and Tender-Network in 13 cases.

In several cases, the competitors can also be associated with Elios. The proposal of INS Energia Kft., an independent auditor, was signed by Ivette Mancz, manager of Elios, and András Puskás, managing director of Sistrade. SMHV Energetika Kft. was involved in 22 Elios projects, mainly as a subcontractor of the company managed by Tiborcz, but sometimes as a competitor. According to a report by OLAF, the proposal of SMHV and the proposals of two other companies were written on the same computer. In addition, the OLAF report mentions that TungsramSchröder Zrt., which was first a competitor and then a regular supplier of Elios, supplied its goods for cheaper prices compared to its competitors. The general director of the European Anti-Fraud Office (OLAF) proposed in its 22 December 2017 recommendation that the Hungarian prosecuting authority should start penal proceedings concerning the public lighting projects implemented by Elios Zrt. As a result, an investigation was ordered for budgetary fraud and other criminal acts on 22 January 2018, once again, after the Hungarian authorities had found no fault in their earlier investigations.

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[fraud/sites/antifraud/files/olaf\\_report\\_2017\\_en.pdf](#) page 15: 35 lighting projects implemented under the Hungarian Environment and Energy Operational Program and cofinanced by the European Structural and Investment Funds. The projects were aimed at updating the public lighting infrastructure in various Hungarian municipalities using environmentally friendly and power-saving LED technology products. OLAF verified the grant applications and found that the initial cost estimations calculated by the applicants were irregular, with artificial supporting documents used to justify a cost benefit analysis. Moreover, a consulting company linked with the main contractor had signed a contract with several beneficiaries to draft the technical annex to their project application, and could thus influence the content of the technical specifications used by the beneficiary during the tender procedure. OLAF also uncovered numerous serious irregularities that had occurred during the public procurement procedures. It also identified conflict of interest between some consultants and the works company. Upon concluding its investigation at the end of 2017, OLAF sent its final report with financial recommendations to the European Commission Directorate-General for Regional and Urban Policy to recover EUR 43.7 million, and judicial recommendations to the General Prosecutor of Hungary.



In November 2018, the Budapest police announced that the case would close because “a crime did not take place.”<sup>45</sup> Government spokespeople dismissed the OLAF report as “a political campaign ploy from Brussels” ahead of the Hungarian elections. MEP Ingeborg Graessle of the European Parliament’s Budget Control Committee reportedly called the outcome of the police’s investigation “surprising.” Additionally, the Hungarian political opposition parties called for the country to join the European Public Prosecutor’s Office.

### *Medical equipment*

In 2012-2013, Atlatzso wrote a number of articles<sup>46</sup> revealing how a Hungarian company behind a medical centre created a complex web of transactions. Reportedly, the main purpose of these articles was to siphon off huge chunks of EU subsidies provided by the European Regional Development Fund.

The OLAF Annual Report 2014<sup>47</sup> highlighted this case as well, arguing that the European Regional Development Fund (ERDF) provided EUR 674 000 for medical equipment for the centre. The OLAF investigation revealed that the supplier of the equipment had purchased the medical devices for EUR 262 000 from a company in Slovakia. Subsequently, the supplier sold the equipment to the centre for EUR 1.7 million, and this was the amount declared on the application for EU funding. The supplier then paid EUR 1.3 million of the sale price in ‘intermediary fees’ to a company registered in the Seychelles. In return, the latter provided an interest free loan of EUR 1.26 million to the medical centre. These transactions resulted in the supplier and the medical centre quadrupling the declared prices of the medical devices. As a result, it became apparent that the EU budget had been defrauded and circumvented the obligation on the medical centre to provide a financial contribution. The OLAF investigation also revealed that much of the equipment was not used at all and other equipment was found to be located at sites outside disadvantaged regions, in breach of the objectives of the programme governing the project. In 2014, OLAF recommended the Commission and the Hungarian authorities to arrange for the full recovery of the ERDF subsidy and the national funding provided for the centre. OLAF also made recommendations to the Hungarian judicial authorities.

