



CORRUPTION
RESEARCH CENTER
BUDAPEST

Rent Extraction and the Rule of Law

The Case of Hungarian Residence Bonds' Law

Research note

Budapest, June 2015

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Rent Extraction and the Rule of Law. The Case of Hungarian Residence Bonds' Law / Járadékszerzés és joguralom. A magyar letelepedési kötvény törvényének esete

Research note / Kutatási jegyzet

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„Bob Woodward: The story is dry. All we've got are pieces. We can't seem to figure out what the puzzle is supposed to look like. John Mitchell resigns as the head of CREEP, and says that he wants to spend more time with his family. I mean, it sounds like bullshit, we don't exactly believe that..

Deep Throat: No, heh, but it's touching. Forget the myths the media's created about the White House. The truth is, these are not very bright guys, and things got out of hand.

Bob Woodward: Hunt's come in from the cold. Supposedly he's got a lawyer with \$25,000 in a brown paper bag.

Deep Throat: Follow the money.

Bob Woodward: What do you mean? Where?

Deep Throat: Oh, I can't tell you that.

Bob Woodward: But you could tell me that.

Deep Throat: No, I have to do this my way. You tell me what you know, and I'll confirm. I'll keep you in the right direction if I can, but that's all. Just... follow the money.”

[Alan J. Pakula: All the President's Men, 1976]

„There is a rule of law, however, only where every power, however large, is subject to the law and limited by it.”

[Roger Scruton]

Abstract

This research note examines the history and background of the Hungarian Residence Bonds' Law (Act CCXX of 2012). We conclude that the residence bond legislation is an example of the violation of the rule of law, of its connection with rent-seeking, and of possible appearance of political corruption. This case is a clear manifestation of what form, what special means, and what consequences political favoritism and political corruption can have and can operate with in a given country.

Introduction

In the context of the contemporary Hungarian legislative environment, the law (Act CCXX of 2012) analyzed in the following case study is interesting from several perspectives. The law's story is noteworthy in each of the following ways:

- 1) It was proposed by a member of parliament, rather than a minister supported by a ministry with its policy expertise apparatus;
- 2) The author of the legislation is not known publically;
- 3) No impact assessment was published, nor was a public consultation held;
- 4) Procedurally a Parliamentary committee, rather than a ministry, is responsible for the law;
- 5) The law grants a monopoly to seven private companies;
- 6) Most of the privileged companies by the law were off-shore companies – headquartered in the Cayman Islands, Cyprus or Schaan;
- 7) Rents available to the private entity come at a cost to the Hungarian government and taxpayers.

With these properties in mind, we put forth the residential bond legislation as an example of the violation of the rule of law, and of its connection with rent-seeking, and of possible appearance of political corruption¹. This case is a clear manifestation of what form, what special means, and what consequences political favoritism and political corruption can have and can operate with in a given country.

¹ In this case we have to take into consideration the probability of reelection of the corrupt representatives. “Since representatives are assumed to seek reelection as one of their goals, the preferences of voters influence the behavior of representatives through their impact on the probability of reelection. The willingness of representatives either to tradeoff political support for private monetary gain or to use money to purchase constituents’ votes will then interact with the organization of the legislature to generate opportunities for corruption.” See Susan Rose-Ackerman: *Corruption. A study in Political Economy*, Academic Press, New York, 1978, p. 16.

Background

Antal Rogán is the parliamentary fraction's leader for the ruling Fidesz party. He serves as chairman of the Parliament's Economic Committee. On Saturday October 27, 2012, he introduced a bill proposing the sale of so-called residence bonds to non-EU citizens. There was no public mention of the proposal ahead of its introduction. Rogán's bill² was cosponsored by two members of his fraction. There is circumstantial evidence that they were not involved in the drafting of the law.³ The government did not conduct any impact assessment, and did not publish anything in connection with the bill.

