Review of Hungarian EU transfers – at the border of two fiscal periods*

Anna Boldizsár – Zsuzsa Kékesi – Péter Koroknai – Balázs Sisak

The paper examines the extent to which the sectors and regions of Hungary benefited from the EU grants of the 2007–2013 programming period, the degree to which they managed to absorb the allocation available for them and the amount Hungary can still expect to receive after 2015 in relation to the previous programming period. In addition, the paper also reviews the shaping of payments related to each operational programme. In respect of the new programming period, the authors review the changes in the allocations available to the member states and the funds that can be used for specific purposes, and also present the challenges of the 2016 drawdown plans based on the experiences of the previous period. In addition to the quantitative analysis of the Hungarian figures, the available data are also analysed in a regional comparison thereby making the priorities of the individual countries comparable in terms of development purposes. As a result, the authors establish that in the new programming period – in line with the shrinking size of the EU budget – the cohesion funds for Hungary will slightly decrease; however, the amount is expected to be distributed among the various economic policy objectives more evenly and the structure of the grants may be more favourable in terms of economic growth.

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1. Introduction

Funds from the European Union play an important role in the development of the external balance position via transfers financing the investments and the increase in the disposable income of the economy. In addition, a considerable part of the funds are capital transfers supporting investment, and thus monitoring and evaluating them is also important when analysing the dynamics of investments

* The views expressed in this paper are those of the author(s) and do not necessarily reflect the offical view of the Magyar Nemzeti Bank.

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(*Keresztély 2013*). Accordingly, in this paper we primarily try to identify the projects for which Hungary used the EU grants from the 2007–2013 programming period, the degree of utilising the available total allocation and the amount Hungary can expect to receive in connection with the previous cycle after 2015. As regards the new cycle, we review the changes in the total allocation available for the Member States and the funds that can be used for the various objectives; in addition, based on the experiences of the previous cycle, we present the challenges of the plans related to the drawdown of funds in 2016. In addition to analysing the Hungarian figures, we also analyse the available data in a regional comparison. On the other hand, it should be emphasised that this paper essentially uses a volume-based approach and does not intend to present the impact of the EU funds on the various macroeconomic variables and the efficiency thereof.[1]

In terms of their economic content, the transfers are classified as current and capital transfers. The current and capital accounts in the balance of payments reflect the absorption of transfers; this is the amount that increases the disposable income of the individual sectors and, *ceteris paribus*, net lending.[2] Accordingly, the EU transfers work toward reducing the economy's external indebtedness. Current transfers are consumption-related grants increasing the disposable income (e.g. direct agricultural subsidies), which are stated in the balance of payments among the secondary or other primary incomes. By contrast, capital transfers are typically investment-financing grants, stated in the capital account. The size of the received grant may also be examined in two ways: the gross transfer is the amount that the country receives from the EU as grants, while the net transfer also considers, in addition to the grants received from the EU (revenue), payments made to the EU (expenditure).

The transfers received by Hungary are provided by a variety of funds. A large part of these funds originates from the Cohesion Fund and the Structural Funds (European Regional Development Fund, European Social Fund),[3] the key objectives of which is to achieve convergence, improve regional competitiveness and expand employment. In addition, the EU provides separate funds for the support of

[1] This paper was prepared by the staff of the Macro Finance and External Balance Department, which is in charge of the central bank's *Report on the Balance of Payments*. The authors relied on the experience gained in the preparation of the *Report*, but the paper presents the topic of EU transfers in much more detail than allowed for by the narrow bounds of the *Report*, which discusses past processes, and also includes an analysis related to the new cycle.

[2] It is also important to note that this reflects the accrual-based value of the transfers. By contrast, the financial account reflects the disbursed EU transfers in the change in foreign exchange reserves, since the state converts the transfers received in euro to forint at the central bank, thereby increasing the central bank's reserves and the economy's external assets. Thus, the funds that increase net lending via the current and capital accounts may be interpreted in the financial account, through the increase in foreign exchange reserves, as an outflow of foreign funds (i.e. by receiving and absorbing the EU transfers, *ceteris paribus*, the economy's dependency on external finance decreases).

[3] Since 2013 European Structural and Investment Funds.

agricultural and rural development through the European Agricultural Guarantee Fund and the European Agricultural and Rural Development Fund. In addition to these grants of substantial volume, grants in smaller amounts are also available for cultural and youth programmes, consumer protection and other objectives.[4]

The amount and allocation of the EU financing funds is coordinated by the European Commission. After determining the total allocation available for grants, the funds are allocated among the objectives (convergence, regional competitiveness, European regional cooperation, employment) and the Member States. When determining the financial allocation of the individual Member States the "population eligible for grants, national and regional prosperity and the unemployment rate" are considered, followed by the decision on the acceptance of the operative programmes defined by the Member States (*European Commission 2007*).

The allocation and absorption of the funds is the result of a long process; the fiscal commitments are implemented by funds and objective at annual level. On the other hand, the funds available for absorption are not lost automatically at the end of the programming period. The grant allocation may be drawn down until the end of the second year after the closure of cycle (n+2 rule);[5] thus the European Commission only withdraws those funds in respect of which no payment request was received until that date. As a result of this, it was possible for the absorption of the grants from the 2007–2013 programming period to continue in 2014 and 2015 (*European Commission 2007*).

2. Absorption of EU transfers in the past

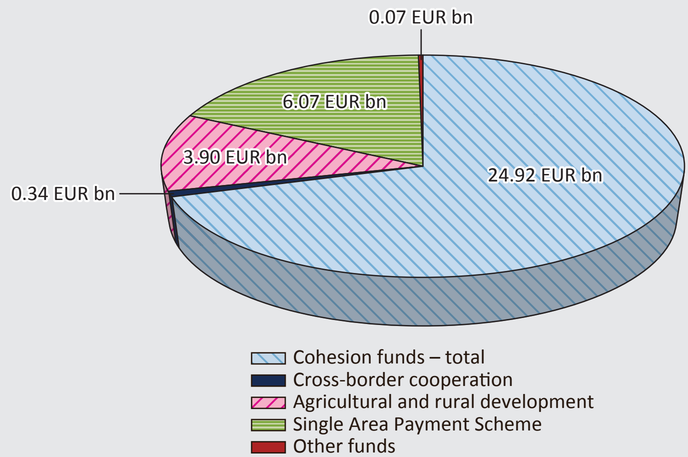
Based on the commitment made by the EU in the 2007–2013 programming period, Hungary was entitled to a grant of EUR 35.3 billion (almost HUF 9,900 billion calculated at EUR/HUF 280, the average exchange rate of the period), accounting for roughly 35 per cent of the country's annual GDP. The largest part of the allocation came from the Structural Funds and the Cohesion Fund; these funds amounted to EUR 24.9 billion (HUF 7,000 billion) (hereafter we shall refer to these two Funds as cohesion policy funds). In addition, the inflow of direct agricultural subsidies in the amount of EUR 6 billion (HUF 1,700 billion) and the rural development grants in the amount of EUR 3.9 billion (HUF 1,000 billion) also accounted for a major part of the allocation. A smaller part of the absorbed funds, i.e. roughly EUR 0.3 billion (HUF 100 billion) was used as part of the cross-border cooperation. Due to the

[4] For more information on the financial assets allocated to the EU's community policies see: the website of the EU Communications Service and its publication "Cohesion policy 2007–2013": *http://ec.europa.eu/regional_policy/sources/docoffic/official/regulation/pdf/2007/publications/guide2007_hu.pdf.*

[5] An n+3 rule, based on similar principle, applied to Portugal, Greece and the Member States that acceded to the EU in 2004 (including Hungary) until 2010.

principle of additionality, the grants received from the EU were supplemented with the necessary own contribution, provided by the Hungarian budget in the amount of roughly EUR 7.2 billion (HUF 2,000 billion) (*MNB 2016*).