No information has been traced about follow-up on the OLAF recommendations.

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<sup>45</sup> <https://www.euractiv.com/section/justice-home-affairs/news/hungarian-police-drops-orban-linked-corruption-probe/>

<sup>46</sup> See <https://english.atlatzso.hu/2015/06/05/eus-anti-fraud-unit-investigates-corruption-case-revealed-by-atlatzso/>

<sup>47</sup> [https://ec.europa.eu/anti-fraud/sites/antifraud/files/docs/body/olaf\\_report\\_2014\\_en.pdf](https://ec.europa.eu/anti-fraud/sites/antifraud/files/docs/body/olaf_report_2014_en.pdf), page 28

## 4. Suggested steps

Frequently, Hungarians who make recommendations to protect the integrity of public governance and judiciary in Hungary are told to ‘stick to your own standards and rules’. This reveals that a tougher attitude needs to be taken in order to properly implement existing European Union law combating ‘illegal activities affecting the financial interests of the Union’ (article 325, Treaty on the Functioning of the European Union)<sup>48</sup>.

The Clean Air Action Group’s paper *Dismantling of Democracy* identifies a number of steps that should be taken.<sup>49</sup> The current-day call for Hungary to join the EPPO fits with this approach; it clearly is a step to fight and prevent ‘fraud and any other illegal activities affecting the financial interests of the Union’. The next step would be for the Hungarian government to face the consequences of not joining the EPPO mechanism.<sup>50</sup>

At the same time, a number of recommendations presented in *Dismantling of Democracy* paper go beyond the scope of this paper and aim to remove the negative effects of the current system of European Union financial support for development. One of their main observations (also shared by the *Black Book*) is that large-scale infusion of funds that are used for ‘projects’, primarily in the sphere of infrastructure or hardware, are highly conducive to corruption. Such ‘projects’ need to be set up by authorities (and companies) to get their hands on the EU money. Alternatively, more generic support could be spent in line with national or local priorities and conditions. This support should only be given on the condition of strict compliance, which should be established prior to and during the funding, with good governance standards, proper accountability procedures, civic participation, and recourse to independent judiciary.

*Dismantling of Democracy* argues that the European Commission already has the competence to withhold funds that do not meet conditions laid down by EU legislation. Thus, the proposals made by the Commission for the next EU budget cycle (2021-2027) can cut funding in case of ‘generalised deficiencies’ as regards the rule of law in member states. Such sanctions could only be overturned by a qualified majority in the EU Council.<sup>51</sup> The European Court of Auditors recommended in July

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<sup>48</sup> Page 246 of <http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%206655%202008%20INIT>

<sup>49</sup> See page 9 – 14, [https://www.levego.hu/sites/default/files/eu-budget\\_democracy\\_hungary\\_2015nov20-honlapra\\_0.pdf](https://www.levego.hu/sites/default/files/eu-budget_democracy_hungary_2015nov20-honlapra_0.pdf)

<sup>50</sup> As suggested here: *Brussels puts Hungary, Poland on Notice*, <https://www.handelsblatt.com/today/politics/handelsblatt-exclusive-brussels-puts-hungary-poland-on-notice/23543186.html?ticket=ST-1092762-AQVnB5b2cnmB1tY1P0KS-ap6>

<sup>51</sup> Proposal by European Commission, [https://ec.europa.eu/commission/sites/beta-political/files/protection-union-budget-rule-law-may2018\\_en.pdf](https://ec.europa.eu/commission/sites/beta-political/files/protection-union-budget-rule-law-may2018_en.pdf). See also analysis by Michiel Luijning in Clingendael Spectator, 11 June 2018, <https://spectator.clingendael.org/nl/publicatie/eus-anxieties-guaranteeing-rule-law#>



2018 that, “the Commission should clearly specify its sources of guidance, and the criteria, procedure and extent of the measures should be more precise.”<sup>52</sup>

The European Parliament provided more detailed definitions of ‘general deficiencies’, which include:<sup>53</sup>

- endangering the independence of the judiciary, which includes the arbitrarily revision of rules on the appointment or terms of service of judicial personnel, by influencing judicial staff in any way that jeopardises their impartiality or by interfering with the independence of attorneyship;
- failing to prevent, correct and sanction arbitrary or unlawful decisions made by public authorities;
- limiting the availability and effectiveness of legal remedies;
- endangering the administrative capacity of a Member State to respect the obligations of Union membership; and
- taking measures that weaken the protection of the confidential communication between lawyer and client.

