Faces of Convergence

Before joining the EU

In the period of socialism Hungary was a bit more open, liberal and developed than the "traditional" Comecon countries in general. Consequently, many experts – so am I – expected that the political and economic transition could happen faster and with less pain. This has not been the case! Although Hungary has joined the NATO relatively quick and started EU accession negotiations early, the actual entry has become a lengthy, nearly 10-year process. On the one hand because, after the change of regime, the Hungarian economic performance – like in other former socialist countries – fell by about 20%, unemployment rose to 15-20% and partly due to the slow progress of reconstructing the previous economic-social funds and setting up a 'new world'. Though the economic situation has been stabilised by the turn of the millennium, the Hungarian citizens still needed to be patient because Germany – due to historical reasons – demanded Poland to be included in the first-round joiners. It was a totally legitim reason but the joining started with a bit of a bitter mouth.

Another important pre-accession element: the Hungarian political and economic elite started from the "Hungarian world" and assumed that greater or lesser irregularities were going to be condoned. This resulted in a massively increasing state and private debt (before and after the millennium) which actually well exceeded the debt ratio of the other new-joiner countries. For example, we were not able to build highways in the frame of Public-Private-Partnership, only public money was utilised for this purpose. The population – obviously – expected a rapid increase in living standards from the EU-accession. It was hoped that the Hungarian Forint will be replaced by euro soon which was reflected in the market as well. Larger transactions, office and real-estate rentals and purchases were made in euros at a much lower interest rate than in Forint. Everybody was ready to get rich!

2004: Get access to the European market!

Hooray! However, we have been under excessive deficit procedure from the accession until 2013! In 2004, at the time of accession Hungary had the third highest GDP per capita within CEE-11 countries. Now, we stand at the 7th place, barely ahead of Latvia overtaking Romania and Croatia and significantly Bulgaria. This is not a success story at all. It is not an acceptable excuse if we see an old EU-member being under the excessive deficit procedure since the euro crisis. But let's start with success stories! The nearly full realization of the four freedoms is a huge value. The free flow of goods and services, the flow of capital, the free movement of citizens feel so tremendous for every citizen in Eastern Europe. We were used to barbed wire, customs inspection at this part of Europe. The world has really opened! Especially for young and educated people, for those who can speak foreign languages and have competitive knowledge. It was a real liberation in political terms as well. Winds of democracy, freedom, equality and rule of law were blowing at that time. Felt so good! Sadly, we did not and still do not really take advantage of these opportunities.

In Hungary that lovely time, unfortunately, coincided with pro-cyclical economic policy and with seriously unruly, over-spending, distributive state. Socialist and liberal politicians expected a lifebelt from the EU. In 2006, hardly after two years as a member of the EU, a gigantic budget crisis hit Hungary as the deficit exceeded 9% of the GDP. Massive constraints were unavoidable. The level of deficit was considered to be acceptable when a new big bang, the global financial crisis arrived. USD 20 million loan provided by EU-IMF kept us above the water but new cutbacks were necessary. Overall, as a result of these events, Hungary was one of the European leaders in economic downturn (including output, unemployment and social care). Therefore, the Hungarian society has been benefiting the membership of the European Union
only since 2014-2015. Before that, citizens only faced difficulties. Despite this, the support of EU membership was at around 70% among the Hungarian society between 2004 and 2010, decreased to 66% from 2011 and started to increase from 2014 measuring a spectacular 80% in 2018 and 85% in 2019. Nevertheless all the propaganda, the Hungarian society is still pro-Europe minded.

In 2007, before the financial crisis, I held a presentation in Budapest in front of numerous domestic and foreign businessmen. The speech was focusing on the future: what we can reach until 2020 and what we need to do for reaching those goals. At that time, we were more or less over the first drastic adjustment. Hungary was ranked fourth in GDP per capita ahead of Bulgaria, Romania, Poland, Latvia, Lithuania, Slovakia while Slovenia, Czech Republic and Estonia were ahead of Hungary. I evaluated positively our share from international trade, our flexibility, the inflow of foreign capital and the opportunity to learn from the experienced foreign investors. However, I considered three main areas where further improvements were indispensable:

1. Improving the business environment
   - More competition, less monopoly (energy market, ICT and transportation)
   - Repression of corruption and black- and informal markets
   - Reducing administrative burdens

2. More transparent and simple taxation system
   - Broaden fiscal base with lower taxation rates
   - More emphasize on stability: fewer tax, less frequent changes
   - Strict, but supportive supervision
   - Only well-targeted tax advantage for specific purposes

3. Put all of our resources to human capital: education and healthcare
   - Predictable long-term governmental behavior (by consensus)
   - Innovation and lifelong learning
   - Transparency and law enforcement
   - Flexible and interoperable labour market
   - More knowledge inflow than outflow; more scientists in than out

Now, in the spring of 2019, the National Bank of Hungary, the Ministry of Finance and the Ministry for Innovation and Technology have published similar suggestions. Unfortunately, it is because nothing has been accomplished from the above mentioned points! The GKI and the KPMG, on behalf of the Prime Minister’s Office – as the domestic governmental institution responsible for the absorption of EU funds – conducted a very detailed analysis on the results of the EU funds between 2007 and 2015. Similar but not that comprehensive study was also published by the National Bank of Hungary. Let’s look at the results.

The GKI-KPMG study showed that the macro-impact of EU funds was very significant. Between 2007-2015 without EU funds Hungary’s GDP would have decreased by 1.8 per cent instead of the 4.6 per cent actual increase. Consumption would have declined by 11 per cent instead of the 5 per cent actual drop, investments by 31.1 per cent against the 2.8 per cent growth. With the use of EU funds, Hungary gained substantial additional external stability. Without this, we would not have been out of the excessive deficit procedure and public debt would have increased significantly instead of a gradual decline. EU financial sources valued at more than EUR40 billion that arrived between 2007 and 2015 were converted to Hungarian forints. They replaced the IMF-EU loan that Hungary had obtained earlier, enabled the switch of the households loan stock denominated in foreign exchange to loans in HUF. With the high external financial surplus and the inflow of foreign exchange. Hungary's international reserves increased and they remained at a high level. The public debt started to decrease, now around of 70% of GDP, still the highest in Central Europe. The study also showed that there were no major differences between the CEE
countries in terms of efficiency of fund allocation while in terms of population and GNI per capita, Hungary received the highest amount of EU funds in Central Europe. This fact indicates that Hungary was the most reliant on EU transfers among the Visegrad countries.

EU funds were considered to be the only financing option for many domestic companies. Surprisingly, 18 per cent of those companies were loss-making, 1 per cent were working on break-even level while 37 per cent could generate only a minimal profit. Majority of those companies barely increased the employment (at the end of the period it could no longer be done because of labor shortage). In spite of the increasing production, the efficiency of companies has not improved. There were no significant differences detected whether a company received reimbursable or non-reimbursable grants. Not even significant differences were measured for those companies who received EU funds compared to those who did not. These adverse results could make us conclude that companies improved those “cheap” areas which were funded and not those which were necessary for further developments. A slightly more favorable picture was seen in the case of medium sized enterprises.

Significant differences have been identified looking at the sectoral dimensions of the effects. Construction was the major beneficiary of EU funds due to the high share of infrastructural development projects. Positive impacts were also detected in plastic-, metal industries and trade. Unfortunately, projects which were supposed to support R&D and innovation were poorly efficient. In public sector, EU funds mostly substituted the previously public financed projects. This practice although enhanced the fiscal movement but it is considered as a source of serious corruption.

**Epilogue**

Overall, a measurable catch-up has been experienced since 2015 in the case of CEE-11 countries and Hungary has higher growth rate than the EU average. At the same time, political-economic tensions are inflated recently. Donor countries are debating the efficiency of the EU funding system thus they have been urging a reform to maintain supportive coordination where significant impacts are measured and corruption is minimal. Contrary, user countries are trying to prove that the Union’s convergence policy is mutually beneficial.

Hungary has not taken enough advantage of the opportunities provided by the EU. We got back to the principal message of the speech in 2007. The development of the Hungarian economy relies fundamentally on the modernization and transparency of the state. In economy it means more competition, education and healthcare reforms, policies to foster research and innovation, the spread of digitalization, modernization of energy system and the improvement of lower-ranked road networks.

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