Figure 1
EU commitment for Hungary in the 2007–2013 programming period
(EUR billion)



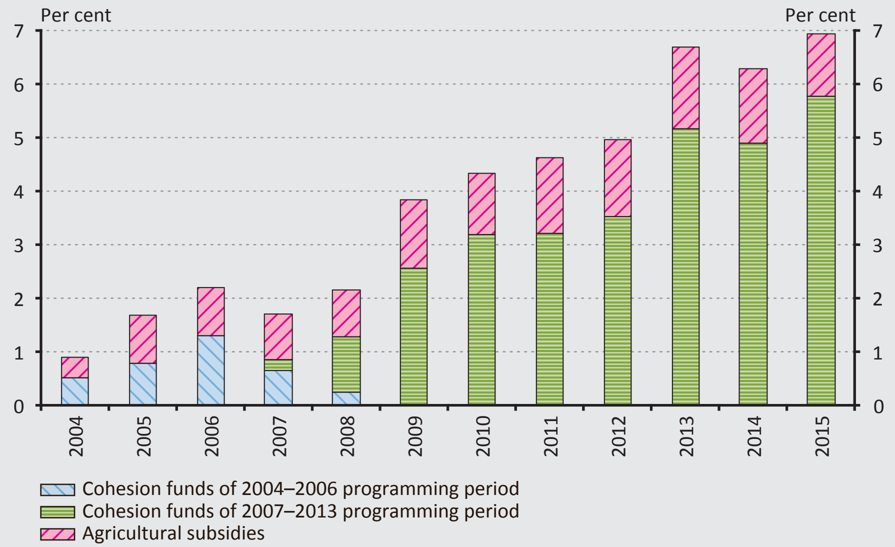
Source: MNB

The financial allocation provided by the EU is determined in foreign currency, and thus the amount of EU grants to Hungary is also influenced by the development of the forint exchange rate. Since parties eligible for grants always submit the invoices in forint, upon the depreciation of the forint less foreign currency is sufficient for the settlement thereof. The programming period was planned at an exchange rate of EUR/HUF of 280, and thus in parallel with the depreciation of the forint the value of the EU grants expressed in forint increased considerably during the period. As a result of this, the anticipated HUF 9,900 billion value of the funds available for absorption may be exceeded by roughly HUF 380–400 billion, as a result of which a higher number of projects may be implemented from the grants allocable to the 2007–2013 period (*State Audit Office of Hungary 2015*). On the other hand, the depreciation of the exchange rate – through the import content of the investments – also generates higher costs than planned, which curbs the increase in the number of projects. As long as the currency effect on the expenditure side falls short of the increase in the forint value of the grants, depreciation of the exchange rate may result in the implementation of more investments.

2.1. General trends in EU transfers

Between 2007 and 2015, domestic agents absorbed transfers in a net amount of EUR 33.4 billion. The amount of absorbed EU grants peaked in 2015, after the end of the 2007–2013 programming period, which was rendered possible by the n+2 rule. The absorption of the transfers originating from the previous cycle, which appeared in the balance of payments, accelerated after 2009; at that time, the net transfer absorption was already around 3 per cent of GDP, compared to the previous level of 1 per cent. "Unused funds from the Cohesion and Structural Funds can still be drawn down within the next two years following the individual EU programming periods. This occurred in the 2004–2006 programming period, when almost 30 per cent of the allocation was absorbed in 2008 and 2009. In the 2007–2013 programming period, the EU grant allocation – which increased considerably, i.e. by 24 per cent of GDP compared to the previous period – was implemented with gradually increasing absorption.[6] In the two years after 2013 the inflow of EU funds was around 6–7 per cent of GDP, which was rendered possible by the n+2 rule." (*MNB 2016, p 24*) It

Figure 2
Distribution of the gross inflow of the EU transfers by programming periods
(as a per cent of GDP)



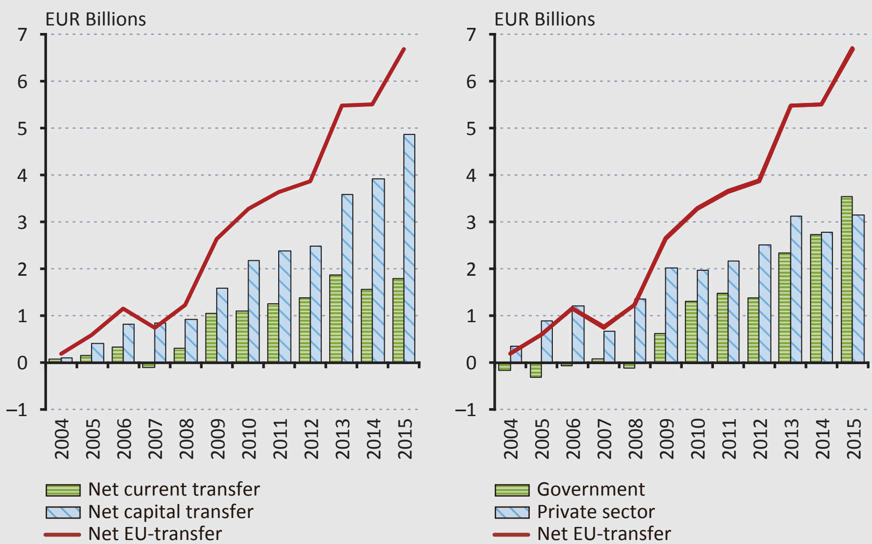
Source: MNB

[6] The substantial absorption of the funds of the 2007–2013 programming period only started from 2009; in 2007 and 2008 the funds of the previous programming period were typically still being absorbed.

should be noted that the fluctuations in the EU grants are essentially attributable to the drawdown of the Cohesion and Structural Funds, while the agricultural subsidies, amounting to roughly 1 per cent of GDP (which to a lesser degree also contain the subsidies from the Rural Development Fund) are distributed relatively evenly between the years (*MNB 2016*).

Capital transfers supporting investments accounted for an increasing part of the absorbed grants, while by 2015 – contrary to the former trends – the transfers received by the state exceeded those of the private sector. In recent years, the absorption of capital transfers increased from 1–2 per cent of GDP close to 5 per cent. These funds typically support the implementation of some sort of investment, and hence this sharp increase also had a substantial effect on the dynamics of investments. By contrast, net current transfers increased only moderately after 2009, amounting to only 1.5–2 per cent of GDP annually at the end of the period. The largest part of these current items are agricultural subsidies determined on the basis of area, independently of projects, and thus the absorption of those is more stable than that of capital transfers. The Member State payments are also included in the current items. The funds necessary for the EU budget are provided by the payments of the Member States, where the largest revenue is generated by

Figure 3
Current/capital and sectoral breakdown of the net EU transfers*
(as a per cent of GDP)

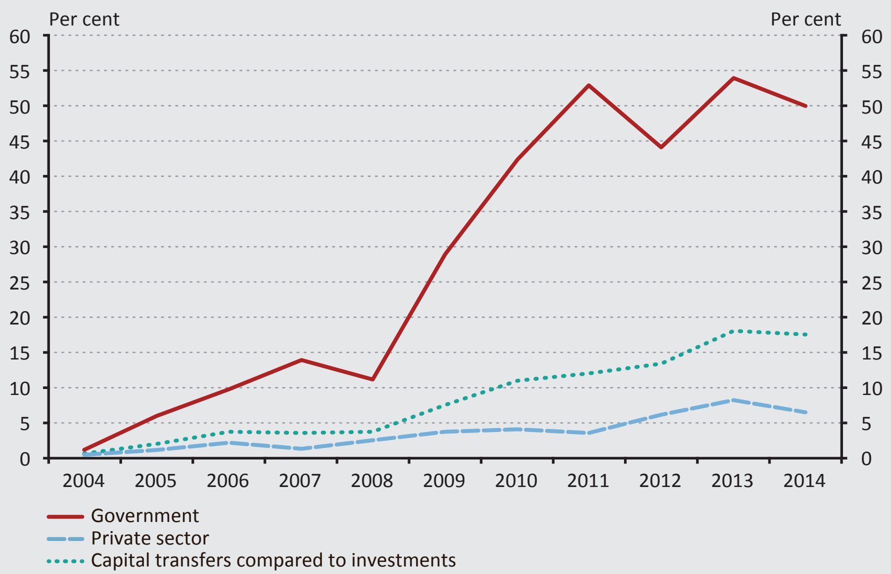


** In addition to the grants received from the EU, this also considers payments to the EU. Payments to the EU reduce current transfers.*
Source: MNB

the GNI-based contribution paid at a standard rate and by the VAT-based payments. During the programming period, Hungary's payments to the EU predominantly appeared among the general government expenditures and steadily accounted for around 1 per cent of GDP (for more details on payments made by Hungary, see the Annex). Up until 2013, the EU grants absorbed by the private sector substantially exceeded the absorption by the state. However, since then – presumably with a view to ensuring a faster drawdown of funds due to the end of the 2007–2013 programming period – the transfers received by the general government started rising quickly and by 2015 the state had already absorbed more transfers than the private sector.

