OPPORTUNITIES AND LIMITS OF ECONOMIC CONVERGENCE FOR HUNGARY

DR. GYÖRGY KOCZISZKY
University Professor, Institute of World and Regional Economics
University of Miskolc, Faculty of Economics
regkagye@uni-miskolc.hu

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The decision makers of the European Union have committed themselves a great number of times in the past two decades to decreasing the economic and social differences between the member states and also between the regions within them. The Regional (Cohesion) Policy of the Community was designed to achieve this aim: this is the policy that the populations in the poorest regions of the new members have trusted in. The results are, however, far from unambiguous. This paper seeks to find the reasons for this by examining the causes in Hungary.

SUMMARY

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 Széchenyi1, Miklós Wesselényi, Endre Ady2, Oszkár Jászi, and István Bibó), in accordance with the spirit of the age and their social standings, asserted their conviction of 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. The facts so far show that our wishes have not become reality. 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 The direct consequence is that the initial great enthusiasm has soon been replaced by disappointment and disillusionment and the recognition that we have again entertained disproportionate hopes. It seems that the economic forecasts of politicians concerning the impact of resources from EU funds have

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.).
also been unrealistic. Given this knowledge, we have to recognise that our accession to the
European Union will not automatically start our convergence.
This 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?

1. 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 period of 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, 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 % per year)
and the per capita GDP was nearly trebled (Figure 1).

![Figure 1. Per capita GDP in Hungary, 1870-2007](source: A. Maddison: Monitoring the World Economy 1820-1992. Paris: OECD, 1994 and author’s own calculation based on CSO data)
industry was given considerable military orders, etc.), 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 km², 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 verified by the analyses of 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 period of more than forty years following World War II (1945-1989) also produced several peaks and troughs. Practically, from the 1980s onwards, the Hungarian economy has consistently lagged behind others. (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, the opening up of markets, 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).

![Relative development of per capita GDP in Hungary (1870-2007)](image)

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

Figure 2.
Relative development of per capita GDP in Hungary (1870-2007)

At the beginning of the new millennium (between 2000 and 2003), hopes were again aroused and economic growth re-appeared. These hopes were shattered in 2007. The global economic crisis, which broke out in the spring of 2008, shook the Hungarian economy...
dramatically. Although there are differences amongst 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 whilst already in a state of ill health. Thus, the consequences are far more serious than 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 by July 2009 it had fallen to only 59.8 % (EUROSTAT, 2009).

Thus, the real convergence indicators of Hungary have shown a relative decline in the past four years (as opposed to the period 2000-2004, when 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.europa.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 (13.5 %) 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 of 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 proves that Hungary continues to belong to the semi-peripheral countries of the world economy.5

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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 millennium 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 Romania, 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 characterised by a 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 pe-
improvement in our economic situation has been halted, and, at the moment, Hungary is sliding downwards (Figure 3).

Figure 3.
Hungary’s economic performance (EU 25)

2. 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 socioeconomic indicators as convergence, which indicates in effect a decrease in the range of standard deviation ($\sigma$ convergence). In the second interpretation, convergence means catching up on a longer term growth path ($\beta$ 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 changes in its rate over time are basically determined by three groups of factors, which have a strong logical interrelation in a given country: the public morals, nominal equilibrium and growth surplus (Figure 4).

Riphery 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.
Nominal equilibrium is described by the stability of state finances (the monetary and budget situation). (As 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).

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**: it 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.
In case of real convergence, the performance of a country with a 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), by selling assets of the national wealth (‘denationalisation’), by reducing the state expenditure, or by credits.

In the case when the political elite violates the written and unwritten legal regulations or, whilst 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 the black economy, corruption and real processes are at least that serious. Part or all of the state intervention intended for increasing capacity, improving productivity, and 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 assume that the performance of the economy will increase or that nominal equilibrium will be created. Obviously the same logic can be followed regarding the evolution of conditions related to regional convergence, noting that the steps taken by the government in power for creating (sustaining) nominal equilibrium may strengthen or also weaken the chances of convergence of a particular region.

### 3. CAUSES OF CONVERGENCE SLOWING DOWN IN HUNGARY

The lack of both nominal equilibrium and of real growth in the economy has not ceased to exist with Hungary becoming a full member state of the EU. This phenomenon 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 also borne out by the increasingly worsening, and more pessimistic, forecasts. (Table 1).
Table 1.
Changes in the components of growth (%)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
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</thead>
<tbody>
<tr>
<td>Consumption by households</td>
<td>-8</td>
<td>-2.5</td>
<td>3</td>
<td>2.8</td>
</tr>
<tr>
<td>Community consumption</td>
<td>-1.1</td>
<td>-0.8</td>
<td>0.3</td>
<td>0.2</td>
</tr>
<tr>
<td>Gross accumulation of fixed assets</td>
<td>-7.1</td>
<td>1.1</td>
<td>7</td>
<td>6.9</td>
</tr>
<tr>
<td>Exports</td>
<td>-10.1</td>
<td>5.5</td>
<td>9.2</td>
<td>9.5</td>
</tr>
<tr>
<td>Imports</td>
<td>-16.1</td>
<td>4.5</td>
<td>9.2</td>
<td>9.5</td>
</tr>
</tbody>
</table>


4. 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, when a well-functioning regional policy has been in place, regional income differences (sigma convergence) have decreased (Table 2).

