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György KOCZISZKY

Economic Convergence for Hungary

Introduction

The hope of catching up with economically more developed countries is not new in Hungarian thinking. The very best of the intellectuals from the Reform Age to the present day (e.g. István Széchenyi[1], Miklós Wesselényi, Endre Ady[2], Oszkár Jászi, and István Bibó) in accordance with the spirit of the age and their social standings asserted their conviction in the need for convergence and discussed its obstacles.

The political propaganda prior to Hungary's accession to the European Union (2004) set out the promise (both directly and indirectly) of catching up fast. Our wishes have not been borne out by the facts so far. Therefore an increasing part of the population looks on the European Union as on a bureaucratic hydrocephalus. The direct consequence is that the initial great enthusiasm has soon been replaced by disappointment and disillusion and the recognition that we have again entertained disproportionate hopes. It seems that the forecasts of the economic politicians concerning the impact of resources from EU funds have also been unrealistic. Given this knowledge, we have to recognise that our accession to the European Union will not automatically start our convergence.

The paper attempts to answer two questions:

- Has our economic performance achieved a substantial breakthrough as a result of our economic policy following the accession or has it been enough only to more or less maintain our position?
- What impact have EU subsidies had on the economic convergence of Hungary and of our region?

Background

Economic history is more or less in agreement about drawing up the periods of growth and development determining the past 150 years of the Hungarian economy.

The nearly fifty years ('balmy days of peace') between 1867 and 1914 (Austro-Hungarian Monarchy) is in general positively evaluated, although opinions are divided on the economic growth rate of the period. It remains a fact, however,

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that Hungary developed from a backward agrarian country (with a semi-peripheral position) into an agrarian-industrial country with a developed food industry in that period. As a result, the growth rate of the economy accelerated between 1870 and 1913 (at a growth rate of 2-3.5 %/year) and the per capita GDP was nearly trebled (Figure 1).

This growth rate was broken by World War I. Although the governments succeeding each other took serious steps to protect to economy (repayment of foreign debts was halted, the industry was given considerable military orders, etc.), the resources had been depleted by 1918 and the economic performance of the country suffered a significant setback.

As it is well-known, the Treaty concluding World War I (04.06.1920) had a serious effect on the economic potential of Hungary (the territory of the country was reduced by 232.000 km^2, and its population by 3.9 million persons).

Opinions are greatly divided on the economic performance of the period between the two World Wars. Unbiased empirical analyses have been published only recently.

As it is verified by the analyses by Maddison (Maddison, 1994), apart from the years of the world economic crisis (1929-1931), the economy of Hungary was characterised between the two World Wars by a growth rate that exceeded that of the decades of the Austro-Hungarian Monarchy.

The more than forty years following World War II (1945-1989) also produced several peaks and troughs of waves. Practically from the decade of the 1980s the Hungarian economy was a permanent laggard (Figure 2).

The economic-political measures of the change in political orientation taking place after 1989 were unable to halt this process. Privatisation, the decline of state interventions, opening up the markets,

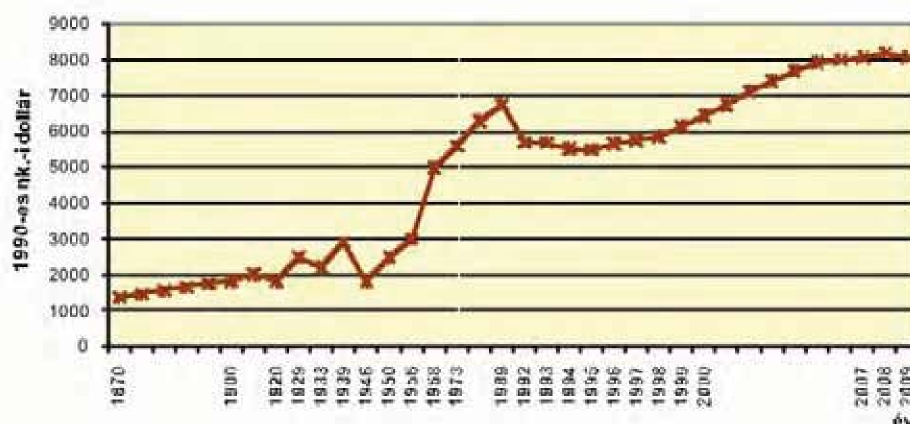


Fig. 1. **Per capita GDP in Hungary, 1870-2009.**

Source: A. Maddison: Monitoring the World Economy 1820-1992.