Additionally, the Parliament voted to create the Panel of Independent Experts to assist the Commission. The Panel would comprise of specialists in constitutional law and finance. Accordingly, the national parliament of each Member State is supposed to appoint one expert. Additionally, the European Parliament will appoint five experts. The Panel would have advisory functions and would also annually evaluate each EU countries.

The European Parliament proposals are now subject to EU inter-institutional negotiations.

One of the recommendations made in *Dismantling of Democracy* is to provide more support to civil society organisations combating corruption, fraud and mismanagement. (The paper suggests to “give substantial financial support to the Whistle-blower Fund created recently by Transparency International Hungary and three other NGOs.”) Presumably under the new financial planning period 2020-2027, this could be realized if proposals for a European Values Instrument are adopted.<sup>54</sup> The European Parliament (in its current composition) expressed support for this; however the Commission appears indecisive, while the agreement of the Council appears very uncertain. In this regard, the Netherlands could decide to set up a similar Fund that supports civil society activity in promoting and monitoring good governance.

A number of the above-mentioned points appear in the programme of political actors in Hungary, for example in Momentum (see Chapter 2, ‘Political reaction’). At the same time, the political

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<sup>52</sup> European Court of Auditors, 17 July 2018, *Plans to link EU funding to rule of law are welcome but need better criteria and more safeguards*, <https://www.eca.europa.eu/en/Pages/NewsItem.aspx?nid=10609>

<sup>53</sup> Information taken on 6 February 2019 from <http://www.europarl.europa.eu/legislative-train/theme-new-boost-for-jobs-growth-and-investment/file-mff-protection-of-eu-budget-in-case-of-rule-of-law-deficiencies>

<sup>54</sup> *European Parliament votes in favour of the European Values Instrument*, <https://www.nhc.nl/european-values-instrument-vote-success/>

leadership in the current and previous Hungarian governments has engaged in power usurpation and corruption (or at the very best, turn the other way when corruption occurs). Considering that most of the battle against corruption will have to take place in the political arena, political efforts to counter corruption should be supported. In formal international relations within the EU, this will not always be easy. However, political parties and parliamentarians (either members of the EP or national parliaments) have more possibilities, including receiving support across their own party or political grouping boundaries. This applies not only to official parliamentary procedures, but to all types of international political contacts.

The current Hungarian political leadership actively engages in international flirtations with actors and ideas outside their own political family. This should be balanced by explicit and outspoken cross-border networking and coalition-building of political actors that defend honesty and fairness in governance.

In summary, the following steps are suggested:

- Stimulate maximum use of opportunities under current EU legislation and regulations to enforce compliance with EU standards as a condition for internal development funding from the EU budget;
- Pursue the inclusion of a strengthened requirement for rule of law conditionality in the new EU budget period as proposed by the European Commission, with public reporting about assessments made of member states' rule of law situation;
- Pursue reform of EU internal development funding mechanisms that allow local, democratically owned priorities to take precedence, in line with analysis and recommendations by academics and civil society in the countries concerned;
- Creating an effective European Public Prosecutor's Office and supporting all efforts to make Hungary join it ;
- Increase financial support for civil society organisations combating corruption, fraud and mismanagement. In addition to supporting the proposal of greatly enhanced EU-level funding, putting in place a Dutch funding modality should be considered ; and
- Develop strong and explicit multi-party support mechanisms and coalitions among EU member states' political actors who prioritize credible steps to maintain and enhance standards of integrity and accountability in governance, of independence of the judiciary and to enable a diverse and active civil society and media.

