András **Vértes**

HUNGARY

András Vértes is an expert in macroeconomics. Since 1998 he is the Chairman of the Board of GKI Economic Research, the most well-known Hungarian economic Think Tank. In 2009 he was nominated to be Prime Minister of Hungary. Over the past 20 years András was adviser to the Prime Minister or Minister of Finance in Hungary, member of the State Reform Committee. He worked for the European Commission and the European Parliament, is author of many books, articles and studies. Member of the Board of Directors of a number of companies. He was awarded the Officer's Cross of the Order of Merit of the Republic of Hungary.

This work is licensed under a Creative Commons Attribution-NoDerivatives 4.0 International License.

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 – including myself – expected that the political and economic transition would happen faster and with less pain. This has not been the case! Although Hungary has joined NATO relatively quickly and started EU accession negotiations early, the actual entry became a lengthy, nearly 10-year process. On the one hand, this was because, after the change of regime, Hungarian economic output – like in other former socialist countries – fell by about 20% and unemployment rose to 15-20%. On the other hand, this was partly due to the slow progress of reconstructing the previous social security system and setting up a 'new world'. Though the economic situation had been stabilised by the turn of the millennium, Hungarian citizens still needed to be patient because Germany – for historical reasons – demanded that Poland be included in the group of first-round joiners. This was a totally legitimate reason but left a bit of a bitter taste.

Another important pre-accession element was that 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 public and private debt (before and after the millenium) which actually well exceeded the debt ratio of the other new-joiner countries. For example, we were not able to build highways in the form of Public-Private-Partnership and 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 soon would be replaced by the euro which was also reflected in the market. Larger transactions, office and real-estate renting and purchases were made in euros at a much lower interest rate than in Forint. Everybody was expected to become rich!

2004: 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 amongst CEE-11 countries. Now we stand at 7th place, barely ahead of Latvia, and only above Romania, Croatia and Bulgaria. This is not a success story at all. But let us 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 tremendous for every citizen in Eastern Europe. We were used to barbed wire and customs inspections in 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 wonderful time, unfortunately, coincided with pro-cyclical economic policy and with a seriously unruly, over-spending, distributive state. Socialist and liberal politicians expected a lifebelt from the EU. In 2006, after barely two years as a member of the EU, a gigantic budget crisis hit Hungary as the deficit exceeded 9% of the GDP. Massive restrictions were unavoidable. The level of deficit was considered to be more or less acceptable when a new big bang, the global financial crisis arrived. A USD 20 million loan provided by EU-IMF kept us above water but new cutbacks were necessary. Overall, as a result of these events, Hungary became one of the European leaders in economic downturn (including output, unemployment and social care). As a result, Hungarian society has been benefiting from membership of the European Union only since 2014-2015. Before that, citizens faced only difficulties. Despite this, the support for EU membership was at around 70% in 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. In spite of all the propaganda, Hungarian society is still pro-EU minded.

In 2007, before the financial crisis, I gave a presentation in Budapest in front of numerous domestic and foreign businessmen. The speech focused on the future: what we could reach by 2020 and what we would need to do to reach 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. I evaluated positively our share in international trade, our flexibility, the inflow of foreign capital and the opportunity to learn from experienced foreign investors. However, I considered three main areas where further improvements were essential:

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 simpler taxation system
    - Broaden fiscal base with lower taxation rates
    - More emphasis on stability: less tax, less frequent changes
    - Strict but supportive oversight
    - Only well-targeted tax advantages for specific purposes

3. Put lots of our resources into human capital: education and healthcare
    - Predictable long-term governmental behaviour (by consensus)
    - Innovation and lifelong learning
    - Transparency and law enforcement
    - Flexible labour markets
    - More knowledge inflow than outflow; more scientists into the country 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, this is because nothing has been accomplished from the above mentioned points! The GKI and 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 of the results of EU funds between 2007 and 2015. A similar but less 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 showing a gradual decline. EU financial sources valued at more than EUR40 billion were received between 2007 and 2015. This replaced the IMF-EU loan that Hungary had obtained earlier, and 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. Public debt started to decrease, now around 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 a break-even level while 37 per cent could generate only a minimal profit. A majority of those companies barely increased employment (at the end of the period it could no longer be done because of labor shortage). In spite of increasing production, the efficiency of companies has not improved. There were no significant differences detected whether a company received reimbursable or non-reimbursable grants. No significant differences were measured for those companies who received EU funds compared to those who did not. These adverse results make us conclude that companies invested in areas which were funded and not those which were necessary for further development. A slightly more favourable 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 inefficiently executed. In the public sector, EU funds mostly substituted the previously public financed projects. Although this practice eased

the fiscal situation, it is considered to be 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 a higher growth rate than the EU average. At the same time, political-economic tensions have increased. Donor countries are debating the efficiency of the EU funding system and have been urging a reform to maintain supportive coordination where significant impacts are measured and corruption is minimal. On the contrary, user countries are trying to prove that the Union's cohesion policy is mutually beneficial.

Hungary has not taken enough advantage of the opportunities provided by the EU. We go 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 terms of the economy, this means more competition, education and healthcare reforms, policies to foster research and innovation, the spread of digitalization, modernization of the energy system and the improvement of lower-ranked road networks.