

WORKING PAPER

EU Funds, Economic Growth and Competitiveness

Andras Vertes

Kiadó: Kína-KKE Intézet Nonprofit Kft.

Szerkesztésért felelős személy: Chen Xin

Kiadásért felelős személy: Huang Ping



Introduction

By joining the European Union, Hungary was entitled for significant financial aid in support of the country's socio-economic convergence to the more advanced nations of the organization. There exists a clear connection between the absorption of these funds and a country's competitiveness, but it is difficult to demonstrate a direct link between the two. This is especially true for the so called "soft" indicators of competitiveness, which for most part are primarily reflections of subjective assessments. However, it is well known that perceptions and expectations can notably influence economic outcomes.

Hungary's position in the competitiveness rankings between 2006-2017 was rather dismal. In the 11 years, the country was pushed back by 13 places (of the 140 countries) in the WEF rankings, currently standing at the 60th position; 17 places back in IMD's rankings (of 61 countries) currently standing at 52nd position. In the World Bank Doing business rankings the current position (41st) of Hungary is practically the same as 11 years ago (42nd), of the 190 countries. When compared against the other Visegrad countries, the Poles have markedly improved in each of the rankings, the Czech have also improved on their positions, although less significantly, while the Slovaks have considerably deteriorated on their positions, coming close to Hungary's levels.

Hungary's position has declined in all of the 12 competitiveness indicators compiled by WEF. For compared with the Visegrad countries the Hungarian indicators have improved in 2 areas, deteriorated in 8 areas, while remained stagnant in the remaining 2. These results reinforce the presumption that in Hungary the use of EU-funds have not had enough positive influence on the country's competitiveness.

Table 1. Changes in the 12 indicators of competitiveness between 2006–2017

	Institutions	Infrastructure	Macroeconomic environment	Health and primary education	Higher education and training	Goods market efficiency	Labor market efficiency	Financial market development	Technological readiness	Market size	Business sophistication	Innovation												
2006	HU	45	CZ	33	CZ	36	PL	21	CZ	27	CZ	31	SK	24	SK	27	CZ	27	PL	22	CZ	27	CZ	27
	SK	50	HU	50	SK	37	HU	40	HU	30	SK	38	CZ	31	HU	43	SK	33	CZ	40	HU	36	HU	30
	CZ	55	SK	53	PL	51	CZ	57	PL	33	HU	45	HU	36	CZ	50	HU	36	HU	41	SK	47	SK	42
	PL	69	PL	65	HU	88	SK	65	SK	39	PL	56	PL	41	PL	64	PL	46	SK	53	PL	56	PL	43
2017	CZ	52	PL	44	CZ	8	CZ	23	CZ	27	CZ	38	CZ	41	CZ	23	CZ	33	PL	21	CZ	30	CZ	36
	PL	72	CZ	49	SK	35	PL	38	PL	40	PL	45	HU	71	SK	32	HU	40	CZ	46	SK	54	PL	59
	SK	93	HU	56	PL	41	SK	47	SK	62	SK	55	PL	78	HU	45	SK	42	HU	53	PL	57	HU	62
	HU	101	SK	63	HU	46	HU	78	HU	73	HU	64	SK	87	PL	53	PL	47	SK	61	HU	96	SK	67