Paris: OECD, 1994 and author's own calculation based on CSO data

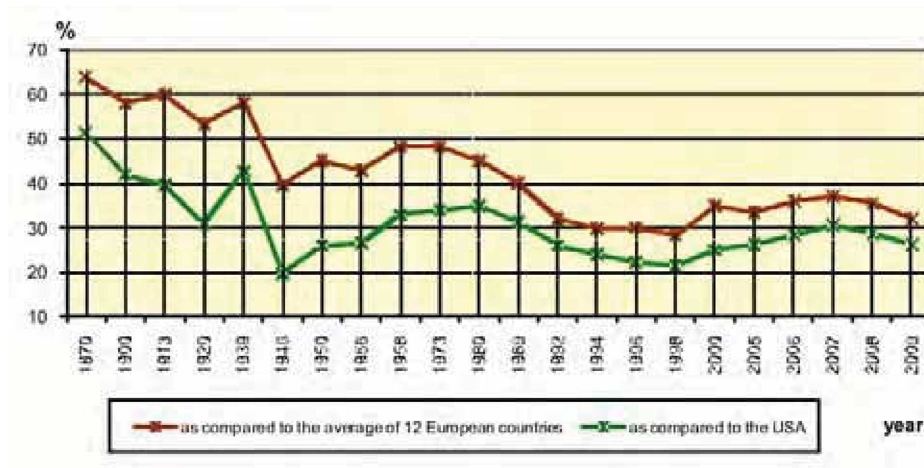


Fig. 2. **Relative development of per capita GDP in Hungary (1870-2009).**

Source: Based on figures in A. Maddison (1995) and author's calculations

the indebtedness of the country, etc. have put a range of companies in difficult situations, and industries have declined. The added value as well as the output of the economy underwent a dramatic decline and its specific performance continued to decrease (Figure 2).

At the beginning of the new millenary (between 2000 and 2003), the hopes were born again and economic growth re-appeared. This was broken in 2007. The global economic crisis breaking out in the spring of 2008 shook the Hungarian economy dramatically. Although there are differences between the opinions of politicians concerning the causes (according to political commitments), there is hardly any dispute about the fact that the Hungarian economy suffered the negative external effect in a state of ill health, and thus the consequences are far more serious than in terms of the Union average.

The per capita GDP at purchasing power parity in Hungary in the year of accession was 63.2 % of the EU average, in 2007 it was only 62.6 %, in 2008 60.3 %, and in July 2009 it reached only 59.8 % (EUROSTAT, 2009).

Thus the real convergence indicators of Hungary showed a relative decline in the past four years (as opposed to the period 2000-2004, when a convergence was registered with the value of the indicator rising from 56.1 % to 63.2 %).[3]

Hungary ranks ninth of the ten countries which joined the Union in 2004 in terms of real convergence in the period 2000 to 2007, and last when considering the period since the accession (http://epp.eurostat.ec.europea.eu). This means that our economic performance is weak not only in an absolute sense, but also when compared to the new members.

According to Eurostat data, in the field of industry and services, the annual gross income of full-time employees in companies employing at least ten persons in

Hungary was 12.8% of the average of the 15 old members in 1998. This ratio increased to 21.7 % by 2008, with the major part of the increase taking place between 2000 (13.51 %) and 2004 (20.56 %).[4]

Nevertheless, foreign direct investments of non-resident companies in Hungary have visibly increased since the accession (according to data of the Hungarian National Bank, FDI remained between 1995 and 2000 in a narrow band between 2.63 billion Euro and 3.70 billion Euro, while in the three years preceding the accession it showed a definite decreasing tendency: from 4.39 billion Euro in 2001 to 3.19 billion Euro in 2002 and then to 1.89 billion Euro in 2003. In the year of accession this tendency changed: FDI increased to 3.63 billion Euro in 2004, then to 6.17 billion Euro in 2005 and also exceeded 6 billion Euro in 2006. In the last two years it decreased to a level around 4.5 billion Euro, with its average amounting to 4.93 billion Euro between 2004 and 2008. Meanwhile the public debt increased, with the highest rate of debt service in the region.