The role of capital transfers increases both within public and the private investments. Public investments implemented from EU funds and public capital transfer absorption sharply increased after 2008. In 2011, the ratio of EU transfers within public investments already exceeded 50 per cent and it was also at a similar level in 2013–2014.[7] Within private sector investments, the ratio of investments financed from EU funds remained at a lower level, but gradually increased, and hence after 2011 it accounted for 5–8 per cent. One interesting question is to what extent

Figure 4
Developments in the rate of capital transfers compared to investments



Sources: Eurostat, European Commission

[7] The large public enterprises developing and operating infrastructure also form part of the general government sector (e.g. Nemzeti Infrastruktúra Fejlesztő Zrt., Magyar Közút Nonprofit Zrt.).

the principle of additionality was enforced under the high ratio of investments implemented from the transfers: in addition to the own contribution related to the grants, the EU also prescribes the type of investments that the beneficiary country should implement to avoid that the grants finance the budget deficit (this paper essentially analyses the direct data of the sources, and hence the issue of additionality could rather be the topic of research focusing on the impacts of the EU funds).

2.2. Cohesion policy funds

In the 2007–2013 programming period, via the tools of cohesion policy, the EU used a significant part of its budget to strengthen economic, social and regional cohesion in the EU. Within this, the EU set the objective of promoting convergence (by supporting the poorest regions, which fell 75 per cent below the Community average), as well as regional competitiveness and employment. The financial funds for the objectives are provided by the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund (CF). The objective of the ERDF is to reduce inequalities between regions, the ESF focuses primarily on employment and education developments, while the CF supports the countries where gross national income (GNI) per capita is below 90 per cent of the EU average – the latter mostly finances large-scale developments in the area of environmental protection and transport.

In the 2007–2013 programming period, funds in the amount of EUR 24.9 billion were allocated to Hungary via the structural funds (ERDF, ESF, CF), supplemented by the national contribution in the amount of almost EUR 4.4 billion (a little more than 15 per cent). A significant part of the funds granted to Hungary was allocated to the convergence objective, while the largest part of the projects were financed by the European Regional Development Fund and the Cohesion Fund (*Lehmann–Nyers 2009*). The framework for the drawdown of the amounts allocated to Hungary is provided by the National Strategic Reference Framework (NSRF). Within that framework, Hungary defined a total of 15 operational programmes: seven sectoral, seven regional and one implementation operational programmes. During the programming period, the largest grants were received by the Transport (TOP), the Environment and Energy (EEOP) and the Regional (ROP) Operational Programmes (*NDA 2012*). The table below summarises the key features of the operational programmes in the 2007–2013 programming period:

The time profile of payments under the individual operational programmes was rather heterogeneous; nevertheless, by the end of 2015 the Hungarian state paid the total allocation of all operational programmes, while there was overspending in most of the programmes. Of the operational programmes, the run-up of the regional operational programmes (ROP) was one of the most even. Within that group, it is worth highlighting the Central Hungary Operational Programme,

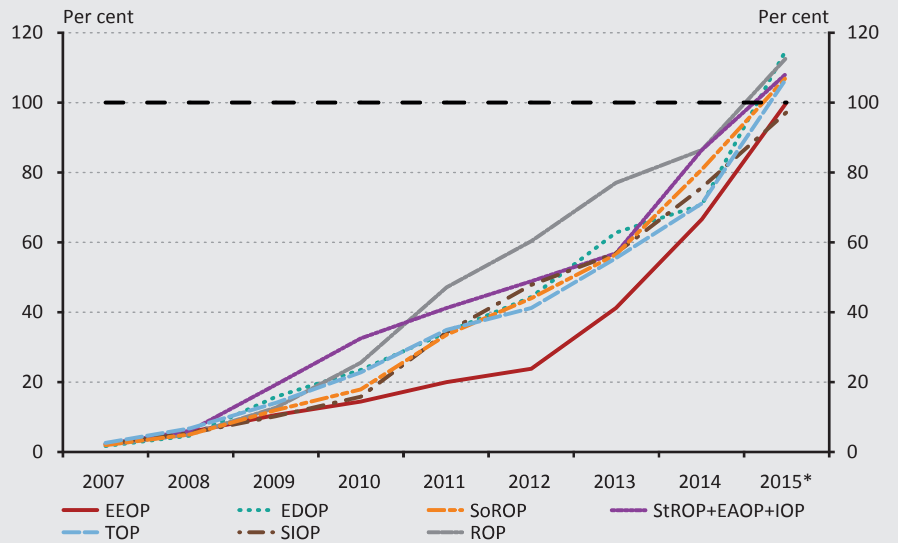
Table 1
Convergence of disadvantaged areas

	EUR bn	Fund	Aims
Sectoral Operational Programmes			
Economic Development OP (GOP)	2.9	ERDF	Stable economic growth, improving productivity
Transport OP (KÖZOP)	5.7	ERDF/CF	Development of transport
Environment and Energy OP (KEOP)	4.5	ERDF/CF	Increase labour productivity, reduce social differences (training, education, healthcare)
Social Renewal OP (TÁMOP)	3.5	ESF	Development of education, healthcare, labour market and social service infrastructure
Social Infrastructure OP (TIOP)	1.8	ERDF	Reducing environmental issues
Electronic Administration OP (EKOP)	0.3	ERDF	Development of IT in public administration
State Reform OP (ÁROP)	0.1	ESF	Increase the level of administrative system's performance and services
Regional Operational Programmes (ROP)			
Central Hungary OP (KMOP)	1.5	ERDF	Improve the quality of life, increase employment rate, create new jobs, convergence of disadvantaged areas
South TransDanubia OP (DDOP)	0.7		
Central TransDanubia OP (KDOP)	0.5		
West Pannon OP (NYDOP)	0.5		
South Great Plain OP (DAOP)	0.7		
North Great Plain OP (ÉAOP)	1.0		
North Hungary OP (ÉMOP)	0.9		
Operational Programme for the implementation of European Cohesion Policy			
Implementation OP (VOP)	0.3	CF	Technical support
Sum	**24.9**		

Source: State Audit Office of Hungary (2015)

in which the payments were made the fastest. In addition, the payments of the West Transdanubia and the South Transdanubia, and the South Great Plain regions were executed better than the average. On the other hand, the projects implemented in the North Great Plain, North Hungary and Central Transdanubia regions confirmed completion of the projects by invoices more slowly than the average. The rest of the operational programmes can be regarded as “tail-heavy”, i.e. they were characterised by the acceleration of payments in the final years. One possible exception to this is the implementation operational programme (IOP): due to the objective of the programme (technical assistance) these funds were drawn down relatively evenly. Partially due to the substantial size of the projects, the Environment and Energy operational programme (EEOP) paid almost 80 per cent

Figure 5
Payments by the individual operational programmes



** Estimation*
Sources: SMIS, HST

of the grants very slowly, only after 2012. Since the total allocation of the latter programme is extremely high, it can be stated that a considerable portion of the EU grants in recent years was paid for environmental purposes.

"Overspending" also occurred in the case of the operational programmes, which were not steady though. Overspending means that the Hungarian state typically paid EU tender funds in higher amounts than the allocation provided by the EU. This is necessary to ensure that no funds are lost should the Commission have any objection. The excess invoice portfolio can be used as a "cover" for the potential problems that may arise subsequently in the case of items already settled with the Commission, instead of the potentially unsuitable invoices submitted or to be submitted, or in the case of suspended payments for financial adjustment.[8] Among the operational programmes, the largest overspending in nominal terms can be observed in the case of the transport (TOP) and economic development (EDOP) programmes. Both of these are amongst the operational programmes with higher allocation, and thus the overspending is presumably also attributable to the intention to be able to submit new invoices for the purpose of financial adjustment or to replace invoices potentially disputed by the EU. In addition, overspending

[8] If the Commission and the Hungarian authorities are able to agree on the degree of the financial adjustment, the grant deducted from the disputed investments may be reallocated to new projects. In this case, the amount deducted from the disputed investments most probably has to be covered from the national budget.

may also signal the popularity of the programmes, the objectives of economic policy, as well as the strengthening of the economy's growth potential. It should be noted that the "popularity" of EDOP may also be supported by the fact that in the new programming period, despite the decrease in the total allocation, the funds planned to be allocated here are substantially higher than in the 2007–2013 programming period. On the other hand, the social infrastructure (SIOP) projects, and the overspending of the EEOP and StROP programmes are negligible. The overspending in respect of the rest of the programmes is around 5–20 per cent.

Based on the data available until the end of December 2015, it is unlikely that any loss of funds from the 2007–2013 programming period will be suffered, i.e. the Hungarian State has paid the available total allocation of EUR 24.9 billion in full. Based on the information available at the end of 2015, it can be stated that the European Union has already paid a substantial part of the allocation for 15 operational programmes (around EUR 22 billion) and, based on existing invoices, Hungary may receive further grants from the EU in the amount of EUR 2.9 billion in relation to the 2007–2013 programming period (*Figure 6*):

i. Up to December 2015, the Hungarian state submitted invoices in the amount of *EUR 0.2 billion*, the payment of which can be expected in 2016.

ii. Suspended amounts or amounts not submitted due to suspension account for a large part of the allocation not paid by the European Commission *(EUR 1.4 billion)*. It is the transport programme (TOP) that is most affected by the suspensions; at present TOP payments of EUR 573 million are suspended. The Commission interrupted the payments of TOP back in December 2013 due to the so-called asphalt mixer case,[9] and it was suspended in summer 2015 as no agreement could be reached on the degree of financial adjustment. In addition, there are also some disputed items in the case of the Social Renewal (SoROP) and Social Infrastructure (SIOP) programmes.