Source: The Global Competitiveness Report, WEF, 2017

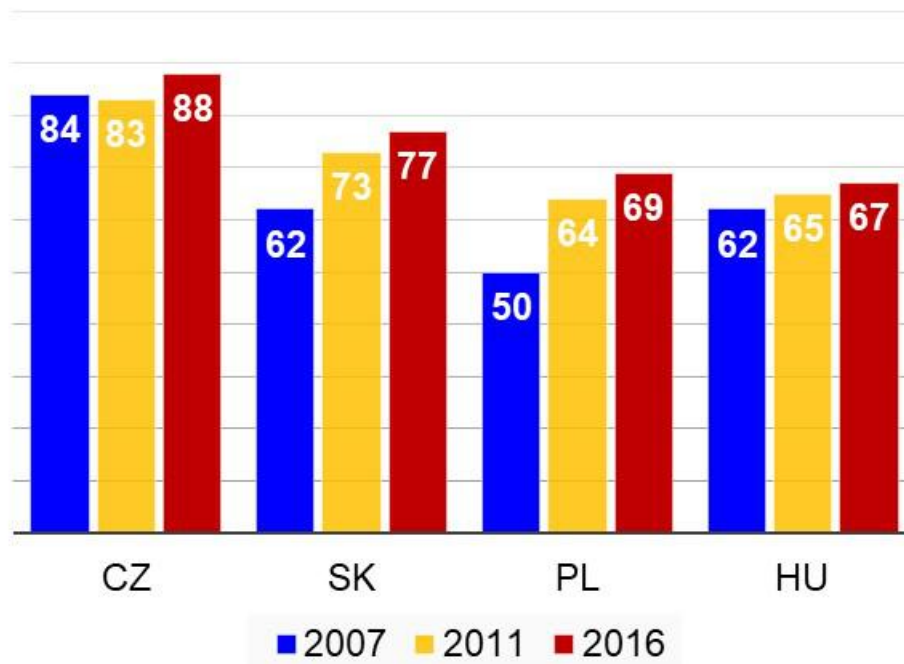
In 2006, Hungary held one of the first two places for 7 of the 12 indicators and only for one it was positioned at the bottom. In comparison, by 2017 the country hold only 2 second and 4 third places, while it occupies the bottom for 6 indicators.

The most important indicators

The GDP/capita PPP is the most common indicator of economic development. In 2007, Hungary’s GDP/capita PPP reached 62% of the EU28 average, which by 2011 rose to 65% and last year to 67%. In spite of the increase, the country is the last among Visegrad countries. The Czech number is the best, reaching 88%; the Slovaks’ GDP/capita PPP was at 77% of the EU average last year, while the Polish number – in spite of starting initially from a much lower position – has caught up to Hungary’s position and even beat it by two percent, to reach 69%. Poland and Slovakia improved very speedy, Czech Republic and Hungary very slowly.

Figure 1. GDP/Capita PPP, 2007-2016

(PPS, EU-average=100)

