

Shell Companies in Corrupt Transactions: A Hungarian Case

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Abstract

Corrupt policy makers in Central Europe often use shell companies as intermediaries to misallocate public resources to private benefit. Based on a qualitative empirical analysis, this paper provides an understanding of how these corporate vehicles are misused for government corruption in contemporary Hungary. We identified two major types of such organizations: “live” shell and “empty” shell companies. Live shells are used by national governing elites to build clientele networks and provide monopolistic market positions for oligarchs. Empty shells are technical vehicles used by local government actors to create valuable assets that can be sold for extra profit. The findings suggest that at national level, the governing elite captures the state and control entire sectors, while the power of local level actors is more limited. They can only manage occasional corrupt transactions via shell companies. The discovered political, organizational and social context has important policy implications.

1. Introduction

Individuals using corporate entities for illicit purposes is a growing phenomenon (OECD 2000:11). One dominant form of such activities is using anonymous shell companies that cannot be traced back to their real owners (Findley et al. 2014:3). Although shell companies may be perfectly lawful, used for mergers or complicated business transactions (Economist 2012), the lack of accurate information about their ownership structure allows their real principals to misuse them for tax evasion, money laundering, mortgage and bankruptcy fraud and terrorist financing. Shell companies are also used for carrying out complex corrupt transactions (FATF 2000:4; De Willebois et al. 2011). According to a recently published OECD (2014) report on international bribery, in 75percent of the analyzed 400 cases, intermediaries were involved to channel the transaction and 35 percent of these “mediators” were corporate vehicles, anonymous shell companies.

Relatively few academic studies have examined the role of shell companies in illicit practices (Findley et al. 2014; Sharman 2010; Aydogdua et al. 2007; Liddick 2000; Benett & DiLorenzo 1987). Moreover academic literature on corrupt shell companies is literally nonexistent. Matthew C. Stephenson’s substantial 234-page bibliography on corruption and anti-corruption includes only one article focusing on the shell company issue.¹

Although a shell company is a legal entity to mediate a corrupt transaction, it needs flesh and blood members to make the whole corrupt scheme work. They need visible but fake owners or CEOs to represent them (at least on paper), clients who do business with them, as well as shadow principals who are officially not affiliated with the company but effectively control it and are the main beneficiaries of its existence. In this sense a shell company not simply a technical tool but also a social phenomenon. Shell companies are especially widespread in post-socialist countries where the boundaries between public and private spheres of social life are fuzzier than in Western democracies. Here secret owners are often politicians, public servants or oligarchs.

Based on a systematic analysis of shell company cases this article demonstrates that corrupt public policy decisions in contemporary Hungary have changed the ownership structure of three areas of business activity (tobacco retailing, agricultural land usage and real estate development). Analyzing 104 newspaper articles we develop two distinguished models of corrupt shell companies. Ownership changes have been brokered using both live shell and empty shell companies. Although their general function is to facilitate the particularistic allocation of public resources, the findings suggest that they

¹<http://www.law.harvard.edu/faculty/mstephenson/2015PDFs/Stephenson%20Corruption%20Bibliography>

are used at different levels of the government structure for different purposes. Live shells are organizations with real operations, assets and employees. In this case the consequence has been that clientelism has prevailed rather than transparency, and market capture is a significant outcome of the corrupt policy process. Here the winners are those close to the national governing elite, and losers are spread through the country. In contrast to this model empty shells are simply technical vehicles. Empty “paper firms” have used to channel local-governmental resources into private hands. Municipal executives and businesspeople benefit from these one-time transactions while local residents lose large amount of their community resources. This Hungarian case study suggests that anti-corruption strategies should not address the corrupt shell company phenomenon as a simple technical or legal issue. Such organizations are deeply embedded into informal elite networks and the country’s political institutional structure. They are products of a broader corruption process, involving policy decisions and multiple actors at different levels of institutional hierarchies.

Due to their secret nature it is almost impossible to quantify the extent of misuse of shell companies for illicit purposes. This paper rather attempts to study the qualitative part of the story and provides an understanding of the organizational, social and political context of shell companies in contemporary Hungary. These are the research questions of this study: What are the main reasons for using shell companies in corrupt transactions? What are the typical economic sectors in which shell companies are used? Who are the main actors and what is the relationship between them? How can we characterize the social and political context of shell companies? The paper also offers some important policy implications. Here I focus on cases where shell companies were used for government corruption, extracting public resources from state institutions. Issues such as tax evasion, money laundering, and mortgage and bankruptcy fraud when all participants are typically private actors and the illicit activity does not involve public organizations are beyond the scope of this paper.