To sum up: the economic statistical data of the past 150 years have proved that Hungary continues to belong to the semi-peripheral countries of the world economy.[5] Our previous climbing upwards has been halted, at the moment Hungary is sliding downwards (Figure 3).

Conditions for sustainable convergence

The general concept of convergence allows for a wide range of interpretation. Economic and regional economic scientists have formulated two interpretations for convergence.

The first definition regards a decrease in the differences between the chosen social-economic indicators as convergence, which indicates in effect a decrease in the range of standard deviation

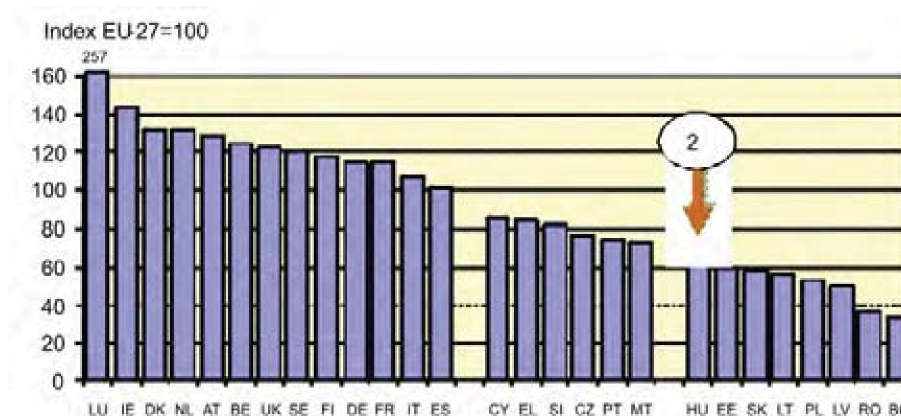


Fig. 3. **Hungary's economic performance (EU 25)**

Source: Eurostat, 2010.

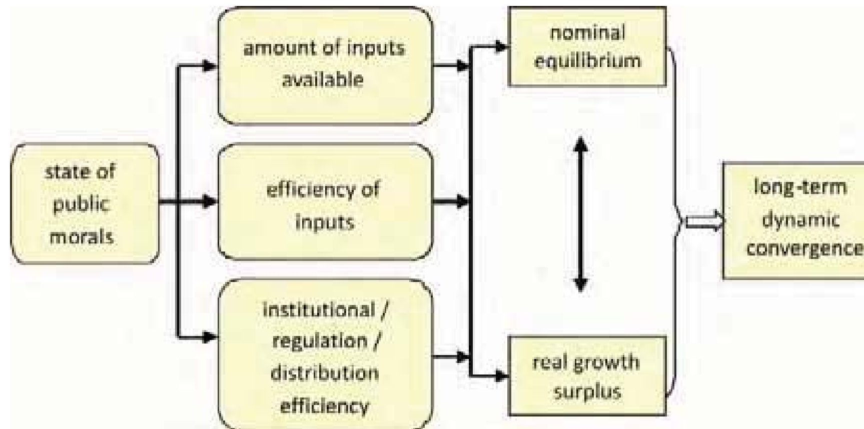


Fig. 4. **Macro-economic conditions of sustainable convergence**

Source: author's own work

(σ convergence). In the second interpretation, convergence means catching up on a longer term growth path (ß convergence). Thus the latter (sustainable or long-term convergence in other interpretations) is of greater importance than the former.

The rate of sustainable (long-term) convergence and the change with time of its rate are basically determined by three groups of factors with a strong logical interrelation in a given country: the public morals, nominal equilibrium and growth surplus (Figure 4).