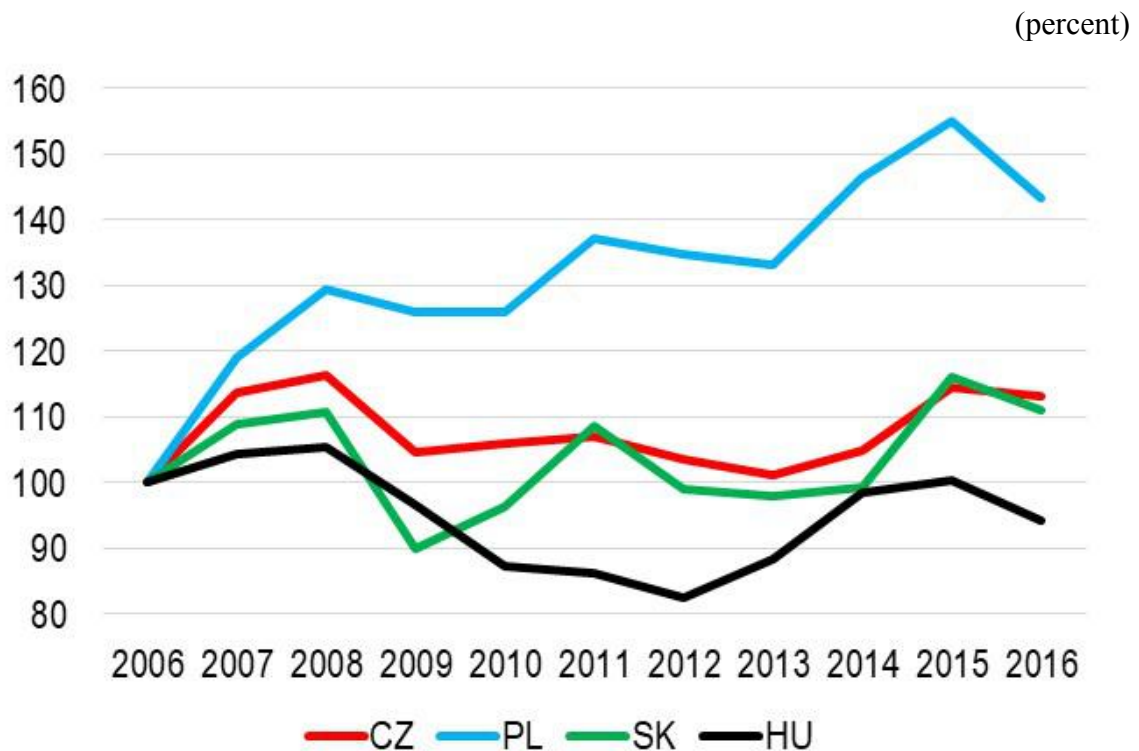


Source: Eurostat

In a crisis, the decline in investments is a natural phenomenon. On the one hand diminishing demand turns surplus resources redundant, while on the other, cutbacks in the credit markets pose financial restrictions on new investments.

Last year, the volume of investments in Hungary was not yet able to reach the levels of 2006. In the meantime, Czechia and Slovakia achieved an increase of 13% and 11%, while Poland 43% in the same area. The decline in 2016 everywhere in the region was connected with the new EU-funding cycle.

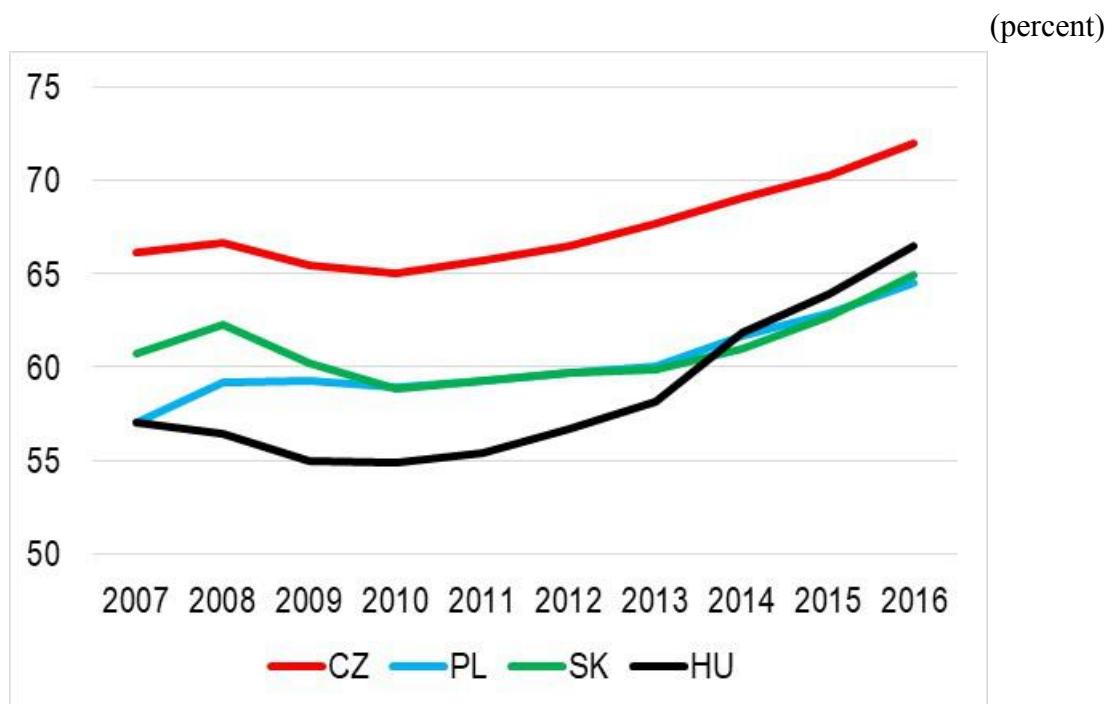
Figure 2. Volume index of investments, 2007–2016 (2006=100)