2. Shell companies as corruption brokers

Organizations analyzed in this article were used to mediate transactions between corrupt actors. These exchanges have a multiplayer structure involving three or more corrupt actors, formal organizations, their visible and secret owners and other outsiders to facilitate a corrupt transaction. This indicates a network-type corrupt structure more complex than the predominant principal-agent model which views corruption as usually a simple transaction between two individuals: an agent and a client (Banfield 1975; Shleifer & Vishny 1993; Lambert-Mogiliansky et al. 2007). Brokerage is an exchange of valued resources from one actor to another via an intermediary (Gould and Fernandez, 1989; Stovel & Shaw, 2012). Although some scholars studied corruption brokerage, the topic is a relatively unexplored within the field of corruption research. Much of the existing literature examines cases where brokers are individuals, who help corrupt actors

find each other and extract profit or ‘commissions’ from the deals (Jancsics 2014; Oldenburg 1987; Lambsdorff 2007:53, 140). It is rare when academic scholars consider organizations as corruption brokers (Szanto et al. 2013).

The most important function shell companies can provide to their shadow owner is the potential for anonymity while guaranteeing the control over the company. This suggests a dual structure of mediation. Although the main action in the legal realm is implemented by the formal organization, the visible and fake owner (or CEO), responsible to fulfill a corrupt agenda, is also a broker. He or she follows the informal orders of the real but secret owner. This is a distinguished type of mediation when a “representative broker” is delegated by another actor or a group to represent the group’s interest and deal with the outside world (Gould & Fernandez 1989). In our two models, fake shell company owners clearly fall in this category. They are representative brokers acting on behalf of a shadow somebody else. This structure qualitatively differs from another brokerage type, where the middleman is a neutral entrepreneur, a freelancer generating profit from being the only link between others and coordinating their activity (Burt 1992:23).

3. Methodology

It is hard to obtain analyzable data on shell company operation since the participants try to keep their activities secret. The seminal study published by Beth Mintz and Michael Schwartz (1985) on interlocking directorates among large US corporations has proved that newspaper articles and popular reports could be suitable sources for academic analysis. Following this tradition the main assumption of this study is that reporters and investigative journalists are naturally good at exploring hidden social relationships behind the visible formal arrangement. They “follow the money” and reveal intervened ownership structures as well as hidden family memberships, friendships and other social bonds between the actors. With some caveats, this paper argues that newspaper articles provide useful empirical data for a systematic analysis of anonymous shell organizations. The major units of this analysis are online or printed newspaper articles collected by K-Monitor a Hungarian Watchdog Organization.² K-Monitor gathers, stores and classifies articles concerning corruption, public financing, and the transparency of public life in Hungary. Due to the highly criticized new media law in Hungary, adopted on 10 March 2011 by the conservative Fidesz-KDNP coalition, and the government’s attempt to exert pressure on private media press freedom declines and self-censorship increases in Hungary (Transparency International 2012; Freedom House 2015; Mong 2015). Despite such negative trends investigative journalists and watchdog organizations do a great job and frequently publish about suspicious cases and corruption scandals, though such cases seldom reach the government controlled official media (Transparency International Hungary 2012; Mong 2015).

² <http://k-monitor.hu/index.html?plang=en>

Using qualitative text analytical technique my main goal was to describe, understand, and explain why and how corrupt actors use formal vehicles in contemporary Hungary. My research leaned toward multiple individual cases published in newspaper articles. I accumulated evidence about shell companies from different sources and tried to define constructs converging into similar patterns.

Hungarians often use the term “stróman” for shell companies. The word was adopted from the German *Strohmann*, for individuals acting on the behalf of somebody else. The use of term “stróman,” can be tracked back in the 1930s when the “Jewish Laws” in Hungary significantly restricted the number of Jews in liberal professions, public administration, and in commercial and industrial businesses. Jewish owners were forced to pass their enterprise to new Catholic owners on paper but many of them continued to control the company from behind the scenes (Kadar and Vagi 2004: 63). Hungarians started to use the word “stróman” to refer to these visible but fake Catholic business owners.

The K-Monitor database includes about 27,000 newspaper articles covering the period between 1997 and 2014 and there is a comprehensive coverage between January 2006 and December 2014. K-Monitor already coded 199 articles that were related to modern “stróman” activities. I also searched for articles by using the keywords “fantomcég” and “fantom vállalat” (phantom firm and phantom company), which are also used as synonyms of shell companies in the Hungarian language. This search resulted in 26 additional articles. Finally, I collected 225 articles published between 2007 and 2014 containing cases related to shell companies. After the first review of my textual materials, I omitted all articles from the analysis that could not provide new information about the examined topic. Many of them simply re-published the content of already existing articles. I also excluded editorials and other commentaries that expressed the personal opinion of the author. Then I systematically coded the remaining 104 article.

Finally, I created 48 main codes, with 20 of them having addition sub-code structures. For example, under the main code “sector” I had 16 sub-codes of different economic sectors. During the coding process, I was interested in what the main explanations of using shell companies are; in what economic sector the transaction happens; who the main actors are; what the relationship between them is. I also intended to describe the social and political context of cases. However, several other codes emerged, outside of this framework. This study focuses only on government corruption; therefore private sector-related shell company activities, mainly tax evasion, money laundering, and bankruptcy fraud were excluded from the investigation.

