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RESEARCH ARTICLE

Capitalist backsliding? From neoliberalism to 'illiberal market economy' in Poland and Hungary

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ABSTRACT: In examining Poland and Hungary, we offer a case study of East and Central European nations and economies transitioning from liberal democracy and free-market principles to what we term an "illiberal market economy". This shift challenges the neoliberal model that underpinned the post-1989 transformations in the region. Furthermore, the emerging systems in Budapest and Warsaw defy conventional categories found in the Varieties of Capitalism literature. While these systems may exhibit surface similarities to coordinated market economies, such as increased state intervention and government expansion, they diverge significantly due to systemic clientelism. Patronal networks enable the ruling party to capture of the state, facilitated by the presence of weak or dependent institutions. Political monopolization of power fosters an environment conducive to rent-seeking and patronage, often reaching corruptive extremes, ultimately serving as coordination mechanisms within the economic system. Authoritarian politics in both Hungary and Poland instrumentalizes institutions to limit the free-market space, resulting in an illiberal market economy — a distinct form of state capitalism infused with an East and Central European character.

KEYWORDS: East Central Europe, Hungary, Poland, illiberal market economy, varieties of capitalism

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1. Introduction

The paper introduces our concept of 'illiberal market economy' (IME) and shows it in the context of Central and Eastern Europe (CEE). The vast literature on the post-1989 socio-economic transformations remains inconclusive as regards the *finalité* of the post-communist CEE states' trajectories towards any particular model of capitalism. The rich diversity of the economic systems in the CEE region offers a fertile ground for comparative approaches trying to map the post-communist economies in the varieties of capitalism (VoC) spectrum. Just like there was no one type of communist economic system in the former Soviet and East-bloc territory, even more differentiation was brought about after the fall of the Berlin Wall and the implosion of the USSR. The variety of post-communist paradigms requires further development and this analysis will contribute to its economic dimension.

This analysis describes and explains the nature of IMEs that emerged in the post-communist area. Its main focus is on the two countries that took a spectacular U-turn in their pro-democratic and pro-market-economy transitions. Poland and Hungary, once treated as poster-children of successful transformation and Europeanization, decided to leave this evolutionary path and launched an illiberal trajectory. They provide two exemplary cases that represent vital importance for the whole region – this results from their geopolitical and geoeconomic localization, the size of their economies, territories, populations, and – last but not least – the symbolic meaning of Poland and Hungary that is related with their enormous legacies in the pro-market reforms in the crucial transitory times (Frentzel-Zagorska 1990; Kaźmierska and Waniek 2021). Nevertheless, illiberal governance, with its key elements such as the peculiar form of state interventionism, appears to be gaining ground across the Euro-Atlantic world following the global financial crisis of 2007 and beyond (Ban and Gallagher, 2015). Hence, this contribution aims at both capturing the above-mentioned change in the context of understudied post-communist capitalism and at making broader generalizations about the effects of this paradigm shift in public policy.

In this paper, we utilize the VoC framework to analyze the transformations of these economies toward what we label as IME. While the VoC is instrumental in distinguishing between coordinated market economies (CMEs) and liberal market economies (LMEs), it falls short of capturing the nuances of economies that diverge into illiberal practices under the influence of quasi-autocratic governance (Hall and Soskice 2001; Nölke & Vliegenthart 2009). These shortcomings necessitate a broader exploration to identify complementary concepts that can accurately depict the hybrid economic characteristics observed there (Magyar and Madlovics 2020). Our proposed concept of IME integrates aspects from the VoC framework such as corporate governance, industrial relations and skills creation while introducing additional dimensions to address the specificities of state intervention (see: Mazzucato 2013; Rodrik 2015), and illiberal statist governance (Ricz 2016). Specifically, IME incorporates increased state intervention in the economy, pervasive patron-client relationships, and the use of economic policies as tools for political consolidation—features that are starkly different from the decentralized and competition-driven mechanisms of LMEs (Lane 2005; Drahokoupil and Myant 2015), yet also not fitting to the ideal type of the CME. IME is essential for understanding the economic trajectory of countries like Poland and Hungary, where traditional capitalist models do not fully encompass the evolving nature of their market economies. By identifying and articulating these unique features, our analysis not only addresses the gaps within the VoC framework but also contributes to a more nuanced understanding of capitalism in the context of lingering illiberalism in the CEE (King 2007; Bohle and Greskovits 2012; Rapacki 2019; Gardawski 2023).

This distinct type of capitalistic formation reveals some clear tendencies of shrinking freedom in the economic dimension. This trend may be interpreted as a counter-revolution towards the post-1989 reforms – a backlash against the neoliberal paradigm, transformation fatigue, and the rise of the "losers of transformation".

This "capitalist backsliding" resonates very well with the heyday of economic populism, economic nationalism, and even economic nativism that has been present in Poland and Hungary under the illiberal regimes. They announced not only the end of neoliberalism but the end of liberalism in general. The most fundamental pillars of both LME and CME are challenged and the new system of institutional complementarities do not create a coherent structure. The competitiveness of Hungarian and Polish economies becomes more and more questionable, and their marginalization brings about more and more stagnation risks that are recognized in the literature about the middle-income trap (Riedel and Anusik 2024).