Source: Eurostat

Employment relative to the population in Hungary has increased from 57% to 66.5% between 2007 and 2016, while the Czech number went from 66.1% to 72%, the Slovakian from 60.7% to 64.9% and the Polish from 57% to 64.5%. In the positive Hungarian result a marked increase in the public works played an important role. It must be highlighted however that in qualitative terms they cannot be compared with market based employment.

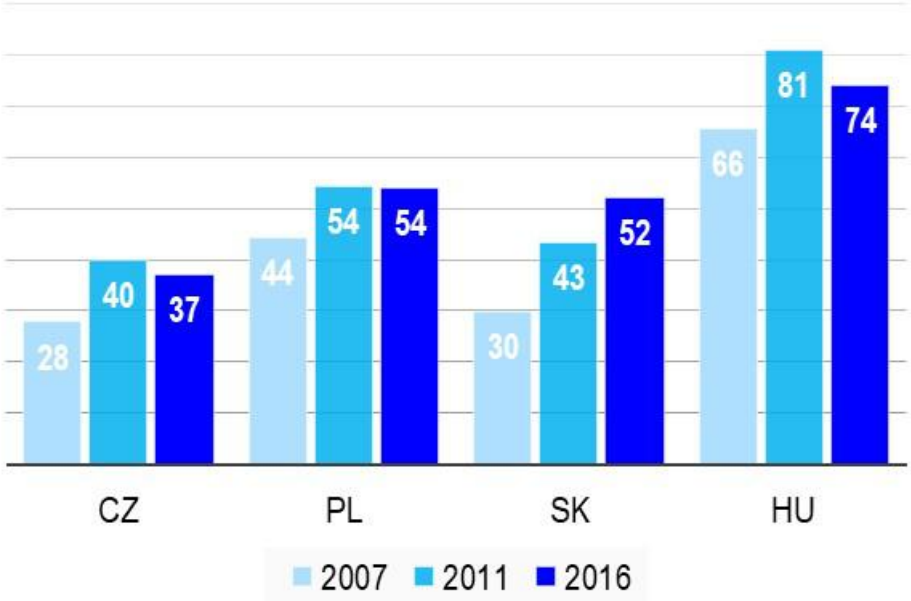
Figure 3. Employment rate aged 15-64, 2007-2016



Source: Eurostat

In 2007 the Hungarian public debt was 66% of GDP, the Polish (44%), the Slovakian (30%) and the Czech (28%) rates were all significantly lower. During the world financial crisis, public debts have seen a marked increase (by 2011 the Hungarian to 81%, the Polish to 54%, the Slovakian to 43% and the Czech to 40%). Later the Hungarian and Czech debt to GDP declined, the Polish stagnated, while for Slovakia it continued to rise. By 2016 the Hungarian and Czech debt to GDP managed to crawl down to 74 and 37%, the Polish stagnated at 54% while in Slovakia the debt went up to 52%.