The data analysis was based on iterative interplay with the data when I constantly checked and revised the emerging codes, categories and indicators. This involved three

main coding phases (Pandit 1996). However since large segments of the code system were restructured several times during the process these phases somewhat overlapped. In the open coding phase the data was broken down by asking simple questions such as what, where, how, who, how many times, etc. As the second step of the analysis I started to make connections between the emerged codes and develop categories, higher level and more abstract elements of the analysis than the original codes. Here I grouped similar incidents together and put them under the same category. Finally I focused on co-occurrences between the existing categories and created the core categories with different context, mechanisms, actions, and causal conditions related to them. These core categories implied eight indicators, the main elements of the construct measures of corrupt shell company types in Hungary. Table 1 shows some examples of this coding process.

Table 1. Examples of the coding process

Text segment	Open code	Category	Indicator	Source
The wife of the National Media and Infocommunications Authority's former Chief of Staff has won four tobacco concessions in two towns, Szentendre és Budakalász. Local residents do not know her; she has never worked in the tobacco retail sector before.	Actors	Actors socially close to the principal: Kin, friends etc.	Brokers	atlatszo.hu. Az NMHH kabinetfőnökének felesége is trafikokat nyithat. 2013.05.09.
His [shadow principal] employees had established private limited companies in November/December, months before the results of the tobacco tender were published. Later these companies became owners of limited partnerships in which partners were tender winner individuals.	Actors	Trustworthy actors who can manage the shell company for a longer term: employee, business partner. Often patron-client relation between the principal and the broker		origo.hu. Ők a trafikbuli legnagyobb nyertesei. 2013. 06. 18.
Foreign companies are banned to buy agricultural land in Hungary. That is why the local government of the city entrusted the lawyer, Mr. Smith to act on behalf of the government. The lawyer bought the land for himself...and then the government provided the permission to change the land's status from plough land to land for commercial purposes. Since it was not an agricultural land anymore XY Ltd with a corporate owner in Luxemburg was able to buy the land while its value increased about tenfold...A big international carmaker will buy the whole area for a logistics park.	Actors	Trustworthy actors who can fulfill the function of technical owner for a short-term: Lawyers, local government, friends		HVG. Titokzatos győri földügylek: befőták az eladók száját. 2012. 10. 31
The mayor and his family will have a significant influence on the town's tobacco business because his wife and daughter have won four tobacco retail concessions for twenty years.	Activity	Continuous economic activity	Shell Company Activity	HVG. Trafikmutyi: idegenek, képviselők és haverok sora. 2013. 04. 25.
The number in the companies' name indicates that they were established for only one project (E.g. Király 27 Kft., Dembi 26 Kft).	Activity	One-time transaction		Magyar Narancs. Az erzsébetvárosi ingatlanpanama háttere. 2008. 04.12.
So far 30 tobacco shops were won by well-known politician's kin, friends, activists and acquaintances in Jászág.	Activity	Allocate small pieces of resource to relatively large number of principals	Resource Allocation	Népszabadság. 'Micsoda szenzáció' Jászágban! 2013. 11. 05.
For example, in Borsod County, of the allocated 2800 hectares land, about 1,600 hectares were obtained by four winners.	Activity	Allocate large units of resources to few principals		HVG. Kikértük a jegyzőkönyveket a botrányos földügylekről. 2012. 05. 16.
Documents prove that stróman buyers, soon after the purchase, sold the properties to foreign investors at six hundred million forints higher price than they originally bought.	Activity	Allocate resource to a shell company, then multiply its value		http://www.magyarhirlap.hu/belfold/elkeszult_az_uj_ingatlanertekbecsles.html

Systematic analysis of news streams provides access to deep structural features of manifest content that would be otherwise unnoticeable yet there are also possible drawbacks of this methodology. News may be biased and selective for several reasons. Newspaper articles are produced and shared in socially organized way suggesting that they do not perfectly reflect the world out there (Jauch et al. 1980). They often interpret and package reality throughout society rather than objectively show it (Franzosi 1987). Moreover such articles are created for purpose other than academic research and thus they often provide insufficient details about the examined case (Bowen 2009). In contrast to researchers, reporters have no obligation to use representative samples or reveal all relevant details and make general claims.

News may also contain factual errors and selection bias. For example, sample of cases analyzed in this study may be biased because of the newspapers' political view and the journalists' particular interest. A similar bias emerges in the study of other hard-to-reach populations such as prostitutes, homeless people, drug users, gang members or criminals (Heckathorn, 1997; Atkinson and Flint, 2001). Since the size, boundaries and other characteristics of the secret corrupt population are unknown the subjects of the analysis cannot be selected by random sampling. The researcher can rely only on available information. Therefore results of this qualitative study are probably not generalizable in the 'traditional quantitative' sense yet they may form a strong foundation for understanding and explaining social phenomena similar to those I investigated here, the use of shell companies in government corruption (Falk and Guenther, 2007; Popay et al., 1998). In this case so called 'analytic generalization' occurs when the developed concept is useful in explaining similar situations (Yin, 2013).