The focus of the conceptual part of this paper is on the notions of *coordination mechanisms* and *institutional complementarity*. Concerning the first we attempt to show how the politics focused around the narrative of 'state agency' triggers evolution towards the hybrid type, mixing the illiberal, state capitalism agenda with the persistent liberal preference of the majority of societies and political class. In the case of the latter we check whether individual institutional dimensions form a coherent whole. The empirical analysis is based on the indicators of institutional performance and case analysis of the illiberal style of public policy-making (economic populism; reactive governance, politically-inclined extension of the social transfers, monopolization and centralizing tendencies). We attempt to show the evolution of Polish and Hungarian capitalism since the countries joined the EU and against the backdrop of regional context (mostly Visegrad Four – V4) and in comparison to Western economies which more clearly represent the LME (e.g. UK) or CME (e.g. Germany) type. Evaluation of both micro- and macro-economic data and the comparative case studies approach are the key methods serving for providing answers of the research questions in this piece.

The aim of our research is to trace the evolution of Poland's and Hungary's economic systems since its accession to the European Union (EU) until 2023 which marks the loss of power by the illiberal government in Warsaw. We also acknowledge the fundamental differences between Poland and Hungary, specifically as regards the changes that followed the 2023 parliamentary elections in Poland. The differences, which before 2023 seemed to be just the question of degree and pacing in the same illiberal trend, turned out to be the difference in kind bearing in mind the paradigmatic change that happened in Poland in Autumn 2023. In order to capture both the similarities and the differences (and to make the most out of explaining them), we apply the VoC framework, supplemented with a description of changes in Polish and Hungarian political institutions, which provide an important background for the process of shaping institutions in the economic sphere. Some works (e.g. Piątek 2023; Szabó 2023) have already attempted to describe the evolution of the Polish economic system towards illiberal state capitalism. However, we also notice that this illiberal model is built on extremely liberal foundations, which is a remnant of the above-mentioned reforms from the end of the 20th century (often labelled as "neoliberal", see: Mączyńska 2014). As a consequence, a distinctive model of capitalism is being formed in CEE, an important feature of which is hybridity. As we argue, this raises serious concerns about the long-term effectiveness of the emerging model.

Although the two cases show many similarities in terms of the input variables: promotion of demand-led growth, less liberal and more discretionary policies, "civilizational" investment projects, integrating party and state structures around state-owned enterprises (SOE) and national assets, they end up with sometimes very different economic performance (reflected e.g. in the dynamics of private investment) as well as the shape of institutional order (levels of corruption, development of the oligarchy, state of democracy). This turns to be partly a result of different geopolitical set-up (such as relations with the EU and external actors like China and Russia). Another reason for varied results in the two regimes may be explained by the path-dependency theory making it relevant to trace the role of initial conditions more carefully.

Noteworthy, the end of the illiberal era in Poland is marked by parliamentary elections that took place in October 2023. The ruling PiS (Prawo i Sprawiedliwość / Law and Justice) won the highest number of votes, but – due to the lack of coalition potential – It lost the majority in the Sejm, the lower chamber of the Polish parliament. At the time of publishing this paper, it is nevertheless too early to state any conclusive judgment about the effectiveness of this change or the long-term outcomes it is expected to bring about. Our analysis ends in 2023 when the illiberal practices were still in place in both Hungary and in Poland.

This paper is structured as follows. First, we provide an overview of the IME type of capitalism and we elaborate theoretically on its specificity in relation to the dependent and state-led types of economy. Then we empirically evaluate Poland and Hungary as countries fitting this model. Finally, we conclude on (dis)similarities of the two cases within the framework of IME. By doing so we summarize our contribution to the existing literature, specifically in the field of economic illiberalism.

2. Illiberal Market Economy – a false contradiction?

Is illiberal market economy an oxymoron? No more than illiberal democracy or market socialism, and both categories made a great added value in the scientific discourse (Zakaria 1997; Wagrandl 2021; Bergson 1967; Miller 1990; Nuti 2023). Just like in the case of illiberal democracy, many critics bring forward the argument that democracy is by definition liberal and the feature of illiberalism questions the very essence of any democratic system. Yet the concept of illiberal democracy settled down and habituated not only political debates but also political science deliberations. It allows to avoid the trap of dichotomous thinking in which the political system can be either democratic or not. Beyond such black-and-white simplifications, the students of democratic theory share the conviction that the picture is much more nuanced and many shades of grey developed in the wide spectrum spread between the ideal of full democracy and the ideal of full non-democracy. The real existing democracies represent a rich diversity of forms, in which specific democratic features reveal stronger or weaker potential. For example, the liberal norms are more valued in some democratic systems than others (Rummens 2023).

Parallel to that, one could argue that market economy is by definition liberal, since the lack of economic freedoms questions the very essence of market mechanisms. Similar to the debate about illiberal democracy, one needs to recognize that various capitalist systems value freedom to different extent. Liberal norms do not appear exclusively in the ownership status-quo, but in many other dimensions, for example the scale and depth of regulations, or methods of coordination. Yet, within the rich diversity of capitalist systems in which the liberal values density differs substantially, at a certain point the liberal component is absent to the extent, that the system can be labelled as "illiberal". Similarly, to the political concept of illiberal democracy, the false contradiction of the illiberal market economy category opens the debate on the newly emerging state-market relations and interactions.