Figure 4. Public Debt/GDP, 2007–2016 (percent)

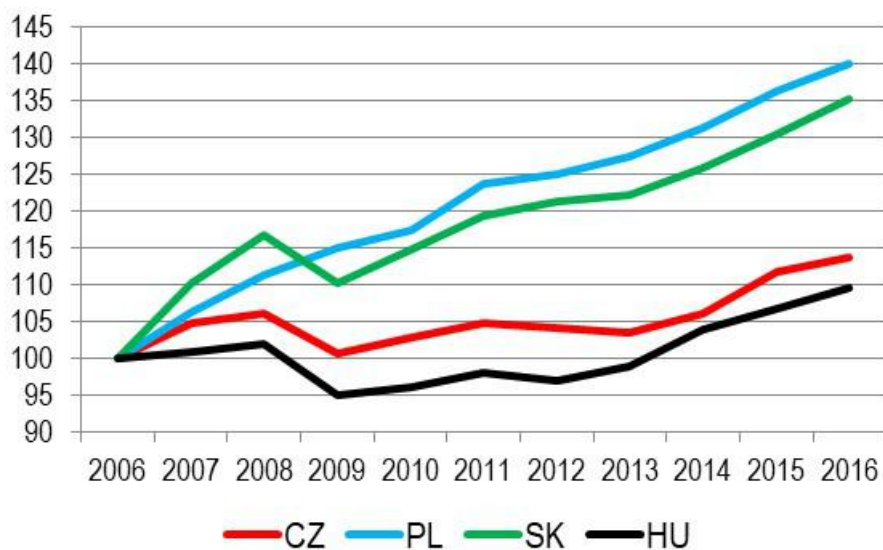


Source: Eurostat

Macro Environment

The slowdown or decline in economic growth – caused by world financial crisis – affected every country in 2009. Poland, partly due to its significant domestic market and through this, its distinctly less exposure to the international environment as well as partly due to its disciplined budgetary policies, was able to avert the same downturn. The Slovaks began to grow again in 2010, while the Czech have seen yet another fall back in 2012 which even in 2013 caused the country’s economy to contract. Hungary was able to reach its pre-crisis real GDP level in 2014, later than the other Visegrad countries. The Hungarian economic performance was able to expand by a mere 9% against the base of 2006, which was the worst in the region. Compared to Poland and Slovakia, the Hungary’s disadvantage is 25-30%. In 2014-2016, with the help of the EU funds, the Hungarian growth rate accelerated and nearly reached the average of the Visegrad countries.

Figure 5. Change in GDP 2007–2016



Source: Eurostat

The human development index is often depicted as the alternative to GDP. This is due to the fact that it establishes a measure for wellbeing on a far more extensive scale, than the indexes for national output do. The index is based on the average of three indicators: the objective of “long and healthy life” is put into numerical terms by measuring life expectancy at birth; “education” is represented in numerical terms based on the literate adult population and on the people with different levels of educational background within the population; finally, the standard of living is represented through the GDP/capita PPP. The HDI index improved in each country under investigation, between 2007 and 2015. The most visible progress took place in Poland, which in 5 years was able to overtake both Hungary and Slovakia. Yet, the Czech remain to be the most outstanding.

Figure 6. Human Development Index (HDI)