In order to strengthen the 'analytic generalizability' of the study I used rigorous research design, systematic data collection and careful analysis. As part of this process I identified the possible political bias of the examined newspapers. I asked two Hungarian academics and two media experts to categorize the newspapers in my sample based on the political view of the media source. The responses were surprisingly consistent. Minor discrepancy happened only in three cases (Élet és Irodalom, HVG, Magyar Narancs) when one expert classified the newspapers' political view as independent while others as thought they were liberal. Table 2 shows the list of Hungarian newspapers, magazines and websites and their political view and Table 3 provides the proportion of articles based on the political view of the media in which they were published.

Table 2. Source of articles

News Media	Political View	Number of articles	%
atlatszo.hu	Independent	2	1.9
Blikk	Independent	8	7.7
Élet és Irodalom	Liberal, Independent	1	1.0
Figyelő	Independent	1	1.0
Hetiválasz	Right	4	3.8
hirszerzo.hu	Independent	7	6.7
HVG	Liberal, Independent	8	7.7
index.hu	Independent	9	8.7
Magyar Hirlap	Right	8	7.7
Magyar Narancs	Liberal, Independent	1	1.0
Magyar Nemzet	Right	11	10.6
MTI	Right	4	3.8
Népszabadság	Left	20	19.2
Népszava	Left	1	1.0
origo.hu	Independent	15	14.4
stop.hu	Left	2	1.9
vallalkozoi.negyed.hu	Independent	2	1.9
Total		104	100

Table 3. Political view of articles

Political View	%
Independent	42.3
Liberal, Independent	9.6
Right	26.0
Left	22.1
Total	100

Focusing only on similar patterns that emerged from different cases and sources improves the internal validity of the research (Eisenhardt 1989). In this study I examined each case (story described in an article) and decided whether it would confirm or disconfirm the gradually emerging construct of shell companies. I am aware that such methodological drawbacks can be addressed only partially yet given the difficulty to gather first hand information on actual corrupt cases I believe that the advantages of the systematic analysis of news streams clearly outweighs its limitations.

It is important to note that the stories I analyze in this paper were published by journalists. Most cases were not investigated nor prosecuted by authorities and the participants were not convicted. Since many actors still held public positions in Hungary, I do not use names of people and companies discussed in the analyzed articles.

4. Findings

All cases selected for this analysis have a common feature. They indicate corrupt public policy decisions. The way the resource distribution was planned, organized and the receivers were selected had been already biased by particularistic interests. This suggests a distinct form of illicit activities: corruption in the input side of public policy, where the implementation of laws and rules occurs (Graycar & Prenzler 2013: 28). These corrupt policy implementations were brokered using two different types of shell organizations.

Several scholars view shell companies as “paper firms” without having real employees, offices, operation and assets (Findley et al. 2014; FATF 2014). However the findings of this study suggest that this is not always the case. The category of “empty shells” -- echoing the mainstream approach of shell companies -- includes firms that serve only as

technical vehicles in a corrupt transaction without real operation. They do not pursue any legitimate business activity. It does not mean that such firms do not need fake owners, managers and contracts in order to simulate real economic transactions. They list their executives, staff, or board of directors in official documents and sometimes on websites.

In contrast to this type I classified companies as “live shells” that had real operation and commercial activity. Live shells are functioning entities, controlled by shadow owners. Within the live shell category, I found two additional patterns of corruption. Table 4 shows the main characteristics of corrupt shell companies in Hungary.

Table 4. Corrupt shell companies in Hungary

	Live Shell		Empty Shell
	Clientele Building	Market Capture	
Real operation & infrastructure	Yes	Yes	No
Function	Principal not allowed to run business	Principal not allowed to run business	"Switcher" function: change the value of the resources
Company Activity	Continuous economic activity	Continuous economic activity	One-time transaction
Resource allocation	Allocate small pieces of resources to relatively large number of principals	Allocate large units of resources to few principals	Allocate resource to a shell company, then multiply its value
Relationship between the actors	All actors belong to the same network of a privileged group. Beneficiaries are lower level actors	All actors belong to the same network of a privileged group. Beneficiaries are elite economic actors	Brokers represent corrupt public servants. The final private buyer is independent from the public side
Level of captured institution	National government	National government	Local or regional government
Brokers	Actors socially close to the principal: Kin, friends etc.	Trustworthy actors who can manage the shell company for a longer term: employee, business partner. Often patron-client relation between the principal and the broker	Trustworthy actors who can fulfill the function of technical owner for a short-term: Lawyers, local government, friends
Principals	Lower-level members of the national governing party: local mayors, ministry employees etc.	Oligarchs, businessmen, top politicians	Local political elite members: mayors, notary, etc.