This debate is crucially important, especially in CEE region, since we are experiencing a counter-revolution on a systemic level. Some authors claim it is a second systemic transition (Ratajczak 2017), whereas this U-turn questions the earlier paradigmatic shift towards a more liberal one. Nevertheless, illiberalism does not seem a logical next step (as in the second transition thesis) after neoliberalism. It is rather a backlash fueled by transition fatigue and populist resentimental ideas and/or ideology. The democratic backsliding is accompanied by the "capitalist backsliding" characterized by the economic system slipping down towards new-old autocratic practices that resemble the state-centric reality of real socialism. Strong and paternalistic state replaced pluralist and liberal socio-economic relations. The liberal democracy breakdown coincides with the liberal market devastation that sums up into an illiberal U-turn on a systemic scale. The new illiberal institutions mutually strengthen one another cementing the system's foundations, making any potential change even more uneven.

We perceive valuable, yet insufficient some IME-related conceptualizations that try to capture the evolution of the capitalist systems of post-communist Europe – from illiberal models of state capitalism (Ricz 2021), through prebendalism (Rogers 2020), developmental state (Haggart 2018; Woo-Cumings 2019), authoritarian capitalism (Sallai and Schnyder 2021), mafia state (Magyar 2016), up to the competitive authoritarian regime (Levitsky and Way 2010), or other mutations of market predatory oligarchies. They all are successful in featuring some specific aspects, like for example the domination of state ownership over private ownership (Vail 2007; Scheiring 2020; Csaba 2021), but none of them captures the very specifics of the illiberal matrix in the post-communist CEE countries.

While acknowledging Magyar's and Madlovics's (2020) critiques concerning the limitations of Western economic concepts to fully capture the nuances of post-socialist transformations, this paper employs the VoC framework to analyze the economic shifts in Poland and Hungary as a deliberate bridging strategy. We recognize that although these economies originate from distinct historical and institutional starting points, they are not isolated from global economic phenomena such as increased state intervention, which is also evident in Western markets. Therefore, we aim to highlight commonalities in economic restructuring that transcend regional boundaries while also addressing unique local dynamics. This approach avoids the essentialism of solely context-specific frameworks, capturing both the idiosyncrasies and the convergences in global capitalist evolution. Such a dual perspective enriches our understanding by situating CEE developments within a wider economic context, thereby providing a more comprehensive analysis of how contemporary capitalism is reshaped under varying influences of economic nationalism, protectionism, and state-driven economic policies.

Noteworthy, IME is not an isolated phenomenon but part of a broader transnational process of illiberal political changes evident even in core capitalist countries. The rise of Donald Trump in the USA and the Brexit movement in the UK exemplify similar populist and protectionist tendencies that challenge established liberal norms and practices at the very core of the LME. These movements, much like the developments in Hungary and Poland, reflect a global re-evaluation of the (neo)liberal consensus that has dominated the post-Cold War era. The presence of such trends in the central capitalist nations underscores that the adaptations seen in CEE are not merely regional innovations but are resonant with broader global shifts in political and economic thinking. In the West, similar discontent with traditional economic policies has led to the resurgence of Modern Monetary Theory (MMT), which advocates for more direct state intervention in the economy through fiscal policy, unconstrained by traditional concerns about budget deficits (Wray et al. 2023). MMT's growing influence in policy discussions in the USA and parts of Western Europe signals a wider reconfiguration of economic policy thinking, driven by demands for greater economic sovereignty and flexibility in economic management. This parallel underscores that the changes encapsulated by the IME in Poland and Hungary are reflective of a global pivot towards more assertive state roles in economic affairs, challenging the notion that these shifts are unique to post-socialist states or are detached from broader economic and political currents affecting the global order. Thus, there is a need for more research on the variety of effects that this change in the ideological-discursive paradigm has on countries representing diverse models of capitalism. The research program of comparative capitalism has to be therefore extended in this aspect. Our focus on CEE originates from two main motivations. First, research on post-communist capitalism needs to be further developed, especially in the light of the most recent developments in the region. Second, it seems that illiberal tendencies in the countries we have selected have advanced the furthest compared to other highly-developed economies. It is therefore worth considering the local factors that could have contributed to this shift. And treating CEE as a laboratory of illiberalism allows us for generalizations going beyond the regional scale and contribute to the on-going debate about VoC.

The false contradiction hidden in the illiberal market economy concept, captures the conflicting relations of some constitutive elements of this type of capitalism. In other words, the contradictory nature of the term itself captures the inconsistencies and disequilibrium that the IMEs reveal. This model recognizes the private ownership as the key form of ownership in the economy, however it promotes stronger and stronger states presence on the market. In this sense it resembles CME models, which are unquestioned and wide-spread across the Western hemisphere. Nonetheless, IME differs from CME in a substantial way, since the patronal networks cultivate clientelist relations between the state and the market, as well as between and among the actors operating in both arenas. It also differs from any known form of state capitalism, since it features the (party) state capture in the first place. It is characterized by centralization but does not promote strong and independent institutions. On the opposite – it brings about the weakening of independent institutions both in the political and economic realms – for the benefit of autocratic politics. The instrumentalization of institutions, that should act independently, for political profit is another feature of IMEs. State interventionism takes the form of counter-competitive measures by limiting the free market space. This is visible not only in the growing size of the public spending, but also in the domination of public investment and ownership over private ones. The state ownership on the market is oftentimes justified by security reasons and takes the form of (re)nationalization or state capture in extreme cases.