The proposal outlines the terms of the resident bonds. A non-EU citizen, hence the petitioner, purchases, through an intermediary, a specially issued five year Hungarian government bond with 250 thousand Euro face value. The petitioner receives a Hungarian residence permit, allowing freedom of movement within the EU. Six months later the petitioner would become eligible for permanent residence in Hungary, affording, with the exception of participation in national elections, the petitioner all the rights of Hungarian citizenship.⁴ The petitioner's immediate family is also eligible. A personal presence is not required for the application, but the petitioner's identity is checked against health and legal blacklists.⁵ Citizenship is not mentioned in the final submission, but accompanying documents and responses to questions from journalists by Mihály Babák, one of the two co-sponsors, indicate that granting of citizenship was also considered.⁶

Two days later the Rogán-led Economics Committee approved the law. The same day the law was introduced to the Parliament in a general debate. Rogán introduced the law and defended it against criticism from a handful of opposition MPs. One week later, a detailed debate was held. Again Rogán answered questions and defended the bill. Finally on December 11th, the Parliament passed the bill, with every amendment proposed, aside from

² The text is available [here](#).

³ Their handwritten names are appended to the submitted [proposal](#).

⁴ Rogán's statements to the Economics Committee introducing the bill put forth its goal as „facilitating the comings and goings” of wealthy individuals that otherwise face difficulties traveling to the European Union. Additionally, he suggested the proposed law would „strengthen bilateral economic connections by opening a special investment-oriented residency institution, not founded along usual criteria, but rather one in which the primary criteria is seriousness, a seriousness in business, which includes a serious investment intentions” [See](#) the Parliamentary Record, October 29, 2012, Monday, from 11:59, discussion in the ground floor's discussion room.

⁵ See the [text of the law](#).

⁶ See [„Kínaiaknak árulná a Fidesz a tartózkodás engedélyt”](#) Népszabadság, 2012.10.29.

a few technical items introduced by Rogán himself, rejected. The law's passage became official on December 27th, and came into force on January 3rd.⁷

The bill was passed without public consultation, nor was an economic or social impact assessment carried out. Given the bill's content and subject matter, one would expect the Ministry of National Economy to be involved. But the entire process was carried out under the authority of Rogán and his Parliamentary Committee. Critically, the Committee granted itself the sole power to select the financial intermediaries who would be authorized to sell the bonds.

The decision on brokers (intermediaries)

Following the passage of the law, the next step was to select financial intermediaries who would sell the bond to petitioners. As mentioned above, this was the responsibility of the Parliamentary Economic Committee. The initially selected firms, with one exception, were based offshore⁸ (for details see Appendix 4). Rogán convinced his committee of the need for this arrangement, saying in a session that it would not be possible to carry out the program without offshore companies. Specifically, that "it is easy to hide behind many different company formations," and that "here Hungarian firms are not capable":

"Let us turn to the next item on the agenda: the law on the entry and residence of third-country nationals. Here the committee has a legal responsibility which, as I understand it, I am afraid I will have to take carry of. „(...)

"In the name of the Committee I would like to state the following information. On the one hand, I expect in the case that any country makes a request – and I emphasize, any country can issue such requests under the law- their authorities should receive our assurances and proof that this program is in line with the laws of the country in question. I have already received such an inquiry from the Chinese Embassy." (...)

„These criteria are clear, and the intermediary's founding documentation must be clear that it only engages in this kind of activity. Typical financial companies are not able to insure, according to their founding documents, that they will only deal in this kind of financial instrument, so let us be clear that this story will not fall under any money laundering laws." (...)

„On the other hand, I have distributed a system of criteria to all members of the committee. Practically, I have tried to present an overview of potential applicants in this area. I would add one thing now that I did not include in the documentation. On account

⁷ On the passage see [here](#). For the final text of the Act CCXX of 2012 see [here](#), and the modified version of Act II of 2007. [here](#).