Nominal equilibrium is described by the stability of state finances (monetary and budget situation). (As it is known, the European Union wishes to keep the differences between the member states within limits and to secure convergence by the prescription of the Maastricht criteria, though with varying results).[6] Nominal equilibrium is determined by an increase in the inputs, particularly the strengthening of savings, the efficiency of their use and the system of institutions and norms handling it. The equilibrium of the financial and fiscal affairs (or the still manageable imbalance) is a necessary, but not sufficient condition of convergence.

In case of real convergence, the performance of a country with the lower performance (development and income levels) approaches those of countries with a higher performance. In practice this can be achieved if the income generating capacity of the poorer country grows more rapidly than that of the richer country. This process can be generated by an increase in productivity and employment and by eliminating factors hindering the growth of performance (e.g. a system of institutions with low efficiency, political instability, etc.).

There is hardly any chance for real or nominal convergence when there is a lack of stable moral conditions or of the will to improve the moral situation.

The general moral situation exerts its

effect both on fiscal and real processes. The larger the proportion of the black (hidden) economy, the higher the budgetary revenue lost. The proportion lost in this way can be replaced by increasing the budgetary revenues (taxes and contributions by the white economy), selling assets of the national wealth ('denationalisation'), and reducing the state expenditure or by credits.

In the case when the political elite violates the written and unwritten legal regulations or although abiding by them, takes the liberties to take steps infringing public morals, then a 'simple' citizen will also regard tax evasion as a forgivable sin (e.g. work without invoice, etc.).

The connections between black economy, corruption and real processes are at least that serious. Part or all of the state intervention intended for increasing capacity, improving productivity, improving efficiency, i.e. the convergence of real processes, may disappear in the current system without having achieved its purpose.

Without improving our public moral conditions and states it is a vain hope to increase the performance of the economy or to create the nominal equilibrium.

Obviously the same logic can be followed in evolving the relations in respect of regional convergence, noting that the steps taken by the government in power for creating (sustaining) the nominal equilibrium may strengthen or also weaken the chances of convergence of a particular region.

Causes of convergence slowing down in Hungary

The lack of the nominal equilibrium and that of real growth in the economy have not ceased to exist with Hungary becoming a full member state of the EU. This has several causes, including the low added value and productivity of industrial production, the errors in the government's economic policy, the shortage of capital of domestic SMEs, etc. Neither the larger market resulting from EU membership, nor the working capital arriving in Hungary, nor the subsidies from the EU Cohesion Fund have been able to compensate for this.

All in all, the Hungarian economy seems to have lost the drive in the past four years that would have been necessary for convergence. This is borne out by the increasingly worsening (more and more pessimistic) forecasts as well (Table 1).

Table 1

Changes in the components of growth (%)

	2009	2010	2011	2012
Consumption by households	-8	-2,5	3	2,8
Community consumption	-1,1	-0,8	0,3	0,2
Gross accumulation of fixed assets	-7,1	1,1	7	6,9
Exports	-10,1	5,5	9,2	9,5
Imports	-16,1	4,5	9,2	9,5

Source: Ministry of Finance, 2009.

Table 2

Development of macro- and mezo-level convergence indicators in selected countries

Country	Number of regions	beta convergence		Regional income inequality (sigma convergence)				
		Period examined	(%/year)	1940	1950	1970	1990	2005*
Germany**	11	1950-1990	1,4	-	0,31	0,20	0,19	0,14
Sweden	24	1951-1933	2,4	0,26	0,15	0,10	0,07	0,06
Great Britain	11	1950-1990	3,0	-	0,17	0,10	0,12	0,10
France	21	1950-1990	1,6	-	0,21	0,17	0,14	0,11
Italy	20	1950-1990	1,0	-	0,43	0,33	0,27	0,25
Spain	15	1955-1987	2,3	-	0,34	0,27	0,22	0,20
USA	48	1880-1990	1,7	0,35	0,24	0,17	0,17	0,16
Japan	47	1955-1990	1,9	0,63	0,29	0,23	0,15	0,12
Hungary***	7	1995-2007	0,81					
EU ***		1995-2007	1,71					

Source: Sala-i-Martin

*Author's calculation; **without the former GDR; *** Author's calculation.