The political monopolization of power is accompanied by similar processes in the economy. This leads to rent-seeking and patronage reaching corruptive levels in an extent in which they become coordination mechanisms themselves. Purely bureaucratic forms of coordination were characteristic for the pre-1989 socialist systems. Whereas in the capitalist economy, it is the market mechanisms that should dominate the coordination processes. Consequently, we label these trends as "capitalist backsliding", since they characterize the process of sliding back to the pre-1989 practices in multiple dimensions.

The above-mentioned understanding of IME corresponds to some ways of defining state capitalism, especially in its illiberal form. Nevertheless, our concept of IME differs from the main definitions of state capitalism in a substantial way. To capture this, it is needed to reconstruct the main characteristics of the latter - instead of providing an extensive review of the literature that has been delivered elsewhere (e.g. Bałtowski et al. 2021; Ricz 2018), here it suffice to recall the rather general definition of Bremmer (2009, 41), who was among the first authors who described the most recent statist wave. He defines state capitalism as "a system in which the state functions as the leading economic actor and uses markets primarily for political gains". Additionally, Judit Ricz conceptualizes the new forms of state-led developmentalism, with recent tendencies showing towards the spread of illiberalism both in the political and economic realms. Though different varieties of new statist models coexist in different countries, she argues that there are sufficient commonalities to treat these together, and call it "illiberal state capitalism".

Positioning our definition of IME in the broader literature of VoC, the closest neighbor we find is Ricz's illiberal model of state capitalism (2021). Admitting that different varieties of contemporary state capitalisms co-exist, Judit Ricz highlights some salient commonalities of the most recent illiberal statist tendencies, that are important from the perspective of IME. Some earlier works (see e.g. Taylor 2014) have been highly skeptical of the illiberal nature of state capitalism and have identified many problems with it, including, *inter* alia: overweening bureaucratic control of the economy, which reduces efficiency and corrupts democratic practices. Moreover, illiberal systems suffer from their 'tyrannical' failure to separate economic and political spheres, which is best achieved by way of state 'divestment' from the former. Such disequilibria bring about various versions of illiberal state capitalisms, from modest forms of interventionism up to predatory systems, including prebendalism. They all share the characteristic that sums up to the fact that their vertical coordination becomes systematic. They also all fit into a lasting trend in which competition is becoming less and less relevant in capitalist economies, where interventionism and re-distribution grows in relevance. The concept of state capitalism has a long and diverse history and therefore it manifests itself in various (re)incarnations. It has also been deployed with respect to very different subject areas, from war planning and SOE to the interaction between the state and large private monopolies and state-led development strategies. Since the

2010s, the concept of state capitalism has experienced a remarkable revival and renewal – it has become increasingly a commonplace in the business press, academic journals, the writings of geopolitical analysts, research bulletins issued by financial institutions, policy documents released by multilateral institutions and in the public statements of policymakers across the political spectrum. Rather than the rise of a particularly interventionist national economic model, present-day state capitalism is best seen as a set of variegated and uneven state transformations rooted in wider geoeconomic shifts and geopolitical reordering (Alami and Dixon 2024).

The illiberal nature of this type of market economy goes beyond the levels of and scopes of free-market shrinking that we observe in various forms of state-led capitalism or in CMEs. Still, they all belong to the family of more or less pluralist systems. Liberal theories do not rule out illiberalism, but illiberalism does rule out liberalism, and this is the main peculiarity of IME to be explored in further studies. Bearing in mind that we do recognize a variety of state-managed versions of capitalist economies on the globe, one of the most intriguing questions is if, and how, changes in Hungary and Poland constitute just a limited back move of the shuttle, largely in line with global tendencies (Magyar 2016; Szanyi 2020; Csaba 2021)? Or rather, has the extent brought about a change in kind as we can observe it in Hungary? The section below provides some answers to these questions.

3. Poland and Hungary as 'illiberal market economies'

While states, economies and societies in CEE have experienced long and costly transitions away from state socialism, and the resulting economic and social dislocations were some of the most severe in the twentieth century, the popular revolt against liberal economic policies materialized only after the EU accession. Especially after the 2008 financial and sovereign debt crisis that has put renewed strain on economies in the region and forced austerity policies that in turn have risen the spectre of political extremism. In line with such economic adversities and costs, political mobilization around illiberal ideas and against liberal democracy and truly free markets has been growing proportionally. Grzegorz Ekiert claims that illiberal movements are gaining ground in countries where they are supported by authoritarian states and in periods when illiberal political parties are in power (Ekiert 2012). Before that time, in the three decades spanning between 1980 and 2010, there has been a trend towards diminishing the economic role of the state through the means of privatization and liberalization. In turn, 2010s brought a substantial change of this situation. Illiberalism, implying that the state intervenes not only by default, but in the name of so called public interest, and not only at times of emergency, but also in regular times, as a rule, has translated into a doctrinal change (Csaba 2021). Such a paradigmatic change undermines a well-ordered liberal society and puts forward the question of the stability of liberal institutions (Freeman 2001).