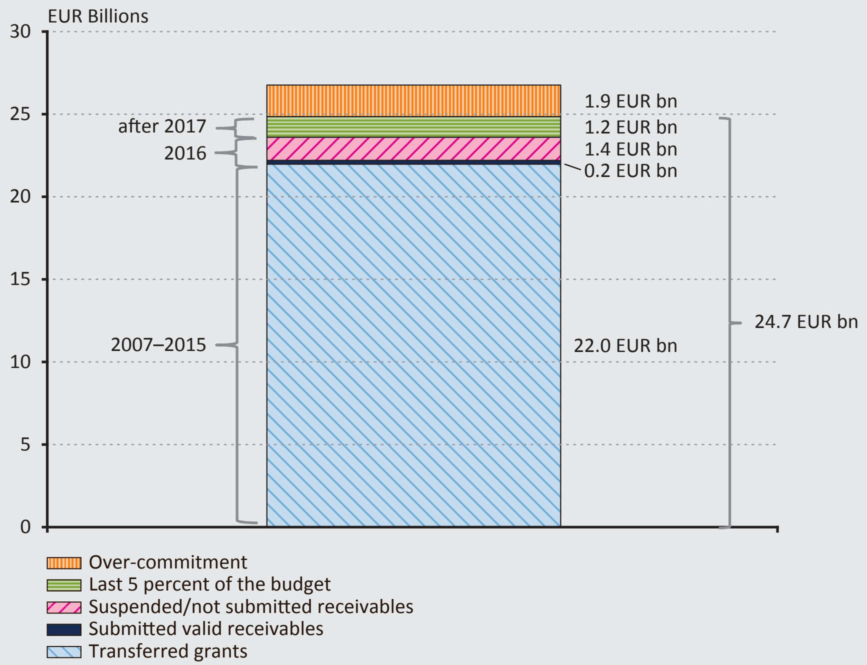
iii. According to the rules, the EU does not transfer the last 5 per cent of the grants, around *EUR 1.2 billion* to the Member State until completion of the full review of the grant given (in relation to the 2007–2013 programming period the Commission is expected to make the payment in 2017–2018).

According to the available data, Hungary has over-secured itself by EUR 1.9 billion, i.e. by almost 8 per cent of the total allocation. Taking all operational programmes into account, overspending ran to roughly EU 1.9 billion, i.e. the EU tender funds paid by the Hungarian state exceeded the allocation provided by the EU by this amount; accordingly, irrespectively of the pending disputed items, a loss of funds

[9] According to the EU, the Hungarian rules were discriminative, as they permitted the delivery of asphalt for the road construction only for suppliers with business seat located within a distance of 50 kilometres.

is unlikely due to the substantial overspending. On the other hand, it should be also noted that although Hungary performs extremely well in terms of absorption, it does not necessarily mean that the impact of the projects on economic convergence was also the greatest in Hungary. For example, *Heil–Nagy* (*2013*) found that due to focusing on absorption the projects implemented from the cohesion funds were predominantly short and less complex, while a major impact on the economy can be rendered probable typically in the case of more complex, innovative and hence longer projects. More efficient absorption of the funds would be facilitated by the application of supplementary policies that increase the fund absorption potential of the less-developed regions (e.g. by establishing a background structure related to research and development), which would be an extremely time-consuming measure. A further consequence of the full allocation of funds is that although, thanks to the last two years, Hungary was able to draw down the grants of the 2007–2013 financial cycle in full, due to the administrative burdens of the previous cycle the issue of tender notices and the conclusion of the contracts related to the new, 2014–2020 programming period was only able to start later.

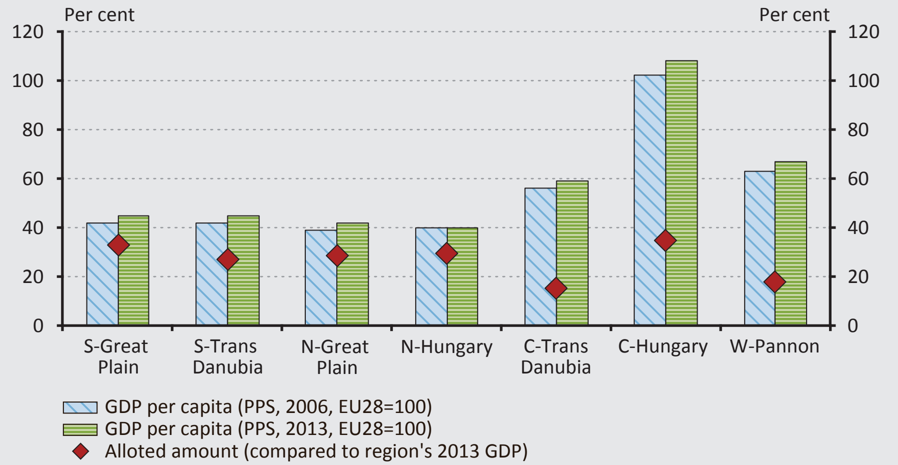
Figure 6
Absorption of the cohesion policy grants of the 2007–2013 programming period up to end-December 2015



Source: Hungarian State Treasury

As regards the regional absorption of transfers received by Hungary, the largest volume of funds was received by Central Hungary, but support for the less-developed regions was also considerable. In Central Hungary, GDP per capita substantially exceeds the average of the rest of the county and is slightly above the EU average. There was a substantial increase in the region's GDP per capita between 2006 and 2013, which was also supported by the transport and infrastructure investments (underground line 4, extension of M0 ring) implemented during the period. In terms of GDP per capita, the two most developed regions, after Central Hungary, are West and the Central Transdanubia regions. These regions received less EU grants in proportion to their GDP compared to the less-developed regions, but in spite of this convergence to the EU average was more significant in these two regions. In the less-developed regions of the county, GDP per capita compared to the EU28 countries was around 40 per cent both in 2006 and 2013. This shortfalls in these areas remained substantial despite the significant inflow of EU funds – reaching 30 per cent of GDP on average in 2013 – which suggests that the rate of convergence is also influenced by the geographical location of the regions. Nevertheless, it is probable that without the absorption of the EU funds the negative consequences of the crisis would have resulted in an even more severe lag in the growth of these regions.

Figure 7
Absorption of EU transfers, by regions



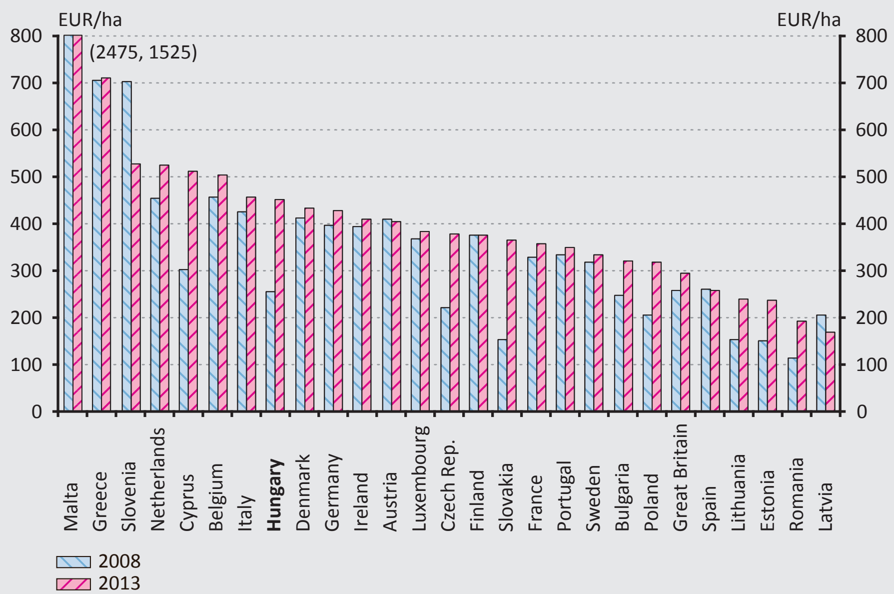
Source: Standardised Monitoring Information System (SMIS), HCSO, Eurostat

2.3. Agricultural and rural development subsidies

One type of agricultural and rural development subsidies are the direct producer and agricultural market subsidies, while the second pillar is the rural development grants. The Common Agricultural Policy (CAP) is the European Union's agricultural subsidy scheme, from which Hungary receives agricultural grants from two sources. A significant part of the EU funding provides direct subsidies to producers and the agricultural market from the European Agricultural Guarantee Fund (EAGF). The second pillar of the agricultural subsidy scheme is the European Agricultural Fund for Rural Development (EAFRD), which provides the rural development grants. From the date of accession until 2013 Hungary received funding from these two sources in the total amount of EUR 12.5 billion.