⁸ See details [here](#), and documentation from the Government Debt Management Agency's [report](#).

of the fact, that it is easy to hide behind many different company formations, either off-shore or not off-shore, whatever label applies – and since here Hungarian firms are not capable, but rather ones outside Hungary -, let us not forget, that it would be difficult to exclude off-shore companies.⁹

Rogán's comments prompt several questions. By what procedure and results did the firms suggested as candidates as dealers for these bonds become candidates? The use of the word applicants suggests these firms applied somehow. It is not known what such an application process consisted of, or how firms and countries were evaluated. Was Rogán approached personally, or were official documents submitted? Finally, it is not known how the final list of firms eventually given the right to sell the bonds were selected.

From the statement, we can only suppose that firms who could apply to Rogán were perhaps those with leaders or owners who knew him directly. According to the first firm mentioned by Rogán it received permission from him directly, though there is no publically available documentation of this.¹⁰

In Committee, Rogán first put forth the eventually largest and most successful issuer of Residency Bonds, the Cayman Islands-registered Hungarian Special State Debt Fund. The HSSDF was granted a monopoly on residence bonds sold to Chinese citizens. Rogán mentions meeting with two owners of the company and how they had 'reassured' him. In Rogán's words:

"Next we come to the applicant. The applicant has practically satisfied all requirements. From my perspective, the most reassuring thing are the names involved. Here Simon Mu, a reputable Chinese banker and investor is involved. Simon Mu is in charge of the firm, Wanhua, which has one of the most important Chinese interests in Hungary, according to Borsodchem's leadership. I therefore believe that from Hungary's perspective he operates with exceptional local knowledge, and he that he is a serious man, who, I had earlier looked into when he was president of the Asian Development Bank, which is the European Bank for Development and Reconstruction's Asian counterpart, for many years, and again, as I mentioned, has indisputable knowledge about Hungary. Attila Boros, though he now lives in Brussels, is an experience businessman with several Hungarian firms in his history. The other two Chinese businessmen are not known to me

⁹ Antal Rogán, [see](#) the Parliamentary Record, March 4th, 2013, from 18:53, discussion in the ground floor's discussion room, Committee Record.

¹⁰ Simultaneously a Singapore-based firm also applied (EURO-ASIA Investment Management Pte Ltd), but they did not meet Rogán's requirements as their application was not in the correct format: „I have other applications, for example there is one from a Singaporean firm, which, though I think is a very good application, but it does not includes these things, and it is just a very one sided little comparison. I will ask them for the same papers.” (See the Economics Committee Record, 2013.03.04.). Subsequently the Committee passed on the application. Eventually they received permission. See [here](#).

*personally, but they have impressive resumés, and although I do not know their knowledge of Hungary, they must be recognized as associates of Simon Mu.*¹¹

The Parliamentary Economic Committee's Fidesz majority accepted Rogán's list of recommended companies.¹² Rogán distributed information, including names and more information on their holdings, on one or two leaders of every off-shore company on his list to the committee. This information was not made public.¹³ The Committee also decided, that the seven selected companies would, according to the law, not be permitted to compete with one another.¹⁴ Specifically, the law provides for country-specific monopolies to be assigned to specific companies. Issuers are forbidden from selling residency bonds to citizens of countries outside their purview. Violation of this rule would result in cancelation of the issued bonds. The firms are required to collect and submit personal data of buyers for review by the Ministry of the Interior.

The Hungarian state provides the issuer firms with a substantial though unknown discount on the bonds. It is only known that the firms pay, on average 221 thousand Euros on the 250 thousand Euro face value bonds.¹⁵ This corresponds to a 2.5% interest rate on the bonds for the Hungarian state.¹⁶ Next to this, the division of countries into monopoly zones allows the firms to charge large fees. The average customer pays around 74 thousand euros in fees to the companies, according to available data.¹⁷

¹¹ See the Parliamentary Record, March 4th, 2013, from 18:53, discussion in the ground floor's discussion room, Committee Record.

¹² Of [the fifteen members](#) of the Committee, ten are from Fidesz, two from Jobbik, two from MSzP and one is independent.

¹³ See the Parliamentary Record, March 4th, 2013, from 18:53, discussion in the ground floor's discussion room, Committee Record.