After 1989, when the one-party state was replaced by a pluralist democracy, there was a shift from a centrally planned to a market economy and the privatization of state property also got under way. After two decades of successful transformation, it was the Hungarians who decided to alter this trajectory first. The U-turn in Hungarian economy, one which questions essentially everything that was of relevance in the post-1989 period in terms of economic pluralism, privatization and liberalization, led Hungary from a relatively consolidated market economy to an autocratic regime (Kornai 2015). It also questions the idea – established during the years prior to the EU's Eastern Enlargement – that neoliberal capitalism and liberal democracy go hand in hand. Some scholars cautiously warned of the simultaneity of transitions, the conviction that liberalism and especially the 'free market' represents the panacea and holds the development program to pull post-communist Europe out of the bankrupt implosion of real socialism. The more recent 'transitologist' and 'consolidologist' literature has mostly focused on the enabling factors that paved the way for the 'illiberal backlash' in CEE.

Explanations range from the transformation fatigue, exhaustion and internal contradictions of the ”liberal modernization paradigm” (Krastev 2007; Rupnik 2012) to problems related to institutional engineering during the early years of transition or the lack of real elite change and circulation (Whiteside 2024). Others have pointed to political determinants, such as increasing polarization and populism, or the role played by external forces such as the Russian Federation or the EU as factors explaining the illiberal backlash (Buzogany and Varga 2018). Crucial are the features of authoritarian capitalism, that intertwined with the liberal institutions' erosion.

In recent years, CEE have furnished several examples of illiberal governments in power. The most prominent and consequential cases are Fidesz, which has ruled in Hungary since 2010, and PiS, which governed Poland since 2015 until 2023 (Pirro and Stanley 2022). Following the transformations that these parties brought into the economic system, particularly with respect to state-economy relations, this section will focus on several dimensions that help delineate the IME, including corporate governance, knowledge creation system and industrial relations with a special focus on the period after mid-2000s, marking both the EU enlargement and the beginning of Western world's "polycrisis".

Corporate governance and capital markets

Poland's and Hungary's corporate governance configuration has undergone significant changes since the 1990s. While it has been increasingly aligning with Western European models, it still retains its distinct characteristics. In this realm, Poland and Hungary initially adopted a ”dualistic” model inspired by German practices, characterized by a clear separation of management and supervisory functions. According to the classic typology of Julian Franks and Collin Mayer (1992), such system can be labelled as ”closed”, marked by medium to high ownership concentration, limited capital mobility, modest stock exchange financing, and relatively low transparency, as managers are often reluctant to disclose information. The division of ownership grants control to the management board, with enterprises, banks, and oligarchic groups holding sway over individual and institutional investors. This banking-oriented model resembles the corporate governance system in the CMEs (like Germany, Austria, the Netherlands or Japan), rather than in the Anglo-Saxon countries. While external factors have influenced Polish and Hungarian corporate governance, it is equally important to assess how these formal institutions operate in practice. Political institutions play a crucial role in this regard, as the dualistic management model intended for internal corporate oversight has often been co-opted for political purposes, resulting in a form of political corruption (Makowski 2016). SOEs' significant presence in the economy further exacerbates this issue. Corruption and rent-seeking have also been observed concerning European funds, which, when mismanaged, can hinder economic development (Fazekas and King 2019).

In the case of the ways of business financing in different types of market economies, we observe interesting trends that make the two countries different. One can notice the pertaining irrelevance of the stock market in the process of raising capital for enterprises. The Hungarian stock market capitalization expressed as a share of GDP even fell in the period 2004-2020, while the Polish stock market have increased only slightly. The role of bank credit, on the other hand, rose substantially in Poland, whereas in Hungary it stagnated. Interestingly, in both countries, a strong narrative about restoring the role of the state in the economy (Krekó and Enyedi 2018) is reflected in data on the volume of bank loans granted to the government and state-owned companies. In 2000, this parameter was 9.4% of GDP in Hungary and 8% of GDP in Poland. The latest available data (analogously: 23.9% and 23.1%) for the pandemic-marked year of 2020 may be overestimated due to expansive fiscal policies aimed at combating the "coronacrisis". Other EU countries also followed this path which even became known as "fiscal dominance" (see Heinemann and Kemper 2017). Yet the average score in the EU was only 14.2% of GDP. This observation can be treated as an indication of the increasing role of state coordination in the area of capital markets in the countries we analyze. Previous studies also showed an increase in public ownership in the banking sector (renationalization) and the introduction of tax instruments aimed at foreign banks (Pyka and Pyka 2017).

In the context of CEE, the role of foreign direct investment (FDI) cannot be underestimated. Putting Hungary and Poland into comparative perspective *vis-à-vis* other EU economies, it is necessary to acknowledge that they (as well as other V4 countries) are still topping the ranks of countries attracting the most of such capital flows. Poland and Hungary still rely heavily on transnational corporations and their internal hierarchies and the illiberal nationalist agenda did not change this fact. This dependence grew after these economies were integrated into global markets in the 1990s, leading to FDI and foreign capital-backed banking as the primary means of capital-raising. The discourse around DME underscores the synergy between a well-skilled, cost-efficient workforce and corporate governance controlled by foreign headquarters. Poland's and Hungary's efforts to attract FDI through initiatives like special economic zones.

Poland's and Hungary's unique advantage also lied in their simultaneous reliance on European funds, which have propelled their economic growth, but also raises questions about sustainability as they shift from being a net recipient to a net contributor to the EU budget. The EU's recent decision to freeze funds for Hungary amid concerns over the rule of law violations and allegations of mismanagement and corruption provides a stark illustration of the potential economic consequences of such actions. This natural experiment highlights the vulnerabilities of economies heavily dependent on external financing, as the freezing of EU funds can lead to immediate financial shortfalls, disrupt ongoing projects, and deter foreign investment, thereby exacerbating economic instability. The situation in Hungary serves as a critical case study for other EU member states, underlining the importance of adhering to EU standards and regulations to ensure continued financial support and economic stability.