According to my findings two types of organizations were used as shell companies: limited partnerships and private limited companies. In the case of limited partnership brokers held the general partner position in the organization. In a few instances shadow principals also appeared as limited partners in the arrangement. However since such partners are subject to registration this was a risky and rather uncommon way to control shadow organizations. Private limited companies were more popular forms among the corrupt actors. Here the owners can only lose the full amount of their investment and their personal assets will not be reachable by creditors and other claimants. This company form is often misused for illicit purposes in other countries as well mainly because of its lower minimum share capital requirements and because their shareholders' identity is not strictly monitored. Moreover private limited companies face a less strict regulatory and supervisory control. In this paper I studied relatively simple company forms however more complex ownership and control structures may exist with many layers of shares registered in the name of different legal persons (FATF 2014). They are more

professionally designed and managed corrupt arrangements and therefore it is even harder to identify their illicit nature.

4.1. Live shells

The main reason of the existence of live shells is that their real owner cannot visibly practice his ownership in an operating firm and therefore needs a seemingly independent broker who can do that for him. In the case of live shells, the state distributes valuable resources, licenses, concessions or other monopolistic market positions that can guarantee profit making. This is not a one-time illegal extraction of public resources but rather an extra-profit opportunity to functioning economic entities. Here the main organizers of corruption considerably restructure whole market sectors or segments of a sector. The way the resource distribution is planned, organized and the receivers are selected is already biased by particularistic interests. Although the rules of distribution are tailored, the actors attempt to create a legally defensible structure and make the receiver side seemingly independent from the policy creators and distributors. Since in life shell cases the state allocates only the rights to make profit, not straight cash, the receivers need an organizational structure capable of obtaining the rights, then operating and making money. In most cases live shells do not only have an owner or CEO but other employees as well.

Two dominant economic sectors emerged in which live shell companies were extensively used: tobacco retail and agriculture. I also identified similar patterns in the telecommunication sector but to a much lesser extent. The tobacco and agriculture cases are related to two large-scale concession projects in which the Hungarian state redistributed substantial amount of public resources. In both projects, journalists identified dozens of suspicious cases.

Tobacco is a 500 billion HUF (about 2 billion USD) annual business in Hungary. In 2013, the Hungarian government made the previously liberalized tobacco retail business a state monopoly and announced a tender for 20-years concession of tobacco sale. This administratively reduced the number of business units from 42,000 small entrepreneurs to about 6,000 newly created tobacco shops with exclusive right to sell cigarettes and cigars. The contract also guaranteed lavish compensation for the concession owners if a future government were to cancel the contract before the end of 20-year concession period. After a non-transparent selection process, investigative journalists gradually identified more and more interpersonal connections between the new concessionaires and the ruling government coalition members, while many previous shop owners who also applied for the tender lost their right to sell tobacco. There are different estimates about the proportion of concessions that were allocated in a particularistic way. Based on cases revealed by journalists, between 25 and 35 percent of the concessions were obtained by

shell companies owned by the networks members of a privileged group, closely linked to the national government.

The fact that the tobacco is now available in a significantly reduced number of locations in Hungary clearly boosted illegal black market activity and cigarette smuggling from neighboring countries. Based on excise tax data and representative surveys, experts estimate that the tobacco black market increased about 9-10 percent due to the new tobacco concession project. It also means that the state's excise tax revenue on tobacco significantly shrunk. Before the introduction of this new system in 2012 it was 345 billion HUF (1.25 billion USD) but it fell to 288 HUF (1.04 billion USD) by 2014.³

The agriculture cases are related to a large-scale subsidized land lease program initiated by the state in 2012. The official goal of the project was providing 65,000 ha of cheap land to lease for local communities in Hungarian rural regions, especially for young people, in order to help them to take off or expand their family farms. However it turned out that on average only 15-20% of the land was given to local farmers and the remaining part was concentrated in the hands non-local actors, closely linked to the governing party. The Secretary of Agriculture went public with this case and resigned in protest after he had realized that in fact interest groups and party loyalists became winners, rather than local farmers. After the Secretary's whistleblowing act, journalists started to dig deeper in the lists of the tender winners and found many interpersonal connections between the new leaseholders and party oligarchs as well as members of the governing party coalition.

The actual technique of how winners were selected was very similar for both the tobacco and agriculture cases. The most subjectively evaluated part of the tender documentation was the contenders' business plan that counted 50 percent in the total score. Tender winners received significantly higher scores for their business plan than losers, while for more objective factors such as the business hours or hiring unemployed or disabled working force, winners and losers received points that were statistically not different.

During the analysis of the articles two main sub-categories were crystalized within "live shell" stories, representing two distinguished forms of biased particularistic distribution of state resources. Both can be found in tobacco concession as well as land leasing examples. In the case of "clientele building" the main reason for using shell companies was forming and rewarding clientele networks around the governing political party. This was a reallocation of small pieces of resources to relatively large number of winners. I called the second category "market capture." Here, shell companies were used to help powerful economic actors and oligarchs obtain dominant market position, while they were able to hide their ownership of the business via shell companies. In market capture, large units of resources were allocated among a few principals.

³ Source: Ministry for National Economy, 2014.

In both categories the journalists revealed close social relationships between the distributors, the principals and the receivers. The actors knew each other, sometimes very well. In clientele-building examples the form of relationship between the broker and the principal was mainly kinship, friendship or at least membership of the “political family” while in the case of market capture, the broker was often a current or former employee or a business partner of the principal. This indicates friendship or unequal patron-client relationship.