Increasing regional divergence

Worsening macro-economic performance has resulted in an increase in regional discrepancies in Hungary. This is in effect contrary to the practice of the developed industrial countries, where increasing macro-economic performance has caused regional divergence; and in case of a well-functioning regional policy regional income differences (sigma convergence) decrease (Table 2).

As a result of the semi-peripheral character of Hungary, the speed of convergence between the regions of Hungary falls behind the EU average. The

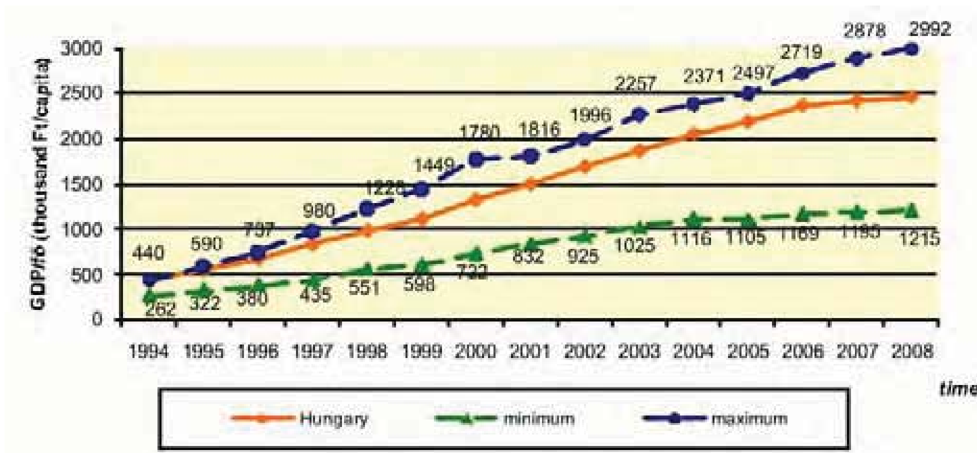
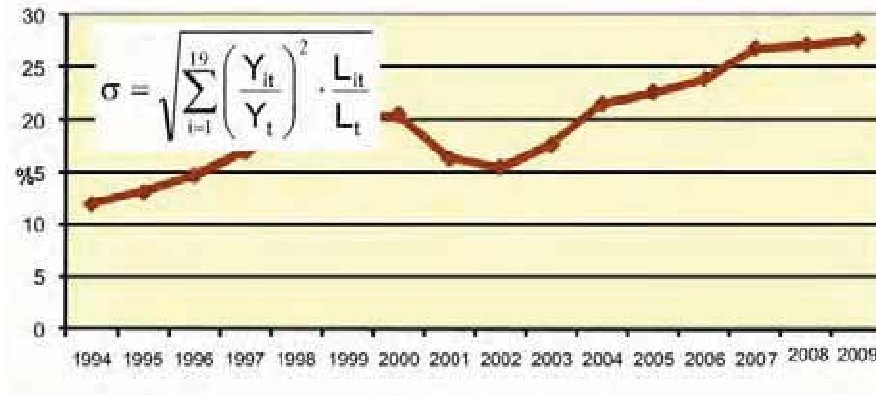


Fig. 5. **Standard deviation of county per capita GDP in Hungary**

Source: author's own work.



$$\sigma = \sqrt{\sum_{i=1}^{19}\left(\frac{Y_{it}}{Y_t}\right)^2 \cdot \frac{L_{it}}{L_t}}$$

Fig. 6. **Development of σ-convergence of per capita GDP in Hungary**

Source: author's own work.

regional policy of Hungary in the period examined was not able to achieve convergence as such either by improving economic activity, or by setting the economy on a new growth path, therefore it is in effect virtual. In the past nearly 15 years Hungary increased its macro-economic performance while at the same time increasing the regional differences as well (Figure 5).

While the growth rate of counties in Hungary with outstanding performance as compared to the basis period (6.17) is well in excess of the national average (5.56), the range of standard deviation has increased (Figure 6).