¹⁴ See: 2007. évi II. törvény módosításáról szóló 2014. évi CVIII. törvény és T/8879/7 számú törvényjavaslat (2012).

¹⁵ The Hungarian NGO [Atlátszó](#) obtained the details of exchanges between the Government Debt Management Agency and the Cayman Islands-based HSSDF.

¹⁶ Regular five year Hungarian state bonds issued in Euros fell below 2.5% in July 2014. They are still below that rate. From this perspective, the Hungarian state could finance itself more cheaply on the open market than by issuing residency bonds – a clear loss for the Hungarian state.

¹⁷ See: http://index.hu/gazdasag/2015/01/29/valaki_boduleteset_kaszal_rogan_otleten/

Consequences

From the passage of the law to early March 2015, 2,356 residence bonds have been issued. Put another way, the companies and the personalities behind them have won 174 million Euros in under two years.¹⁸ The distribution of bonds sold to individuals by nationality is not public, and therefore we cannot know the income of the issuing firms. We do know that in September 2014 80-90% of residency bond sales were made to Chinese citizens.¹⁹ Put another way, we can roughly estimate that 80-90% of the revenue resulting from the sale of residence bonds goes to personal acquaintances of Antal Rogán.²⁰ As for the benefits to the Hungarian economy foreseen by Rogán, a lawyer who specializes in helping third country nationals obtain these bonds claims that his clients only care about the EU access they provide.²¹

When legally compelled to answer questions as to why Antal Rogán and the Economic Committee grant licenses without calls for tender and monopolies to select firms, the press office of Fidesz fraction simply referred back to the text of the law.²² More specifically, to the question of why the choice of firms is left to the discretion of the Committee, the government replied that *“according to the law, the Economic Committee makes the decision. The selection process takes place within the framework of an open procedure, and any firm is free to lodge an application.”*²³

In response to a question on the size of the fees taken by the firms, the government responded that „the market sets the price of these services, and that the state cannot influence this.”²⁴ On the subject of Rogán’s confidence in the names behind the firm responsible for China, the Fidesz response puts forth that

¹⁸ In 2015 the face value of the bond increased to 300 thousand Euros. The discounted value offered to the firms has not been published by the State Debt Management Agency. Besides this only the number of buyers is known in 2015: 143. The lower number of applicants, proportionally speaking, suggests a lower interest rate, but this is not certain. See [“Még többet kereshetnek Rogán ismerősei”](#), and [“Még mindig jól fog a letelepedési kötvény”](#).

¹⁹ During the September 25, 2014 meeting of the Economic Committee it was mentioned that 1102 bonds were sold during this period, leading to 1882 residence permits for Chinese citizens (including family members), the second largest group were the Russian, with 78 permits issued. See the [Parliamentary Record](#).

²⁰ Rogán’s own words imply that the Chinese inspired the idea of the law: „I confess to you honestly that the idea first came to me while serving as President of the National Organization of Chinese-Hungarian Friendship, when over the course of several meetings I came to know the Chinese conventions in this regard with other countries; but it is certainly not only applicable to China, but rather, to be clear, countries outside the European Union, and outside the scope of the North Atlantic world. Given our position in Central Europe, I think Hungary should not miss out on this opportunity.” See the [Parliamentary Record](#).

²¹ See [VG.hu](#)

²² See: [“Bődületeset kaszálnak Rogán ötletén”](#)

²³ The Fidesz response to Index.hu’s e-mail, 2015.01.12.

²⁴ As above. Note the contradiction of citing market prices in monopolistic setting.

"[the firm] is the largest Chinese investor in Hungary, and [as investors] they have brought tens of thousands of jobs to Hungary, and that they have been a reliable partner of the Hungarian government for over fifteen years. "²⁵

Addressing the non-transparent corporate structures common amongst the issuing firms:

"every firm must present its owners at application, hence it is false to claim that they are offshore, as generally when one speaks of such firms their ownership is unknown. Moreover, these firms are not taking, but bringing money into the country."²⁶

The Hungarian National Bank's position on the matter is that according to the law, the bonds and their transactions fall outside the scope of the Bank's capital market surveillance framework. Indeed, besides the Economic Committee, no Hungarian government body has the ability to track or monitor activity of this program.