The level of agricultural and rural development subsidies received from the EU was already high in Hungary in 2008 and increased further in the 2007–2013 programming period (*Figure 8*). As a result of the gradually increasing direct subsidies, by 2013 the agricultural grant per hectare increased by more than one and a half times; with this, among the countries that joined the EU in 2004 it is Hungary that receives the highest amount.

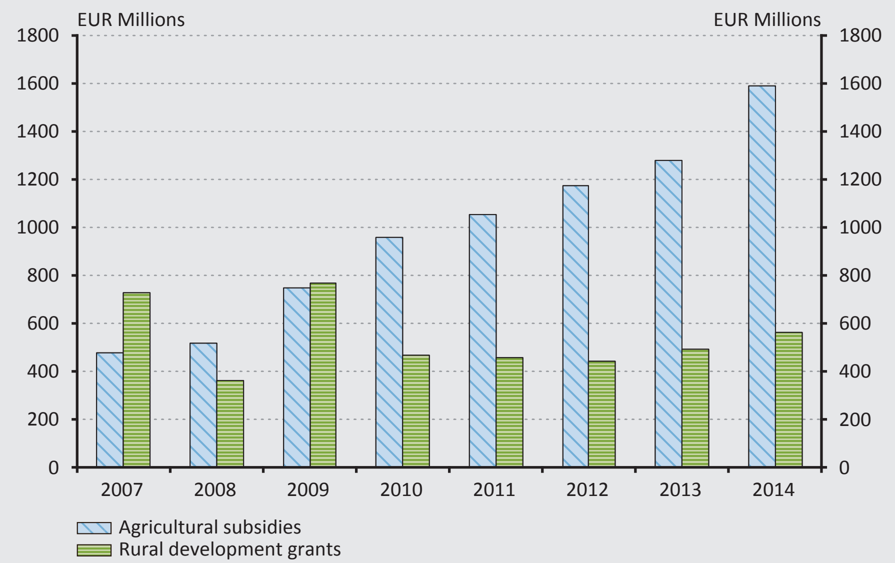
Figure 8
Member States' agricultural subsidies per hectare in 2008 and 2013



Source: State Audit Office of Hungary (2015)

Since EU accession, access to subsidies from EAGF, as the first pillar of the common agricultural policy, has gradually expanded for Hungary; the different financing rule also contributed to the gradual increase in the absorption of the grants. For the newly acceded countries in 2004 the amount available for drawdown was 25 per cent of the EU15 average, and this ratio gradually increased year by year, to reach the subsidy level of the EU15 countries by 2013. A substantial part of the EAGF funds (95 per cent) was used for direct area aid, while the remaining part (5 per cent) was used for other grants. The direct producer grants can be drawn down in respect of land where agricultural activity is pursued primarily. The system of absorbing direct subsidies differs from those customary for funds originating from other organisations of the European Union. The payment to beneficiaries is executed in the given fiscal year, the full amount of the subsidy allocable to the period is absorbed, and thus there is no need for the n+2 years rule. Accordingly, the data related to the absorption of direct subsidies can be quantified already after the closing of the respective year. The available allocation has gradually increased since accession, which was also reflected in the higher absorption of the grants: the direct producer grants received by Hungary increased more than threefold from the level of EUR 0.5 billion in 2007, to approximate EUR 1.6 billion by 2014 (*Figure 9*).

Figure 9
Agricultural and rural development subsidies from the EU



Source: State Audit Office of Hungary (2015)

The second pillar of the European Common Agricultural Policy is the rural development subsidy scheme, provided to the Member States by EAFRD. The purpose of these subsidies is (*i*) to improve the competitiveness of the agricultural and forestry sector; (*ii*) support environmental protection; (*iii*) improve the quality of life in rural areas; and (*iv*) encourage the diversification of economic activity in rural areas. The rural development subsidies, in contrast to direct producer subsidies, are not transferred automatically to the users of the funds, but are allocated through tenders similarly to development funds. Similarly to the cohesion policy funds, the projects must be implemented within n+2 years after the assessment of the tenders, i.e. after the closing of the programming period the grants can be drawn down for another two years. As a result of this, the rural development subsidy allocation was drawn down in almost full.

3. International experiences

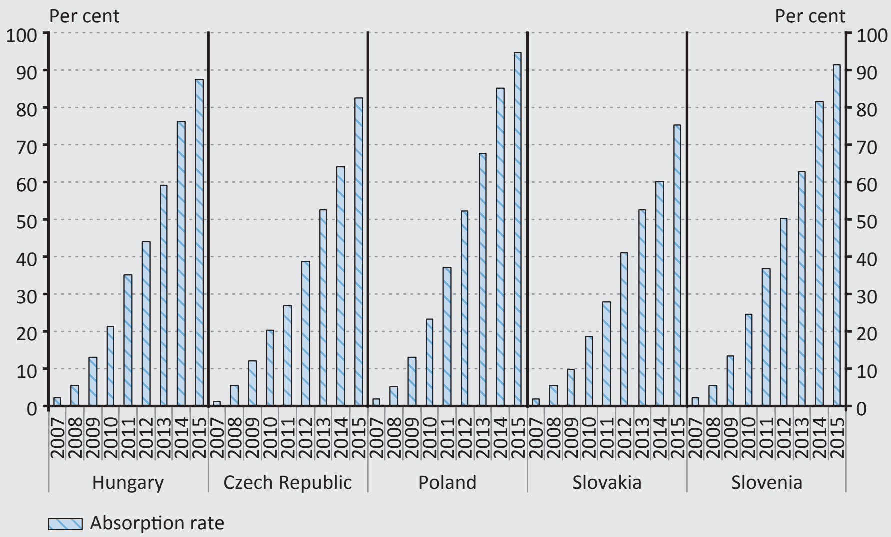
The Cohesion and Structural Funds essentially finance investments to reduce and eliminate the regional difference within the European Union. The purpose of these funds is to enable the Member States to reduce their handicap and underdevelopment compared to the core countries of the EU. For this reason, it is important to ensure that the countries that joined in 2004 use the grants for the realisation of these objectives. Accordingly, in Section 3 we present the international comparison prepared on the absorption of EU funds.

3.1. Absorption ratios

Most countries have already drawn down the bulk of the cohesion policy funds; nevertheless, the absorption of funds by the Hungarian economy may be deemed outstanding by international comparison. By the end of 2015, Hungary had drawn down almost 90 per cent of the available funds, which is a favourable ratio compared to the countries in the region and the Member States as well. In the Visegrád countries, the absorption of cohesion policy funds is similar; however, the Hungarian absorption rate is exceeded only by Poland, where the rate was above 90 per cent.[10] The high drawdown of funds by Poland was supported by the very efficient institutional system performing the distribution of the grants, as well as by the high ratio of infrastructure investments (*State Audit Office of Hungary 2015*). In the region, Slovenia's absorption of funds exceeds that of Hungary, while Slovakia lags behind the level of the countries in the region, which may be partly attributable to the fact that the EU stopped several large public investments and payments due to suspected fraud and corruption (*State Audit Office of Hungary 2015*).

[10] The absorption rates show the amount transferred by the European Commission from the available allocation to the given Member State rather than the effective use of the EU transfers. The EU does not transfer the last 5 per cent of the grants to the Member State until the completion of the full review of the grant given (in relation to the 2007–2013 programming period the Commission is expected to make the payment in 2017–2018).