Knowledge creation

Another dimension of the standard VoC framework concerns the institutional determinants of innovation. Noteworthy, the public spending on education has been falling since 2004 in both countries. Expenditures on R&D improved slightly in the Polish and Hungarian economies (reaching 1.4% and 1.6% respectively in 2021), but still remained lower than that of Germany (3.1% of GDP in the same year). On the output side in turn, one can still observe relatively poor Polish and Hungarian performance in terms of the number of triadic (meaning registered in USA, Europe and Japan) patents per million inhabitants.

Poland's economic progress in narrowing the development gap with Western countries can be measured by indicators like median disposable income in purchasing power standards, which improved from just over 45% of Germany's in 2011 to nearly 60% in 2021. Nevertheless, the country faces a critical challenge in boosting its innovative capacity. Dependent development, while advantageous in some respects, has not fostered significant innovation, as the country still occupies a middle position in global value chains (e.g. assembling semi-standardized industrial products for foreign producers). The emphasis on attracting capital and infrastructure investments, while neglecting investment in human capital and innovation, has hindered Poland's innovation ecosystem. While before the COVID-19 pandemics Polish students performed well in international assessments like PISA, the education system struggles to produce a sufficient number of qualified workers in some sectors, resulting in labor shortages (mostly due to the lack of effective vocational training). Additionally, public financing of higher education remains insufficient, and mismatches persist between the supply and demand for certain skills, leading to private sector-driven training in specialized areas.

The innovation performance of the Hungarian economy has also been relatively low. The inventive capacity of domestic small and medium enterprises has been limited and multinational enterprises have not invested much in R&D in Hungary. The weak financing of universities and the R&D sector, along with the Viktor Orbán governments' assault on civil rights and political liberties, has contributed to a substantial brain drain. After years of neglect, Orbán's government has recognized the growing significance of research and innovation spending for economic development and has realized that the EU will focus more strongly on R&D in the following years. The 2019 and further budgets provided for a substantial increase in public spending in this area. At the same time, however, the government has initiated highly controversial structural reforms that have infringed upon academic freedom and are likely to weaken the country's overall performance. The creation of the new and powerful Ministry of Innovation and Technology went hand in hand with a "privatization" of the universities and the ruining of the Hungarian Academy of Sciences. The process of privatizing universities has involved placing eight universities under newly established 'private' foundations controlled by loyal Fidesz supporters. Officially justified as an attempt to make the public research sector more competitive, these changes have drastically reduced the autonomy of the institutions (Agh et al. 2022).

Employment relations

Over the past three decades, Poland's and Hungary's labor markets underwent significant transformations. Structural unemployment, a major concern in the 1990s, has decreased substantially, but there is a growing prevalence of fixed-term contracts, leading to job insecurity. Gender pay-gaps, low participation of women and older individuals in the labor force, and the absence of a comprehensive migration policy present ongoing challenges. The nature of industrial relations in Poland is described as moderate, evolving from post-communist corporatism to rooted neoliberalism. Unionization has declined (from 19.1% of employees in 2004 to 12.7% in 2018), primarily due to privatization and the rise of small and medium-sized enterprises. However, there is a convergence between the PiS party and the largest trade union, which supports government policies related to retirement age and minimum wage. Collective bargaining remains limited, with negotiations often occurring at the company level, covering a small portion of employees. Between 2004 and 2018, Hungary recorded the biggest drop in unionization in the whole V4 group – from 11.4% to 8.3%. In this period, both countries dropped also in terms of the number of employees whose wage contracts are covered by collective bargaining.

Poland's social policy and welfare state regime faced challenges after 2015, including underfunded public health services, 'creeping privatization' of public services, and an emphasis on the consumption- and demand-led economic growth through fiscal policy. Housing issues and pension reform also pose significant challenges. Hungary's public expenditure on social protection under Fidesz decreased from 21.8% in 2010 to 16.4% of GDP in 2019, whilst Poland's spending under PiS increased from 19% in 2015 to 20.9% of GDP in 2019. Hungary's spending fell in all but two areas examined by Eurostat (2021) which included health, family and children, old-age, and disability expenditure. For instance, disability pensions were scrapped in 2012, affecting about 100,000 people (Tomášek 2023). In Poland, notable increases included family and children expenditure, which doubled between 2015 and 2019, and health expenditure. Old-age expenditure also rose, after PiS came back to the minimum retirement age of 60 and 65 years for women and men, respectively, and implemented a 30% increase in the state-financed minimum pension (Eurostat 2021). This data shows a lack of convergence between the two countries as regards the welfare-state provision. Yet, the convergence is visible in the size of the government – in addition to the above-mentioned rising credit to SOE, the ratio of government expenditure to GDP increased in Poland from 41.45% in 2018 to 47.04% 2023. In Hungary, the increase was less dynamic but reached higher levels - from 46.1% in 2018 to 48.24% in 2023.