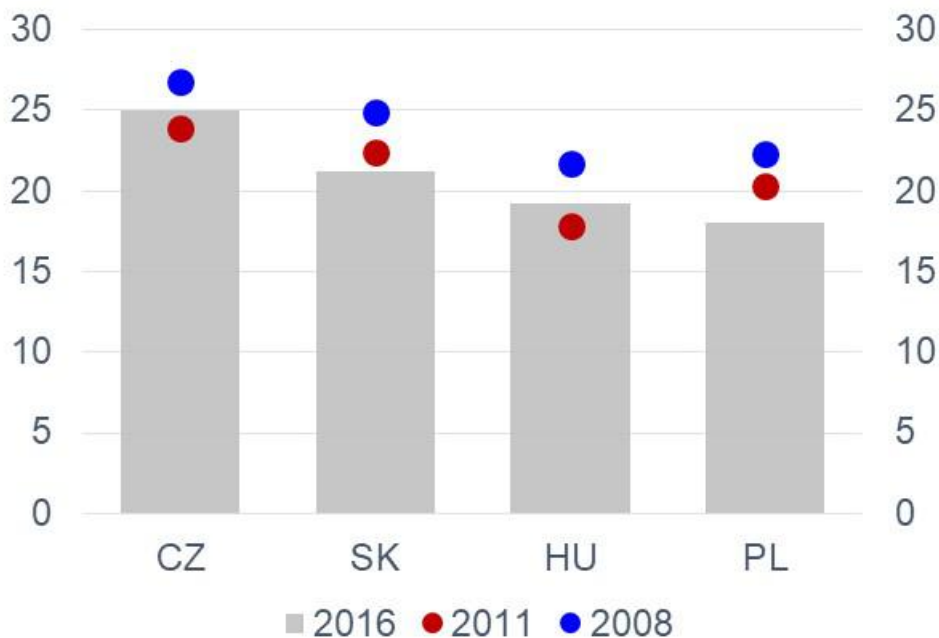


Source: Human Development Report UN

The investment rate against the GDP may be utilized even as an indicator for the economic environment: this is because for the private sphere of the economy, investments are signals for trust as well. According to growth theories investments have to achieve a critical level (for Rostow it is 18-20%) for economic growth to set off.

Decline in investments during an economic crisis is natural. The Hungarian investment rate reached its pre-crisis levels by 2015 only, at the time this was the lowest among the Visegrad countries. All of the countries in the region saw a turn down in the rate between 2008 and 2015 together with the EU's own average. The later shrinking by 4%. In 2015, Hungary was the third behind Czechia and Slovakia with its 22% investment rate among the four Visegrad countries, while in 2016 the rate fell sharply everywhere in V4 countries because of cyclical nature of the EU-funding.

Figure 7. Investment rate (percent)

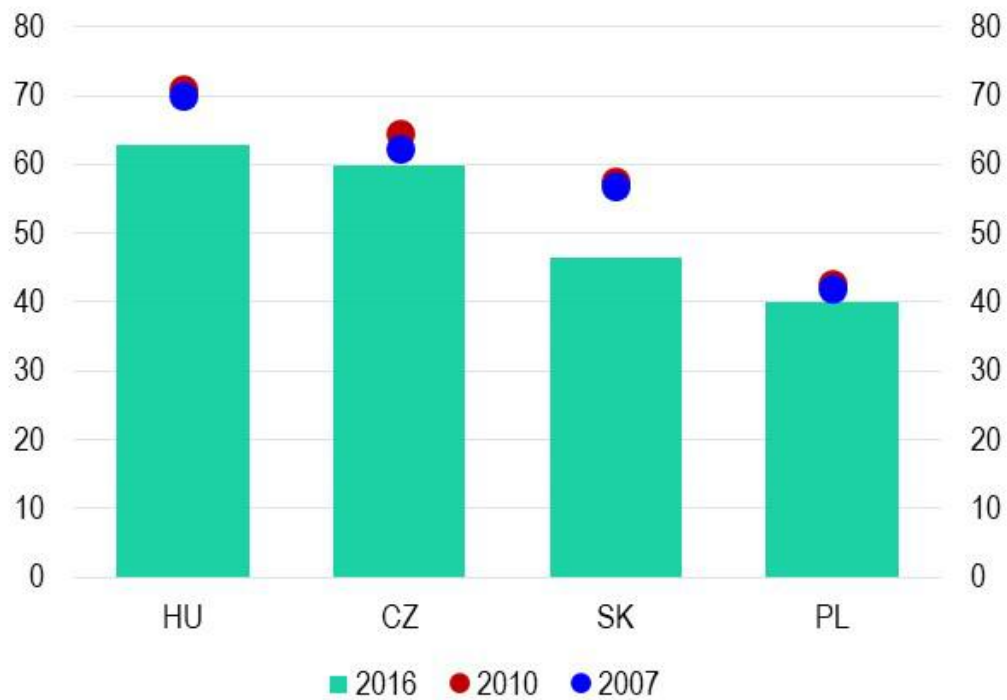


Source: Eurostat

After 2008, there was significant slowdown in the growth of foreign direct investment (FDI) compared to previous years, because of the world financial crisis.