Figure 10
Trends in the drawdown of cohesion policy funds
(as a per cent of the total allocation)



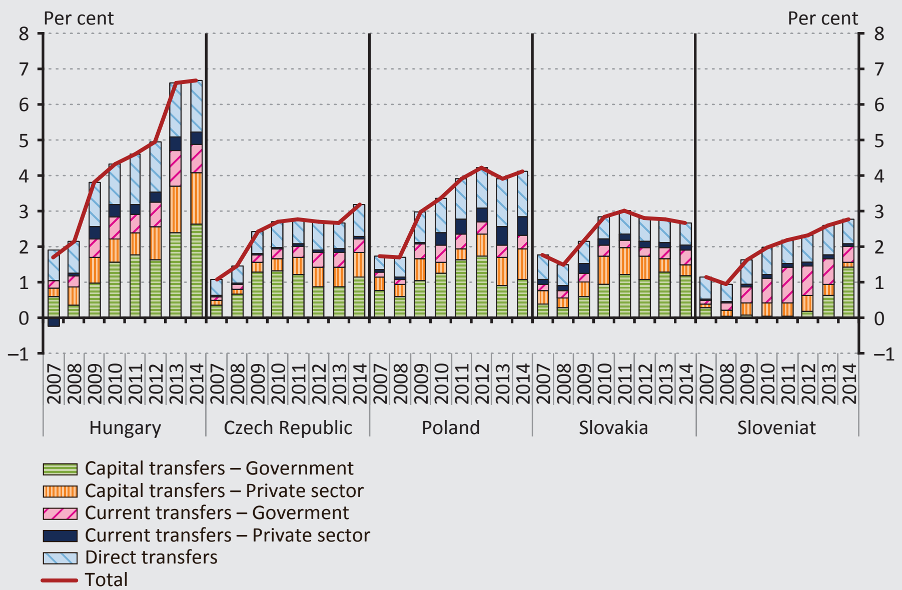
Source: European Commission

3.2. Sectoral breakdown

*Although the drawdown of cohesion policy funds evolved similarly in the countries of the region, the absorption of funds as a per cent of GDP significantly outstrips the regional level in Hungary***.** In addition to the absorption rate, it is also worth comparing the extra funds provided for the implementation of the investments as a per cent of GDP in the individual countries. Based on the absorption of the EU funds as a per cent of GDP, Hungary's performance was outstanding among the countries of the region, and despite the fact that the grant drawdown rate was higher in Poland, the absorption exceeded the Polish level as well. The inflow of transfers during the period was the most uneven in Hungary among the countries in the region: it started slowly in the first years of the programming period (*KPMG 2013*), but after a gradual increase in 2014 it already amounted to more than 6 per cent of GDP. The outstanding absorption of EU transfers supported the general government to larger degree, and the private sector to a lesser degree.

Examining the EU funds absorbed in the countries in the region, it can be seen that the role of the public sector increased during the period, and the capital transfers increased at an accelerating pace, exceeding the inflow of current transfers by 2013. Similarly to the absorption of funds by Hungary, in the Czech Republic a large part of the grants – around 50 per cent – was received by the state and 20 per cent by the private sector, while the remaining part of the transfers was drawn down in the form of direct aid (e.g. area aid). In Poland, the ratio of the funds flowing to the private sector is higher, i.e. around 25 per cent, while public absorption reached a lower level, around 45 per cent. The structure of the EU grants flowing into the Polish economy has changed over the years: the ratio of absorption by the private sector increased to almost one-third of the funds in 2013–2014. While a large part of the transfers is often used by the public sector through the implementation of high-value investments, in Poland an increasingly large part of the grants was absorbed by the private sector, but this did not entail a decrease in the funds. This is related to the fact that in Poland investments increased significantly in the period under review, while in the new programming period it may face similar challenges as Hungary in terms of investment financing.

Figure 11
Breakdown of absorbed transfers by sectors and type
(as a per cent of GDP)

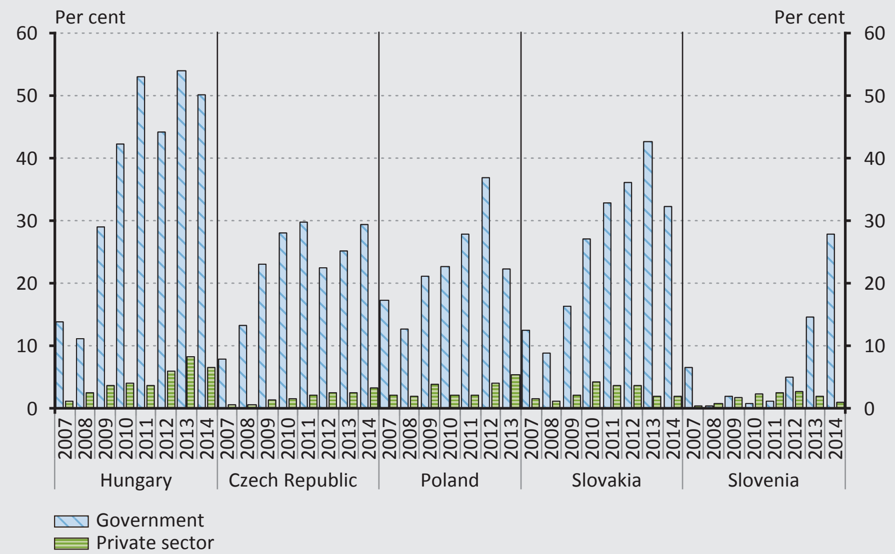


Source: European Central Bank

3.3. Role of transfers in investments

Among the countries in the region, capital transfers played the strongest role in Hungary both in the public and private sector investments. Between 2007 and 2014, Hungarian public investments amounted to around 4 per cent of GDP, 40–50 per cent of which was financed from capital transfers received from the EU; thus, the implementation of these projects did not increase the budget deficit. On the other hand, private sector investments significantly exceed those of the state: on average they amount to 17 per cent of GDP. The received capital transfers play much smaller role in the financing of private investments; nevertheless, the ratio thereof is higher than the regional level. The weight of EU grants is also more significant in public investments than in the countries in the region, where less than 40 per cent of all public investments are implemented with the use of EU funds. Among the countries in the region, the structure of the financing of public investments has changed to the largest degree in recent years in Slovenia, since the ratio of EU funds – as a result of the strict fiscal policy of Slovenia – has increased from a low level at an accelerating pace. On the whole, due to the significant role of capital transfers, the financing of the investments may represent the largest challenge for the participants of the Hungarian economy after the change of the programming period.

Figure 12
Ratio of the capital transfers to investment in the region



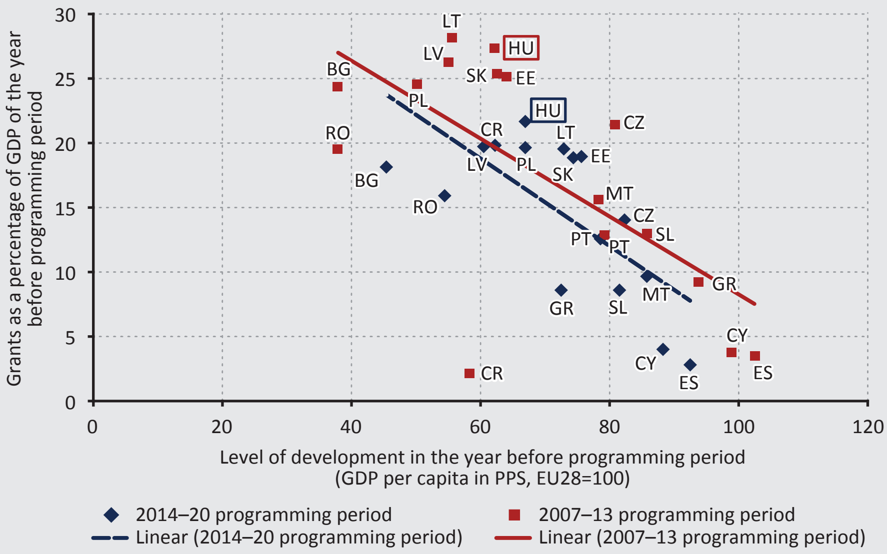
Sources: European Commission, Eurostat

4. The new programming period

4.1. Change in the transfer allocation to the individual countries

As regards the budget of EU grants, Hungary belonged to the winner countries in both programming periods compared to its maturity. The budget of the aids granted by the cohesion policy essentially depends on the relative development; the more developed a country is, the less aid it can expect (*Figure 13*). Accordingly, the developed Western countries received only negligible aid from the cohesion policy funds in both programming periods. In the 2007–2013 programming period within the group of supported countries, the Central and Eastern European countries received significantly higher aid than the South European states, compared to both their development and GDP. Among the preferred countries, support for Hungary in the previous period was particularly high. The preferred status of the Central and Eastern European countries is preserved in the 2014–2020 programming period as well. Compared to the relative development, Hungary remained among the front-runners; moreover, compared to 2013 GDP it received the highest grant allocation. Nevertheless, it is obvious that at the EU level the total grant budget has decreased substantially for the 2014–2020 period, as the relative development has also improved significantly in the vast majority of the supported countries.