Reversed way of hypothesis testing

In summary, the Hungarian residential bond selling program established in 2012 under the guise of fostering investment and building bilateral ties with third countries is highly problematic. It is exceptionally risky, from a good governance perspective, that the individual who wrote the bill is so central to its implementation. It is critical to note, moreover, that the owners of the firm now in an excellent position to extract significant rents (as a consequence of the structure of the law) were personal acquaintances of the individual lawmaker and relatively unknown to the public.

Despite its poor marks according to fundamental principles of the rule of law, transparency, and anti-rent seeking legislation as outlined in this study, it must be noted that the law was properly passed. The regularity, which has accompanied this process, and the goal towards which all the elements of this story lead to created the need to reverse the usual formulation of scientific hypotheses. The focus of the study should not be what made one of the Fidesz - the governing party in the Parliament – representatives propose this bill, formulate it and have it approved, but instead, the hypothesis that political corruption was or could have been part of the procedure should be refuted. In other words the statement that each and every step served the enrichment of those coming up with the concept of the law via the offshore companies selected in the procedure should be refuted. The examination of all these aspects could be the subject of a future research.

²⁵ As above

²⁶ As above

Appendix: The list of privileged companies by the Hungarian Residence Bonds' Law

	Date Licensed	Firm	Countries/Citizenships Covered	Geographical Areas
1	2013.04.09.	Hungary State Special Debt Fund (89 Nexus Way, Camana Bay, Grand Cayman KY1-9007)	China, Vietnam	China, Vietnam, Hungary
2	2013.05.27.	Discus Holdings Ltd (236, St. Paul Street, Valletta, VLT1215, Malta)	South Africa, Indonesia, Kenya, Nigeria	South Africa, Indonesia, Kenya, Nigeria, Hungary
			USA, Kazakhstan, Thailand	USA, Kazakhstan, Thailand, Hungary
			Azerbaijan, Turkey	Azerbaijan, Turkey, Austria, Hungary
3	2013.06.20.	Innozone Holdings Limited (195 Arch. Makariou III Avenue, Cy-3030 Limassol, Cyprus)	India	Cyprus, India, Hungary
			Persons registered in Cyprus	Hungary
4	2013.08.29.	Arton Capital Hungary Pénzügyi Tanácsadó Kft. (1068 Budapest, Székely Mihály u. 8.)	United Arab Emirates	United Arab Emirates, Hungary
			Afghanistan, Pakistan	Afghanistan, Pakistan, Malta, Hungary
			Persons registered in Afghanistan, Pakistan	Magyarország

5	2013.08.23.	VolDan Investments Limited (Schaan)	Russia, Ukraine, Turkmenistan, Georgia, Belarus, Uzbekistan, Montenegro, Serbia, Bosnia and Hercegovina	Russia, Ukraine, Turkmenistan, Georgia, Belarus, Uzbekistan, Montenegro, Serbia, Bosnia and Hercegovina, Poland, Slovakia, Czech Republic, Romania, Hungary
6	2013.08.22.	EURO-ASIA Investment Management Pte Ltd (28C Stanley Street Singapore)	Singapore	Singapore, Hungary
7	2013.07.25.	S&Z program Limited (Schaan) – [the license was withdrawn later by Economic Committee of Hungarian Parliament]	Egypt, Morocco, Tunisia, Algeria, Yemen, Oman, Iran, Qatar, Kuwait, Lebanon, Iraq, Saudi Arabia, Syria, Lybia, Jordan, Bahrain	Egypt, Morocco, Tunisia, Algeria, Yemen, Oman, Iran, Qatar, Kuwait, Lebanon, Iraq, Saudi Arabia, Syria, Lybia, Jordan, Bahrain, UK, Switzerland, Hungary

Source: National Debt Management Agency: <http://www.akk.hu/object.b61e5dc4-a342-4a5e-b69a-0b6239feba2c.ivy>