Patronal networks as type of coordination and institutional (in)complementarity in IME

This size of the government correlates, in the case of the analyzed economies, with patronal networks, clientelist relations, rent-seeking and patronage reaching corruptive levels. Within the EU Hungary is perceived as one of the most corrupted states – with 44 points achieved in 2019, Hungary finished in last position both among V4 countries, and among the new member states that joined the European Union in 2004 and is ranked as the second most corrupt EU member state, preceding only Bulgaria and Romania in joint first position. From the political perspective, both Hungary and Poland (up to 2023), have been considered a hybrid system between democracy and autocracy, which coincides with the crony state capitalism. In certain segments of the economy, loyalty overwrites performance - family members and cronies of political actors and those in power have much better chances to get contracts and positions. Finally, citizens and economic actors seeking the mercy of the state or the government are more interested in rent-seeking than showing (market) performance (TI Report 2019).

What makes the Hungarian and Polish cases different from the illiberal model of state capitalism is the fact that key political and economic decisions are being made outside of the formal structures of the state amid a troubling lack of accountability and transparency. It brings about a highly corruption-generating setting in the two countries, although to differing extents. In Hungary, Prime Minister Viktor Orbán’s regime has successfully captured the most important sectors of the economy and his family members are among the primary beneficiaries of this system. In Poland, the PiS regime has built a clientelist network through which the party’s leader, Jarosław Kaczyński, has consolidated his control over the United Right (*Zjednoczona Prawica*) governing alliance[1]. While in Poland the party state capture came about later in comparison to Hungary, the coercive element of clientelism has become more present in recent years in both states (Zgut 2021).

While Poland and Hungary have both made substantial progress, particularly in reducing income disparities, they face significant challenges in fostering innovation, improving their education systems, and addressing labor market issues, as well as in maintaining a balanced social policy and welfare state regime. These challenges will require strategic and comprehensive efforts from policymakers to ensure sustainable growth and development. Whether the IME model is sustainable is highly questionable bearing in mind the economic performance of Hungary and Poland in the previous years. The first two decades of transformation were quite successful – the low-base effect allowed both countries to catch up the Western highly-developed economies in an impressive pace. The problems occurred in the last decade that was marked by a series of overlapping crises that challenged their growth engines.

It is also worth mentioning the institutional (in)complementarity of illiberal systems. Despite the generally neoliberal nature of both Polish and Hungarian political transformations, the reformers did not manage to develop truly LME-type institutions in all areas. Over the last three decades, Polish capitalism has become rather an intermediate (or hybrid) case, combining the features of both ideal varieties. Some elements of the matrix have been ‘transplanted’ from the CME type (e.g. in the area of corporate governance). Perhaps this is the main argument for the thesis that Poland experienced a ‘transformation without transition’ at the end of the 20th century. We illustrate with the Polish and Hungarian example the peculiar model of IME. Before the populist-nationalist governments came to power, it was easier to conceptualize the two countries as some

[1] Noteworthy, when assessing the early stages of the *United Right* government, Magyar (2016) stated that in Poland there is an emergence of a conservative-autocratic regime, in which ideology plays a much greater role than in Hungary. After 8 years of PiS rule, it is well documented that in terms of creating a corruption machine and draining public money (Markowski 2019), these systems were more similar to each other than analysts might have initially thought.

deformed version of LME. This illiberal type of market economy means that the state (or the ruling party) filled the institutional void created by the neoliberal transition. The initial conditions – such as a significant share of public property in the economy – also seem to play an important role. This moral hazard has been launched by the governments of Poland and Hungary, which decided to utilize the state's assets in order to exercise the party interest and to maintain power. It results in a growing size of government and weakening democratic control of its expenditures, the "renationalization" efforts or prices control in the key sectors. Although the oligarchic structures differ in the two countries (as Poland is an exception in the CEE region with the party-related oligarchs being employed rather in the strategic SOEs and not in the private sector), the role of patronal networks doubtlessly increased. This creates a huge potential for further development of rent-seeking and clientelism in the economic matter.

4. Concluding remarks

Going beyond the conventional categories of VoC literature, we introduced the concept of illiberal market economy, exemplifying it with the CEE country cases. Until now, illiberalism was predominantly studied in its political realm, in this paper we address this deficit recognizing that the authoritarian politics in both Hungary and Poland instrumentalized institutions to the extent that it limited the free-market space, resulting in an illiberal market economy — a distinct form of state capitalism. It is characterized by patronal networks that enable state capture, facilitated by the presence of weak or dependent institutions. Political monopolization of power fosters an environment conducive to rent-seeking and patronage, often reaching corruptive extremes, ultimately serving as coordination mechanisms within the economic system. Moreover, in this paper we put forward a concept of "capitalist backsliding" and illustrate it with the Polish and Hungarian cases since the two countries have become Central European laboratories of illiberal U-turn (Riedel 2019). Fareed Zakaria (1997) in his classical work claimed that illiberal democracy is a growing industry. From the perspective of a quarter of a century, we acknowledge this statement. Both in Europe and globally, a rich variety of illiberal systems have evolved during that time. According to Zakaria, in illiberal democracies political power is increasingly centralized while the freedom of people is concurrently eroded. Depending on the degree of centralization, the character of an illiberal democracy can range from "nearly liberal" to "openly autocratic" (Zakaria 1997). Naturally there is a wide spectrum of illiberal democracy, ranging from modest offenders like Argentina to near-tyrannies like Belarus, with countries like Romania and Bangladesh being in-between. Situation is the same with economic illiberalism – Russia differs from Turkey, and Turkey from Hungary, nevertheless the wide spectrum ranging from the interventionist state capitalism to authoritarian predatory oligarchies needs to be separated by a line in which the level and scope of illiberalism becomes the defining feature of the respective system. For the purpose of delimitating the line between liberal from illiberal regimes we conceptualize the category of IME.