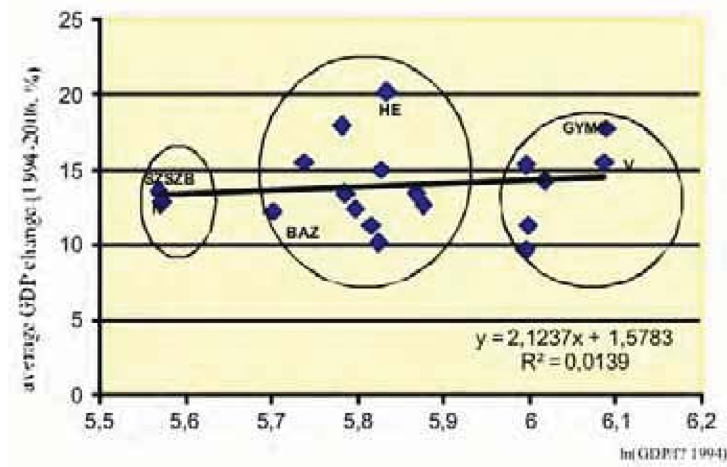


Fig. 7. **Convergence clubs of counties in Hungary**

Source: author's own work.

Table 3

Changes in per capita GDP (thousand HUF /person in Hungary

County	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Pest	324	394	487	643	760	894	1 035	1 309	1 493	1 678	1 816	1 949	2 018	2 233
Fejér	410	542	696	980	1228	1283	1 577	1 561	1 596	1 782	2 009	2 091	2 292	2 415
Komárom-Esztergom	341	471	599	716	827	918	1 104	1 397	1 561	1 997	2 282	2 497	2 426	2 738
Veszprém	339	460	543	669	795	901	1 115	1 262	1 343	1 483	1 606	1 633	1 713	1 929
Győr-Moson-Sopron	440	590	737	905	1182	1449	1 780	1 816	1 996	2 257	2 371	2 430	2 719	2 838
Vas	439	581	734	951	1150	1317	1 517	1 529	1 679	1 985	2 067	2 068	2 332	2 373
Zala	401	496	620	751	881	989	1 122	1 310	1 472	1 754	1 875	1 871	1 878	2 032
Baranya	356	433	518	662	769	868	1 005	1 122	1 258	1 401	1 516	1 584	1 702	1 834
Somogy	325	413	498	579	672	760	911	1 058	1 158	1 301	1 421	1 439	1 469	1 538
Tolna	401	497	600	690	838	978	1 092	1 206	1 342	1 345	1 457	1 512	1 593	1 767
Borsod-Abaúj-Zemplén	299	410	468	570	670	736	851	950	1 054	1 182	1 371	1 499	1 563	1 662
Heves	310	405	493	599	716	805	946	1 113	1 250	1 398	1 523	1 528	1 626	1 828
Nógrád	263	322	380	435	553	605	722	832	925	1 025	1 116	1 105	1 169	1 162
Hajdú-Bihar	353	421	521	632	741	794	963	1 126	1 249	1 435	1 564	1 620	1 698	1 805
Jász-Nagykun-Szolnok	335	419	503	620	704	745	894	1 062	1 152	1 239	1 327	1 358	1 542	1 643
Szabolcs-Szatmár-Bereg	262	327	391	474	551	598	731	847	934	1 069	1 167	1 196	1 257	1 352
Bács-Kiskun	329	425	502	602	696	769	916	1 038	1 178	1 280	1 434	1 466	1 567	1 686
Békés	338	422	507	590	673	750	893	985	1 069	1 158	1 263	1 302	1 359	1 462
Csongrád	402	503	614	737	864	947	1 110	1 195	1 327	1 465	1 607	1 670	1 744	1 891
Hungarian average	425	544	669	830	983	1113	1 325	1 499	1 691	1 870	2 050	2 185	2 363	2 527

Source: KSH.

Table 4.