In 2016 in the Visegrad region the FDI in proportion to the country's GDP was the highest in Hungary, nevertheless decreased in the past years. During the same period, in Czechia, Slovakia and Poland have gone through a moderate decrease, too.

Figure 8. Inward FDI (yearend stock in proportion to GDP, percent)

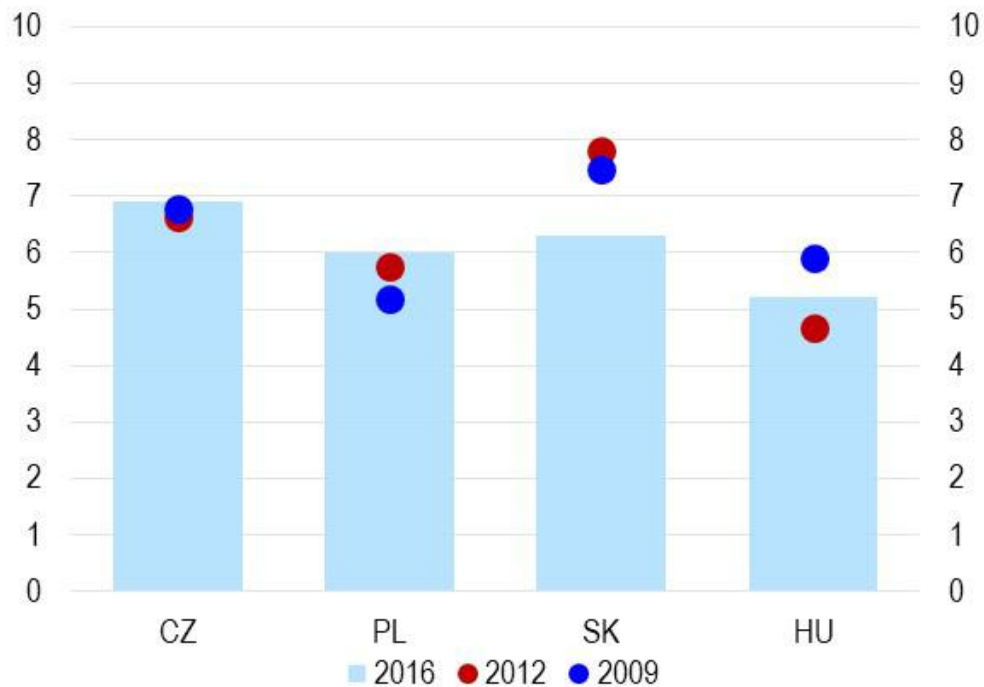


Source: UNCTADSTAT

With regards to providing incentives to attract FDI, Hungary's position in 2016 was better than in 2012, when compared against its regional partners, yet still worse than in 2009, the year of the crisis. All of the Visegrad countries are ahead of Hungary in this regard. Since 2012 there has been a drastic decay in the investment incentives in Slovakia, while Poland and Czechia have been able to improve them moderately.

Aside to the traditional measures of attracting in foreign investments (lower taxes, subsidized acquisition of land, etc.) more and more countries employ methods like state subsidized real estate rentals or simplified administrative burdens. In a number of countries protectionist measures have clearly held back the free flow of capital. A key aspect for foreign investors is a transparent investment and business environment.

Figure 9. Incentives for FDI



Note: 0=a investment incentives (if they exist at all) with no influence over foreign investments; 10=a incentives with a strong influence over foreign investments