Especially the Hungarian case is a critical one, since Orbán is widely recognized as the *godfather* of illiberalism. In this sense *Orbanomics* is an answer to the crisis of the post-1990 liberal dependent economic model (Scheiring 2020). This kind of policy mix includes also anti-liberal anti-business policies serving the interests of the political elite and loyal oligarchs. This illiberal matrix (Rydliński 2018) is sometimes described as 'unorthodox' policy mix. This usually means a series of measures that are contrary to conventional wisdom. Surprisingly enough, at least for some time, this set of ad-hoc regulatory interventionism, nationalization followed sometimes by privatization to people befriended with the authorities, marginalizing foreign ownership in banking, energy sector and trade, and super lax monetary policy together have indeed been successful in bringing about sustainable and high rates of growth, real convergence to the core EU. There are two ways of interpreting this success of Orbán: that incremental change translated into a new quality in post-

2010; and that = the uniquely favorable external conditions rather than institutional and policy innovations explain less than exceptional outcomes (Csaba 2022).

This illiberal backlash against the neoliberal transition is, to a large extent, a bottom-up phenomenon. Already in the early 1990s David Ost (1992) warned that the danger of new dictatorship in CEE comes from the bottom, not from the top. While initial fears about popular revolts against neoliberal economic reforms implemented after 1989 and against growing inequalities faded away after the first decade of transformations, warnings of the populist backlash fueled by illiberal political entrepreneurs feeding on popular discontent, have been a constant element in the commentaries on the region (Ekiert 2012). Already in 2007, Krastev claimed that the liberal era that began in Central Europe in 1989 has come to an end. Populism and illiberalism are tearing the region apart. Similarly, Rupnik (2007) argued that the recent populist backlash is a direct challenge to the liberal paradigm that has prevailed in the region for a decade and a half.

Despite the fact that the reports on liberalism's death are premature, the challenge imposed by illiberal forces are existential. The contestation of liberalism is not reducible to political parties or any single macroeconomic determinant, and therefore should be approached as a broader phenomenon. To achieve this we should focus on the characteristics of the post-communist society, longing for redistribution and state paternalism. Former East bloc societies' value structures rest on a relatively weak commitment to democracy, distrust, a lack of tolerance and a demand for strong state intervention. Moreover, a large number of post-communist societies associate democracy with economic growth, material wealth and state-controlled redistribution. This is demonstrated by the recognized correlation that the majority considers a prosperous economy to be as crucial for democracy as free elections. Even more interestingly, surveys conducted in the past decades show that on the whole the Hungarian population believes that in economic terms the country is worse off than under socialism (Bíró-Nagy 2017). This anti-neoliberal reaction, is a part of a broader phenomenon, we may call it "post-liberalism" or "neoilliberalism" – namely we live in the illiberal age which is a challenge for the liberal order in general (Kazharski 2020).

Both in the case of Hungary and Poland, we have observed some similar trends as regards state's presence on the market and other parameters of state interventionism. Nevertheless, Budapest and Warsaw reveal some divergent trajectories, or rather Hungary – being chronologically first in building IME – is simply observing a faster implosion of its illiberal economic system. In both systems we witness the growing size of the government, measured in the ratio of public spending in relation to the GDP. Unlike in many other state capitalism systems, in Poland and Hungary it brings about systemic clientelism – the patronal networks that allow (party) state capture. Such clientelist relations between the state and the market are possible only due to the existence of weak (in)dependent institutions. Political monopolization of power creates an optimal environment for rent-seeking and patronage reaching corruptive levels in an extent in which they become coordination mechanisms themselves. Autocratic politics – both in Hungary and Poland – generates such instrumentalization of institutions that it takes the form of counter-competitive measures by limiting the free-market space. This way, they produce IME which is a peculiar variant of state capitalism with CEE flavor.

Our main finding is that the CEE countries with their specificity (such as the legacy of neoliberal transformation, transition fatigue, rapidly rising inequality, fragility of democracy, weak political institutions, etc.) were more susceptible to changing macro trends in the global economy. Therefore, the increase in state coordination in the economy that took place globally after 2007 in the CEE countries turned out to be disproportionately greater than in the countries of Western democratic capitalism. In this sense the CEE proved, one more time in history, to be the peculiar laboratory in which global trends and tendencies are accelerated and magnified, and therefore are visible in a sharper contrast. This has been true earlier in the case of democratic backsliding, the rise of authoritarian populism, and many other instances. This paper has focused on the economic dimension and demonstrated the "capitalist backsliding" in the region. It enabled to introduce the concept of illiberal market economy whose explanatory potential goes beyond the CEE or post-communist context. It may serve as an analytical category that is complementary to and advancing the already existing typologies present in the VoC literature. At the crossroads of the political economy of state capitalism and illiberalism studies we established the IME concept. Its analytical potential may serve scholars exploring the state of art and developmental trajectories of socio-economic systems across the globe, whenever they cannot be captured with the classical (e.g. LME/CME) categorizations. Our study broadens the scope of available models to be employed in future investigations of illiberal tendencies in economic realms.

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