Figure 13
Relation between EU grants and relative development in the individual programming periods

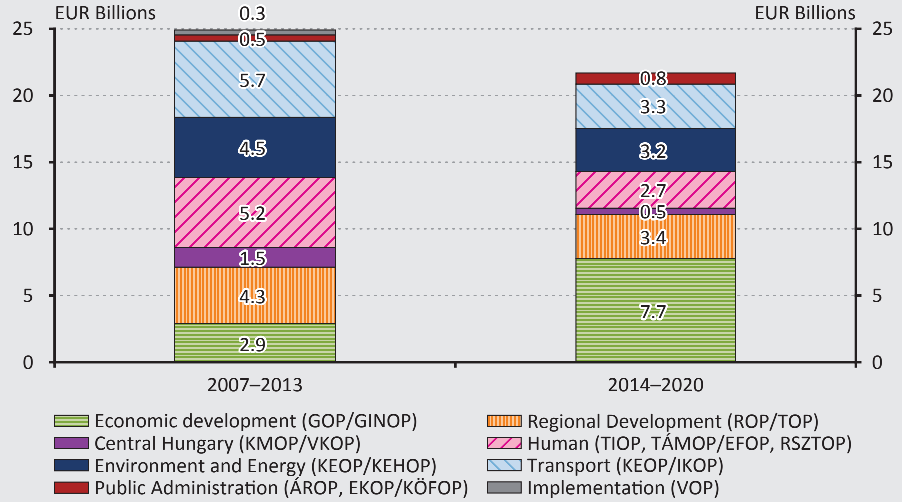


Source: European Commission, Eurostat

4.2. Trends in funds available for individual objectives

Although in the new programming period the budget allocated by the cohesion policy decreased slightly in nominal terms, the structure of the grants may be more favourable for economic growth. In the new programming period, within the framework of the Partnership Agreement, Hungary may absorb – in addition to the annual agricultural aids – grants of EUR 25 billion (EUR 22 billion from the cohesion policy funds, EUR 3 billion for rural development grants), which slightly falls short of the allocation in the previous programming period. In the 2007–2013 programming period, the transport infrastructure had the highest weight among the supported objectives, but social convergence also received considerable support. The areas important in terms of the economy's competitiveness, such as support for small and medium-sized enterprises, education and research and development, benefited from relatively less support. In the new, 2014–2020 programming period, the support funds are distributed more evenly among the various objectives, while the funds usable for environmental protection[11] and employment increase. On the whole, the amounts available for the development of the economy – according to the communication by the government – may significantly exceed the values of the previous period.[12] The major part of the funds allocated to economic development is provided by the Economic Development and Innovation Operational Programme (EDIOP): this includes funds to be used for growth in tourism, the expansion of

Figure 14
Change in the development objectives in the fiscal periods based on the operational programmes



Source: Prime Minister's Office

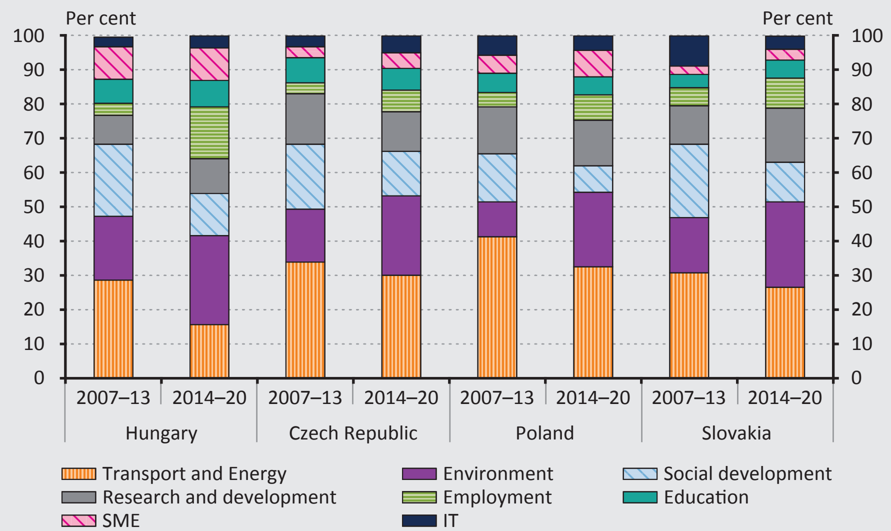
[11] It should be noted that although at the level of the operational programmes the ratio of funds usable for environmental protection has decreased, it increased when taking all funds together, since grants from the other operational programmes may also be used for this purpose.

[12] According to the intentions of the government, the economic development goals will be served, in addition to the Economic Development and Innovation Operational Programme (EDIOP, EUR 7.7 billion), primarily by the allocations of the Territorial Development Operational Programmes (TDOP, EUR 3.4 billion) and the Competitive Central Hungary Operational Programme (CCHOP, EUR 0.5 billion).

the production capacity of small and medium-sized enterprises, for research and development and for the improvement of competitiveness, while – instead of the separated operational programmes of the previous period – several funds aimed at promoting higher and more efficient employment also appear here. The "Road to Labour Market" programme and the programmes supporting flexible work and the employment of low-qualified workers permit the more efficient utilisation of human resources, which is especially important, because the development of human resources, in addition to infrastructure, may result in the more efficient absorption of the EU funds, as these factors may strengthen the potential growth of the economy in the longer run as well (*Allard–Annett 2008*).

The processes with regard to the utilisation ratio in supported areas are similar in the Visegrád countries: the ratio of public road and railway infrastructure investments is decreasing, while that of environmental investments is increasing. In the previous programming period, the largest portion of the grants in the Visegrád countries was used for transportation and energy infrastructure investments; e.g. in Poland these accounted for more than 40 per cent of the total allocation (*Figure 15*), which may have been attributable to the relative underdevelopment of the public road network. However, in the new programming period the ratio of the grants related to social infrastructure and activity will decrease in all four countries. On the

Figure 15
Areas supported by cohesion policy



Note: The composition of the individual areas has changed for the 2014–20 programming period; therefore, in the classification of the areas of use we used different terms than the official terminology.
Source: European Commission

other hand, the volume of EU resources available for environmental protection will increase everywhere; in the new programming period, in Hungary it may exceed the ratio of the infrastructural investments. It should be noted that the EU resources for the development of employment are increasing to an outstanding degree, and – compared to the other countries – support for the SME sector may remain significant, while in the case of grants used for research and development Hungary's lag compared to the region will decrease.

4.3. Acceleration of payment of EU funds in 2016

According to the baseline forecast of the Inflation Report of March 2016, the amount of EU transfers that may be absorbed by Hungary may fall by roughly EUR 3 billion in 2016 compared to the previous year. At the beginning of the new programming period, the payment of EU funds according to (Hungarian and international) experiences will fall substantially short of the values measured in the last years of the programming period (*Babos–Kiss 2016*). In addition, payments in the first years of the new period were also complicated by the fact that the determination of the allocations to the individual countries for the new period, the breakdown of the amounts to operational programmes and priorities, and the conclusion of the cooperation agreement proved to be such a time-consuming exercise that it was only possible to announce tenders for the absorption of the funds belonging to the 2014–2020 programming period from the end of 2015.

The government took several measures to ensure the drawdown of the EU funds faster and in a large amount, to prevent economic growth in 2016 from being curbed by the deceleration in transfers and to minimise the risk of loss of funds in the new programming period. The government already recognised the risk of a decline in EU funds last year, and thus from mid-2015 it continuously took measures to avoid a larger-scale decrease in payments of EU transfers and a more significant deceleration of the economy. The most important measures are as follows:

i. In August 2015, the government decided that – in order to avoid losing EU funds – *it will announce all Hungarian tenders by mid-2017 for the 2014–2020 period.*

ii. In November 2015,[13] a government resolution decided that the winning bidders would get higher *supplier advance* (50 per cent instead of 30 per cent) –in addition to the faster payment of EU funds, this measure may significantly improve the liquidity of the corporate sector, which may also boost the sector's investment activity by reducing the chain debts.

iii. In addition, grants received for reducing energy expenditures will be allocated to larger institution facility managers (public institutions, churches, civil

[13] Hungarian Official Journal, 24 November 2015

organisations) instead of households, which will contribute to the faster absorption of funds by *increasing the concentration of expenditures.*

iv. In the new programming period, the ratio of repayable funds is significantly higher: as part of the package of policies, the government – as a general rule – *also allocates non-repayable EU funds to most repayable funds.*

v. It may also accelerate payments that in the case of numerous projects the *preparation costs may be advanced by the central budget.*

vi. In January 2016,[14] the heads of certain ministries were ordered to prepare a *terms of reference containing the quarterly breakdown of the budget figures,* which – due to the rather short deadline, but generous incentive system – may generate higher interest in the drawdown of funds.

vii. By *increasing the expert capacity* efforts are made to reduce the time of assessing the bids.