Clientele building. Clientelism is targeted distribution of resources to supporters in exchange for their loyalty (Grzymala-Busse 2008). Party patronage and clientele networks are especially widespread in post-communist democracies of Central and Eastern Europe (Nakrošis & Liutauras 2012; Gudžinskas Kopecký et al. 2008). This study provides insights into the mechanisms of how shell companies are used in a systematically organized clientele building procedure in Hungary. Here the shadow principals are public servants, national politicians or mayors who are legally banned having a formal position in business firms. The most typical pattern was that family members, spouses, siblings, parents and parent-in laws or even neighbors of people linked to the governing party won several concessions.

It was a highly publicized case when the immediate neighbor and friend of a top politician received nine tobacco concessions in the busiest locations of Budapest downtown. In many other instances, the shadow owner was a mayor or deputy mayor. In one case a secretly recorded conversation was leaked in which a mayor of a city openly discussed possible winners and losers of the tender with other assembly members. The mayor claimed that tender winners should be at least “committed right-wing conservatives” as the current national and most local governments are. Talking about another candidate, the mayor asked his colleagues if the person “delivered” enough votes for the party in the latest local parliamentary elections. This suggests a classical example of political clientele building when low-level actors affiliated with the party are rewarded with concessions for their political support and loyalty. Such targeted spending generates sufficient support to stay in power without allocating resources all society members (Grzymala-Busse 2008).

Market capture. The second category of live shells suggests cases when the number of licenses or concessions that one person permitted to receive was limited; therefore the bad principal needed brokers who would win the tender and run the business for him/her. In these examples, the resource allocation helped the shadow owners, oligarchs and other businessmen to develop invisible dominant market positions in a sector or a region by controlling large amount of organizations through brokers. In market capture, the brokers were mainly employees or business partners of the shadow principal but we can also find some cases when family members or friends were the fake company owners.

Journalist revealed a close social relationship between the authorities who allocated the concession and the winners. In order to manage and supervise the whole tobacco concession project, the Hungarian state established the National Commercial Tobacco Company. Documents proved that in the late 2000s, the current CEO of this Tobacco Company had been a board member and top manager in companies owned by a businessman, whose shell companies received several tobacco concessions in the tobacco project.

Investigating the tobacco contracts, reporters exposed a huge cluster of concessionaries that in fact formed a whole tobacco retail “empire.” Shell companies of current and former employees or partners of a complex company holding won 500 concessions all around the country. It turned out that the owner of the holding and the main shadow principal was the person who designed and “tailored” the traffic concession law. It was leaked and verified that an earlier version of the law was prepared with his personal laptop. Since in this case it was hard to fill such about 500 shell companies merely with employees, the organizers of this cluster used anybody available for being a broker, from elderly parents to young siblings and even a pensioner housemaid. Some other powerful actors were also able to cover whole cities or even counties with tender winner shell companies. Moreover, tobacco shops in the best locations including busy gas, bus and train stations, the airport, and crowded shopping malls were typically obtained by powerful businessmen. Such positions guarantee long-term extra-profit.

In the agriculture case we can also identify market capture patterns. Obtaining large tracts of land as a low-cost, long-term lease can be profitable even without any productive activity. The European Union’s subsidy is 300 euros per hectare for farms. Given the low-cost of the lease per hectare, once a farmer is able to get 100 hectares, his yearly income from the subsidies alone will be 7.5 million forints (about 30,000 USD), even if he leaves the land unplanted. In Borsod County, about 60 percent of the leased land is in the hand of shell companies related to four people. In Fejér County only eight people share the obtained land’s 80 percent. The Prime Minister’s close soccer buddy, the mayor of his hometown, is also among the biggest winners of the agriculture case. Via shell companies, the mayor obtained 1,250 hectares, which means he is eligible to receive about 300,000 USD annual EU subsidy, beyond that comes the actual profit from the crops.

4.2. Empty shells

Empty shell companies are different from their live shell counterparts. They do not have real operation, employees, infrastructure or assets. The main reason for using them is that they serve as technical vehicles in a corrupt transaction. In most cases, empty shells were used to facilitate the allocation of local-governmental resources into private hands. During an interim period, the official owners of the shell companies were lawyers,

friends and, in some cases, the local government itself. Finally, the real private sector owners who bought the shell companies became mainly oligarchs or Hungarian subsidiaries of multinational corporations.

Similarly to the live shell model empty shell cases can be classified as corruption in the input side of public policy since here also, local level regulations are manipulated in order to misallocate public resources. Yet this pattern is also a bit different from live shell cases. Before the implementation of laws and rules that will serve particularistic interest the public resources are transferred to the shell organization. Due to the newly created regulatory framework, the value of the resources owned by the shell company will be multiplied and then the whole enterprise will be sold to a third party for extra-profit. This suggests that empty shells in corrupt transactions have an important “switcher” function. They help smoothly turn the public character of resources into private one and at the same time they facilitate the increase of the value of the same public resource after the introduction of a new public policy.