Range of per capita GDP standard deviation and changes in relative variance

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Hungary	425	544	669	830	983	1113	1325	1499	1691	1870	2050	2185	2363	2363
minimum	262	322	380	435	551	598	722	832	925	1025	1116	1105	1169	1169
maximum	440	590	737	980	1228	1449	1780	1816	1996	2257	2371	2497	2719	2719
relative variance	11,99572	13,06815	14,67219	16,95513	19,09979	20,07193	20,46015	16,32432	15,47635	17,62038	17,03029	17,16	17,03	17,03

Source: author's calculation based on figures by KSH

According to the standard deviation of economic performance, Hungary became split into three parts. The lagging behind of Szabolcs-Szatmár-Bereg County seems to be permanent. The situation of Borsod-Abaúj-Zemplén County is somewhat better, but no real improvement can be perceived. The performance of counties in Western Dunántúl and in the region of the capital is steadily above average.

Impact of European Union subsidies on regional convergence

Already the first works on economic growth raised the question of what role governments played in generating growth and of what capacities governments had that the private sphere did not.

The 1950s and 1960s (the golden age of state intervention) was pervaded by a naive approach to the operation of governments. Explicitly or not, the supposition was entertained that the public sector served the advancement of social welfare with each of its acts. Therefore hunting for annuities played an insignificant role in the motivation of political decision makers and executives. It was thought that the public sector formed a monolithic unity, economic decisions were reasonable to understand and there could be no inconsistencies between the policies.

The consistency of the individual steps in economic policy was regarded as given not only in space, but in time as well. Therefore the political time horizons of governments were believed to be sufficiently long for the decisions of the present not to enter into conflict with those to be employed by the future governments. However, these conflicts arose either as a result of errors, or of political considerations (e.g. winning the elections to come) that urged governments in the short term to choose alternatives that were obviously incompatible with long-term objectives.

It was also taken at face value that economic policy decisions were reversible. Civil servants could be dismissed when they were no longer needed, or after the objectives strived for were achieved, entitlements could be automatically eliminated, etc. Conversely, we know today that it is much easier to increase entitlements than to decrease them, or that it is much easier to hire than to fire civil servants.

Finally mention must be made of the misconception that the instruments of economic policy are completely under the control of decision makers, and they in turn can rely on an honest and efficient civil servant body, which executes all the decisions made at a higher level in an objective and efficient way. (It is sufficient to refer here to corruption, the problem of employer and agent, or the hunt for annuities – the relevant literature is also the product of the past years.)

Experience has shown that this romantic or idealised image is far from reality. Actually the public sector is not monolithic, but consists of a number of political centres with conflicting interests and thinking, which are not necessarily governed by the same conception of public interest; the economic policies

Table 5

Impact of subsidies in increase in GDP

Country	GDP/EU* subsidy	Contribution to increase in GDP (%)		
		1989-1993	1994-1999	2000-2006
Portugal	~ 3 %	3,9	4,6	6,1
Spain	~ 1,5 %	2,9	3,1	4,2
Greece	~ 2,6 %	4,3	5,6	6,1
Ireland	~ 2,8 %	n.a.	8,9	8,6
Hungary	~ 2,1 %	-	-	1,2**

Notes: * AGENDA 2000 (max. 4 %);
** in 2004-2006

Source: The Role of Fiscal Transfers for Regional Economic Convergence in Europe (No.1029.2009).

followed by them are not necessarily consistent in space and time; while it may easily happen that they are hunters for annuities and are under the influence of various groups of interests; it is also possible that those making some of the economic political decisions ignore how the economy works in reality; there may be employer-agent problems present; measures may be irreversible; bureaucracies may have low efficiency and/or be possibly corrupt (or both).

The fundamental objective of the cohesion policy of the European Union is to achieve the convergence of regions with low performance. It follows that subsidisation is only efficient if it generates surplus output (as compared to the condition without subsidies).

The literature makes the impact of surplus performance contingent on the efficiency of the operation of the system of institutions and on that of utilisation.

Empirical studies and analyses verify in this respect as well that there are considerable differences between the member states. Side by side with obviously positive examples, low absorption capacity is not infrequent. Unfortunately, this is what was typical of the first two years following Hungary's accession (2004-2006) (Table 5).