According to the government's expectations, as a result of these measures the Hungarian absorption of EU transfers from the Cohesion and Structural Funds may reach HUF 2,048 billion in 2016 – on the other hand, based on the historic figures the payment of the said amount appears to be rather ambitious. Accordingly, the objective of the Hungarian government is – calculating using a budget exchange rate of EUR/HUF 310.80 and an own contribution of 15 per cent – to pay EU funds this year roughly in the equivalent of EUR 5.7 billion from the seven-year allocation of almost EUR 25 billion, which would represent the absorption of 23 per cent of the total allocation. In order to demonstrate the weight of the task burdening the public institutional system, it make sense to examine this amount from several respects.

i. On the one hand, in the previous programming period, the execution of payments of similar magnitude required more than two years.

ii. On the other hand, it is worth mentioning that while, in respect of the appropriated funds, over-appropriation of the EU funds (utilisation over 100 per cent) already materialised at the end of 2013, in the area of payments this was realised only two years later, by the end of 2015. Since the public institutional system presumably dealt with the tenders of the previous period even at the end of 2015, to avoid the loss of EU funds, the appropriation of the EU funds to a larger degree by accepting bids may commence only at the beginning of 2016, followed by payments with a delay – this delay may be offset by the higher advance payment.

iii. Finally, in comparison with the previous period, the government's objectives with regard to payments to be made in 2016 in respect of the individual operational

[14] Hungarian Official Journal, 22 January 2016

programmes may also be regarded as ambitious: in the previous period, only 10–15 per cent of the allocations could be paid within three years, while this year's objective typically accounts for 20–25 per cent of the allocations. On the other hand, the success of this may be significantly supported by the fact that in the new programming period it is typically the operational programmes that performed well in the previous period which have higher allocations– i.e. the government focused not only on economic policy objectives and strengthening the growth potential of the economy, but also considered the popularity of the programmes and the speed of the drawdowns from the programmes.

Table 2
Comparison with the payments of the previous period

Operational Programmes		Budget (EUR bn)	Payment target in 2016 (EUR bn)	As a percentage of the budget	In the previous programming period (2007–2009)
GINOP	Development and Innovation Operation Programme	7.7	1.6	21	16
TOP	Territorial Operational Programme	3.4	0.8	22	13
VEKOP	Competitive Central Hungary Operational Programme	0.5	0.2	37	18
EFOP	Human Resources Development Operational Programme	2.6	0.6	22	11
RSZTOP	OP for Supporting Socially Disadvantaged Persons	0.1			11
KEHOP	Environment and Energy Efficiency Operational Programme	3.2	0.7	23	14
IKOP	Integrated Transport Development Operational Programme	3.3	0.8	23	11
KÖFOP	Public Administration and Services Operational Programme	0.8	0.2	23	16
	Rural Development Programme (EMVA), Hungarian Fisheries OP (HOP)	3.5	0.8	23	17
Sum		**25.1**	**5.6**	**22**	**14**

Source: Authors' work, Hungarian Official Journal, SMIS

5. Summary

The grants received from the European Union have a significant impact on the Hungarian economy: in addition to the positive impact on external balance, it is also worth emphasising their role in supporting investment. Towards the end of the 2007–2013 programming period, the absorption of EU transfers gradually increased; net grants – reduced by contributions – reached 5–6 per cent of the GDP. Current transfers remained relatively stable, and hence the increase can be primarily attributed to the investment-supporting capital transfers. As a result of the accelerating payments, it is unlikely that there will be any loss of funds from the 2007–2013 programming period, i.e. the Hungarian State has paid the available total allocation of EUR 24.9 billion in full. In excess of the total allocation, overspending of roughly EUR 1.9 billion also occurred, which may help avoid the loss of funds as a result of pending disputes. On the other hand, in addition to the absorption approach, it also makes sense to examine the impacts the received grants may have exerted on the Hungarian economy. This paper did not intend to quantify all impacts, but it is worth emphasising that the transfer from the EU supported public investments to a substantial degree, i.e. over 50 per cent – on the other hand, in the case of the private sector, this ratio is substantially lower, i.e. around 5–10 per cent. As regards the regional absorption of the transfers received by Hungary, Central Hungary received the highest volume of funds, but support for the less-developed regions was also substantial, which may have contributed to the fact that they managed to reduce their shortfall compared to the EU average to a slight degree. In terms of a regional comparison, it is worth noting that although the drawdown of cohesion policy funds was similar in the Visegrád countries, as a per cent of GDP the highest grant was received by Hungary, which is primarily attributable to the fact that – similarly to the new, 2014–2020 programming period – Hungary received a favourable total allocation compared to the country's maturity. The support resources are allocated more evenly among the various objectives in the new programming period in respect of Hungary, and thus the amounts available for economic development – as stated by the government – may significantly increase compared to the lower values of the previous period. On the other hand, in 2016 the absorption of EU transfers is expected to fall significantly, despite the government's measures, which can be explained by the gradual pick-up in payments in the new period.

Annex: Budget revenues of the EU and Hungary's contribution

The resources of the European Union predominantly originate from the Member States' contributions. The European Union's own sources of revenue can be broken down into three main categories:

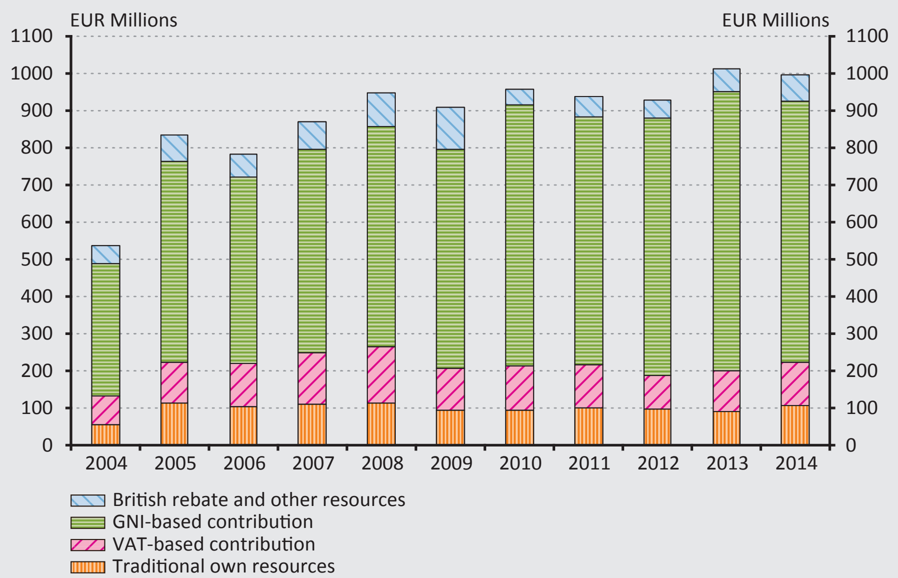
i. *GNI-based contributions:* The Member States pay a certain defined percentage of their gross national income to the budget. These funds account for a substantial part of the EU's budgetary revenue (in 2014 more than two thirds). The GNI-based contribution is a so-called "balancing resource", meaning that the rate of the contribution to be paid is determined in such a way that helps avoid a budget deficit.

ii. *Traditional own resources:* The customs duties imposed on non-EU countries and the sugar levies originating from the common organisation of the sugar industry constitute the traditional source of the EU's revenues since 1970. The Member States are obliged to pay 80 per cent of the levies and duties collected by them to the EU budget, while they may retain the remaining 20 per cent to finance their collection costs.

iii. *Value added tax-based contributions:* The basis of the Member States' contribution is the estimated value added tax revenue; a certain percentage of this must be paid to the budget.

The largest part of fiscal expenditures are financed from the own resources contributed by the Member States; however, the EU also earns other revenues of

Figure 16
Hungary's contribution to the EU budget



Source: European Commission

lesser significance. Such revenues may include the tax on the income of employees of EU institutions, penalties imposed on enterprises violating competition law or other rules, or the retained earnings from previous years. The own resources are supplemented by the *compensation* of the budgetary imbalances between the contributions of the Member States. The "UK rebate" of 1984 reduces the contribution of the United Kingdom, which in 2007 was adjusted by the impact of the contributions of the newly joined Member States.

Hungary's Member State contribution was around EUR 0.8–1.0 billion annually, the major part of which comes from GNI-based resources. The ratio of the traditional own resources from customs duties and sugar levies, and the VAT-based contribution is roughly the same, representing a burden of around HUF 100 million for the Hungarian budget. The amount of contributions under other titles – the largest part of which is the UK rebate – was around HUF 50–70 million in recent years. Hungary's annual budget contribution amounts to almost 1 per cent of GDP – with this, among the newly joined 12 countries, the contribution as a percentage of GDP was the lowest in Hungary (albeit the difference between the countries is negligible).

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