One major way to make a land much more valuable with administrative tools is to switch its status from agricultural land to an area where houses and shops can be legally built. In Hungary local governments have the discretionary power to make this change. I collected several examples of this pattern. Here, shell companies purchased agricultural land and after the local government changed the status of the land and the shell company obtained all permissions necessary for a real estate project a multinational corporation, who wanted space to build factory, shopping mall or residential buildings, bought the shell company. Since foreign citizens or firms are banned from buying agricultural land in Hungary, they can purchase land only when it is already classified as building area. The shell companies are the vehicles to turn a cheap agricultural area into legally purchasable asset for a foreign corporation and investor.

In other cases shadow principals, mostly local mayors, acquired insider information about planned routes of highways, railways or subways. These infrastructure projects considerably increase the price of the properties close to the road or railway lines. Mayors used shell companies to buy land before the official announcement of the future infrastructure project. In these cases, the shadow owner had to wait a few years before they could realize the profit of the transaction, but finally the state generously compensated the shell company for expropriation or commercial investors paid a high price for the land close to the infrastructure project.

In contrast to clientele building and market capture cases when the national government misallocate resources, corrupt actors at the local government level cannot build an entire quasi-market for their shell companies. Their legislative power is “only” enough to increase the value of the resources owned by the shell company. They can create highly

valuable assets that can be sold for extra profit but they cannot guarantee long-term operation and profit making to the shadow principals. Therefore, corrupt empty shells always end up market-type transfers, in which the public resource turns into private property when a third party buys it. It does not mean that there is no collusion between the public and private parties, however after this final transaction, the shadow principal does not control the shell company anymore. Empty shells are established for a one-time corrupt transaction.

4.3. Relationship structures

The relationship structure between shadow principals and public actors is different in the two models discussed here. When the national government allocates its resource illegally as clientele building or market capture, all actors seem to be somewhat related to the same network of a privileged group. Shadow principals' and brokers' access to resources depends on their membership in states-based groups, a widespread phenomenon in Central and Eastern Europe. In these cases shell organizations are important vehicles in the sophisticated and systematically accomplished corruption scheme. Sometimes principals have a formal position in public institutions or the governing political party. In other cases, they are informally linked to government elites.

Even in the case of market capture when oligarchs are the owners of the shell company, we can find close social bonds between these powerful economic actors and the state-side members of the transaction. For example, a well-known oligarch, whose company has won most public tenders for years, was a college dormitory roommate of the Prime Minister. Another oligarch, who was mentioned earlier in this study, also won both tobacco concessions and subsidized land, is also an old family friend of the Prime Minister's and the mayor of his hometown.

Hungarian oligarchs, similarly to their Russian counterparts, are not independent. They have been always linked to political parties since their main source of profit was siphoning off public money from the institutional system of the state. However, since the early 2000s, they have been forced to deeper integrate into the political system and become more or less dependent on a narrow political elite circle. Currently the oligarch system in Hungary constitutes a vertically structured complex network controlled by a small political group. For this reason they are called "poligarch" rather than of oligarch (Magyar 2014).

The relationship structure of empty shells is different. Here the private party who finally purchases the shell company is more or less independent of the public side. Of course, there is a possible collusion between the two parties but this is a "coalition" for a particular transaction. The private actor is usually not part of a wider informal network of a privileged group as we saw in live shell cases. Although empty shell companies may be

brokered by friends or family members, in many cases the broker is a more neutral (lawyer), and sometimes simply a technical (local government ownership) actor.

5. How to curb corrupt shell companies

The shell company phenomenon analyzed in this paper constitutes a serious social problem in contemporary Hungary. The live shell type is especially worrying because it suggests that corrupt networks are deeply embedded into the entire government. The findings indicate systemic integrity issues at national and local governmental levels affecting lives of large groups of citizens. This is in a sharp contrast to the conventional notion that corrupt transactions do not have clear losers. In our cases we can accurately identify social groups negatively impacted by the corrupt deals. Losers of live shell transactions are spread through the country. Thousand of entrepreneurs, small shop owners and small-farmers, were wiped away from their business. In the tobacco concession case the increasing proportion of smuggled cigarette from unidentified sources raises significant health issues among the smoker population. Dealing with smugglers also criminalizes ordinary citizens. The guaranteed 20 years concession period makes future governments and the taxpayers very expensive to cancel the phony contracts. Considering the agricultural land lease project the concentration of oligarchic land in the countryside may further increase social inequalities in rural Hungary. Moreover empty shell cases suggest that corrupt actors pass the most valuable property of a local community to private ownership for a cheap price.

There are three reasons why conventional anti-corruption policies may fail against the corrupt shell phenomenon in this Central European case. First, the informal nature of the principal-broker relationship will make it hard to identify real owners. Second, social cohesion, the basic foundation of representative brokerage structure, suggests that the actors do not rationally evaluate the possible outcomes of their behavior. Here stricter criminal code or more effective law enforcement may be ineffective. Third, this study finds that in many cases shell companies are one particular elements of a broader corruption scheme that starts at the public policy decision. Focusing only on shell organizational structures as the main problem without addressing the whole political and power context may significantly limit the impact of any anti-corruption policy.