The tendency has not changed in essence since 2006 either. The impact of subsidies arriving in Hungary on GDP growth lags behind the EU average. This has or may have a number of causes:

- the political 'brainstorming' present in resource allocation.
- the majority of EU funds arriving in the Hungarian convergence regions (60-65 %) has the one-time effect of increasing demand or of improving community infrastructure, and not of strengthening the economic potential, including a high proportion of 'soft projects'.
- Resource allocation happens on the basis of political (partial) interests, and the majority of resources are not spent on investments supporting long-term convergence, thus their impact is also weaker.
- Resources are not additive, but substitute in character. In the

majority of cases they do not appear as additional funds, but replace previous own investments.

On the shortcomings hindering regional convergence

In spite of the subsidies of the past years, the economic performance of the Hungarian regions lags behind (at various rates from time to time) what we have hoped for; divergence rather than convergence has emerged. The causes are complex. Beyond the conditions for nominal and real convergence, the moral foundations are lacking, which has a fundamental influence on the room for manoeuvring of the former.

A regional level convergence program seems to be virtual. Part of the subsidies (resulting from the types of the programs) is used for 'political scenic plans'. It is only an extraordinarily small proportion (hardly verifiable) that attempts to change the economic structure. As long as there is no intention in the political elite to change this, hardly any advance of merit can be expected.

Notes

[1] „How could we lift Hungary out of the mud?" asks István Széchenyi in his letter to Miklós Wesselényi in 1830 (Széchenyi, 2004).

[2] „Ferry-boat county, ferry-boat county, ferry-boat county. Even in its best dreams it only shuttled between two banks: from the East to the West, wishing to go back. Why did they lie that the ferry, oh Potemkin, you holy man with anointed hands, you only cheated on Czarina Catherine?... Idealists and malefactors united to build castles of the air-stones of falsity and shouted to the whole world with joy that Europe had been built up under the Carpathian Mountains.

The Great Humbug did not hurt Europe, the lie was believed at home. We were told that Europe was here, we were preparing for a life of culture and jerked ourselves forward with taut nerves." Ady Endre, Budapesti Napló, 15 October 1905. (Complete Prose Works of Endre Ady, Vol. 7. Arcadum Adatbázis Kft.).

[3] It is worth noting that in Slovakia, which joined the Union at the same time as Hungary, 50.1 % in 2000 rose to 55.5 % at the time of accession and to 67 % in 2007; between the turn of the millenary and 2008 the same indicator rose from 68.5 % to 80.2 % in the Czech Republic, from 48.3 % to 53.3 % in Poland, and from 44.6 % to 67.9 % in Estonia.

[4] In 2006, the value of the indicator was 22.93 % in the Czech Republic, 10.28 % in Rumania, 19.49 % in Slovakia and 17.67 % in Poland (the last figure is for 2005). In Hungary the annual gross income grew by 10 % in 2006 as compared to 2004, and in 2007 the increase in incomes was 26 % as compared to the year of the accession.

[5] The centre-periphery world theory comes from Immanuel Wallerstein (1983). According to it, in a global world a centre at a high level of economic and social development concentrates capital, state-of-the-art technology, information, and science, and this is where innovation originates from. The economically backward periphery has the role of providing raw materials for the centre, and is described by low technical level and social underdevelopment. These – in addition to other features – determine the difference as well. The exchange of goods between the centre and the periphery is performed with terms of trade beneficial for the centre. A relation of economic dependence develops between the two regions with the capital of the centre playing a major role. The model was refined in the late 1980s with the introduction of the concept of semi-periphery.

[6] The Maastricht criteria (as is well-known) defined four convergence criteria for the introduction of the common currency (Euro):

- Price stability: the rate of inflation in the period examined may exceed the average of the three countries with the lowest inflation by max 1.5 %.
- Budgetary deficit is not to exceed 3 % of the GDP, and national debt is not to exceed 60 % of the GDP.
- Long-term nominal interest may exceed the average of the interest of the three countries with the lowest inflation by maximum 2 %.
- Stable exchange rate: in the European Monetary System (EMS) exchange rate mechanism the national currency is not to be devalued against another currency (Euro) for at least two years.

The (above) criteria ensure the manageability of the imbalance of a given country in addition to the introduction of the common currency (Euro) under low and controlled inflation.

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