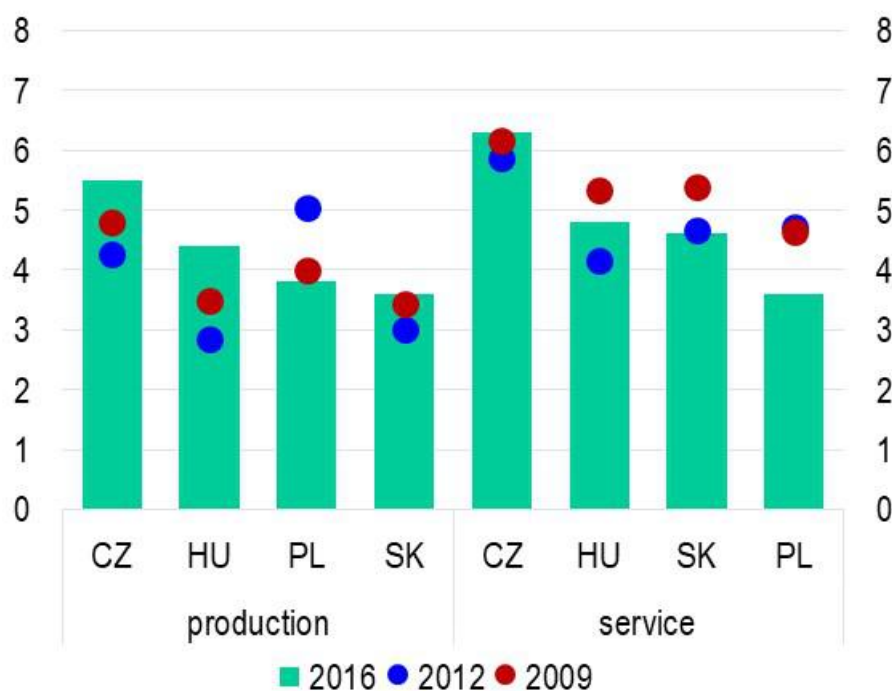
Source: IMD WCY Executive Opinion Survey

The danger of production relocation to another country has either diminished or stayed relatively low since 2009 in every country of the region according to IMD’s corporate survey. Currently the potential for production relocation is smaller in Czechia and Hungary than in Poland and Slovakia, moreover Hungarian business leaders have a more positive outlook than the EU average.

Most of the multinational corporations present in Hungary have carried out large investments in the country and as a result it makes it very difficult for them to move their facilities elsewhere. In addition, the largest investors have received significant subsidies and other forms of state support. However, further investments will require the strengthening of rule of law, of a transparent and favorable regulatory, legal and tax environment.

The likelihood of relocation of services to a foreign country has not changed significantly since 2009. Hungary, in 2016 was at the EU’s average in this regard, just like Slovakia. For the Czech – just as in 2009 – there is a lesser chance for services to move abroad than in any of the other countries in the region.

Figure 10. Likelihood of production or services facilities relocation to another country (0 = significant, 10 = insignificant)



Source: IMD WCY Executive Opinion Survey

The Hungarian tax system has received criticism for several reasons: the aggregate tax burden is greater than the country's regional partners', taxes are manifold and too often they unreasonably designate winners and losers in advance. Taxes are particularly high on labor activities: the tax wedge is 48% in Hungary, 44% in Czechia, 42% in Slovakia and 35% in Poland. In part this is also responsible for the low employment and high illegal employment levels.

The tax system was significantly transformed after 2010. Personal income tax was reduced and reformed to a flat rate for all income groups (15%). However, insurance (social) contributions have increased while the tax credit grants were eliminated. The measures on an aggregate had a negative impact on state revenues first, yet they were offset by increased taxes on consumption and the numerous, differentiated sectoral "crisis" taxes.

Hungary's 38.5% tax burden to GDP was higher than the EU average and by far the highest in Central and Eastern Europe. It was lower however than in 2007 (40.3%), yet higher than in 2010 (37.8%). Differences in the tax burden have not significantly changed for the Visegrad countries after 2007 they have slightly decreased for Hungary, Czechia and Poland while in Slovakia a moderate increase took place.

About the author

Andras Vertes is the Chairman of the Board of GKI Economic Research Co., the most well-known Hungarian economic Think Tank. In 2009, he was nominated to be Prime Minister of Hungary.