Much of the policy literature emphasizes the importance of supervisory and legal regimes in the fight illicit shell companies. These reports call for stricter regulations and better company registries to ensure that authorities can acquire adequate, accurate and timely information on the beneficial ownership of shell companies. They assume that anonymity is enhanced through the use of formal mechanisms, such as bearer shares, nominee shareholders, and nominee directors (OECD 2000). In these cases the right of the real owner is usually guaranteed by a private contract called declaration of trust. However examples of this study suggest that shell companies are often controlled via trusted

individuals when there is no any formal relationship or contract between the fake and the real owner. Even the most accurate and updated company registry will fail to reveal such connections. Data mining techniques for example, looking for same family membership based matching mother's maiden name, may expose some informal links in the ownership structure. However large number of cases will be still excluded when close social bonds cannot be proved by official data.

Mainstream anti-corruption measures are based on the assumption that corrupt actors behave rationally and evaluate the costs, benefits and risks of participating in a corrupt exchange and act according to this calculation. Therefore proper incentive and punishment structures may successfully reduce the actors' willingness to be corrupt (Rose- Ackerman 1986; Becker & Stigler 1974; Bardhan 2006). However giving ownership and decisional power to a stranger, especially when the shell organization has real assets, is risky. The fact that the organization receives resources in a corrupt way makes this arrangement even riskier. Since very often the secret principal does not affiliate with the organization through any formal tie, he/she does not have control over the activities happening in the official realm. Due to the extremely high risk (and thus transaction cost) of illegal deals and the lack of formal affiliation shadow principals cannot rely on the typical market or administrative tools to control a company (Frances et al. 1991). They must use only informal network structures to coordinate activities (Powell 1990). This network-type governance mechanism is often called clan control in the literature (Ouchi 1980). In this situation interpersonal trust, choosing family members to become brokers, is a crucial risk-reducing factor. Social bonds and loyalty are generally stronger sources of stability in a relationship than simple utilitarian considerations (Bernstein 2011). Same network membership indicates relatively high social cohesion, an effective mechanism for monitoring compliance with group norms, sustaining a strong sense of shared fate, and regulating the behavior of group members (Stovel and Shaw 2012). The particularistic norm systems of close-knit trust networks often become dominant over society-wide formal norms making norms criminal law and other rules especially ineffective against illicit transactions coordinated by particularistic norms (Schweitzer, 2004). The examples of this study suggest that mainstream anti-corruption measures may work only when the social bond between the broker and the principal is relatively weak, brokers are lawyers or less connected employees.

Both the tobacco and agriculture cases show that not only corruption on the policymaking side but also a form of systemic corruption when the illicit practice is part of the normal operation of the whole political institutional system. The corrupt elite is able to turn off crucial control mechanisms (Jancsics & Javor 2012). Live shell cases are large-scale corrupt transactions involving hundreds of people, organizations, ministries, national and local authorities, and huge amount of public resources. Despite the fact that these well-publicized cases required coordinated action of many participants the state's control

institutions, such as police, prosecution and other audit organizations did not take any steps to investigate this systemic corruption schemes. Actors whose task is to monitor and punish corrupt behavior were also corrupt and did not act in the interest of the general public (Persson et al. 2010; Rothstein 2011:99–104). There were not trustworthy actors with considerable decisional power in the formal institutional structure.

This paper confirms other empirical studies suggesting that the Hungarian state is captured by particularistic interests (Fazekas & Tóth 2014; Transparency International Hungary 2012). These interest groups are able to manage market capture, monopolizing significant market segments by using the regulatory power of the state. The current corrupt governmental network is much more centralized than it was under the previous Hungarian governments. There is a dense corrupt cluster very close to the core, which constitutes a small powerful governing elite (Fazekas & Toth 2014, Magyar 2014). In the case of state capture typical anti-corruption measures are useless since legal mechanisms can be effective only after the systemic network corruption has been dismantled (Mungiu-Pippidi 2009).

Since powerful corrupt elites control almost all public institutions the only possible force to fight against them should come from the outside of the public realm. However the fact that there are clearly recognizable losers of these cases has a positive side. The first step to curb systemic corruption would be to organize these losers against the corrupt governing elite (Mungiu-Pippidi 2009). However this strategy requires a grand coalition of all actors willing to fight against the network. Only organized collective action of the losers, civil sector actors, journalists, businesspeople, opposing political parties, trade unions, and even ordinary citizens can force captured states to turn back and serve their citizens again. Particular external circumstances may also significantly strengthen the efforts of anti-corruption coalitions. Attacking corruption systems during economic crises, societal stress or during election campaigns may provide an important “big bang” effect. This is the best time to implement radical changes in the political culture and institutional structure (Rothstein 2011; Mungiu-Pippidi 2009). This also offers a good opportunity to the international community for putting strong external pressure on corrupt systems.

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