Table 2.
Development of macro- and mezo-level convergence indicators in selected countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of regions</th>
<th>beta convergence (Period examined)</th>
<th>Regional income inequality (sigma convergence)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>(%/year)</td>
<td>1940</td>
</tr>
<tr>
<td>Germany**</td>
<td>11</td>
<td>1950-1990</td>
<td>1.4</td>
</tr>
<tr>
<td>Sweden</td>
<td>24</td>
<td>1951-1933</td>
<td>2.4</td>
</tr>
<tr>
<td>Great Britain</td>
<td>11</td>
<td>1950-1990</td>
<td>3.0</td>
</tr>
<tr>
<td>France</td>
<td>21</td>
<td>1950-1990</td>
<td>1.6</td>
</tr>
<tr>
<td>Italy</td>
<td>20</td>
<td>1950-1990</td>
<td>1.0</td>
</tr>
<tr>
<td>Spain</td>
<td>15</td>
<td>1955-1987</td>
<td>2.3</td>
</tr>
<tr>
<td>USA</td>
<td>48</td>
<td>1880-1990</td>
<td>1.7</td>
</tr>
<tr>
<td>Japan</td>
<td>47</td>
<td>1955-1990</td>
<td>1.9</td>
</tr>
<tr>
<td>Hungary***</td>
<td>7</td>
<td>1995-2007</td>
<td>0.81</td>
</tr>
</tbody>
</table>
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 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, convergence is, in effect, virtual. For almost the last 15 years, Hungary has increased its macro-economic performance while at the same time increasing the regional differences as well (Figure 5).

![Figure 5. Standard deviation of county per capita GDP in Hungary](image)

Source: author’s own work

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

Table 3.
Changes in per capita GDP (thousand HUF/person in Hungary)

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<tbody>
<tr>
<td>Pest</td>
<td>324</td>
<td>394</td>
<td>487</td>
<td>643</td>
<td>760</td>
<td>984</td>
<td>035</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
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<tr>
<td>Fejér</td>
<td>410</td>
<td>542</td>
<td>696</td>
<td>980</td>
<td>1228</td>
<td>1283</td>
<td>577</td>
<td>1</td>
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<td>1</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>2</td>
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<tr>
<td>Komárom-Esztergom</td>
<td>341</td>
<td>471</td>
<td>599</td>
<td>716</td>
<td>827</td>
<td>918</td>
<td>104</td>
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<td>1</td>
<td>1</td>
<td>1</td>
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<tr>
<td>Veszprém</td>
<td>339</td>
<td>460</td>
<td>543</td>
<td>669</td>
<td>795</td>
<td>901</td>
<td>115</td>
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<td>606</td>
<td>633</td>
<td>713</td>
<td>929</td>
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<tr>
<td>Győr-Moson-Sopron</td>
<td>440</td>
<td>590</td>
<td>737</td>
<td>905</td>
<td>1182</td>
<td>1449</td>
<td>780</td>
<td>816</td>
<td>996</td>
<td>257</td>
<td>371</td>
<td>430</td>
<td>719</td>
<td>838</td>
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<tr>
<td>Vas</td>
<td>439</td>
<td>581</td>
<td>734</td>
<td>951</td>
<td>1150</td>
<td>1317</td>
<td>517</td>
<td>529</td>
<td>679</td>
<td>985</td>
<td>106</td>
<td>167</td>
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<tr>
<td>Zala</td>
<td>401</td>
<td>496</td>
<td>620</td>
<td>751</td>
<td>881</td>
<td>989</td>
<td>122</td>
<td>310</td>
<td>472</td>
<td>754</td>
<td>875</td>
<td>871</td>
<td>878</td>
<td>032</td>
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<tr>
<td>Baranya</td>
<td>356</td>
<td>433</td>
<td>518</td>
<td>662</td>
<td>769</td>
<td>868</td>
<td>005</td>
<td>122</td>
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<td>401</td>
<td>516</td>
<td>584</td>
<td>702</td>
<td>834</td>
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<td>Somogy</td>
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<td>413</td>
<td>498</td>
<td>579</td>
<td>672</td>
<td>760</td>
<td>911</td>
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Source: author’s own work

Figure 6.
Development of \( \sigma \)-convergence of per capita GDP in Hungary

\[
\sigma = \sqrt{\frac{\sum_{t=1}^{19} \left( \frac{Y_{lt}}{Y_l} \right)^2}{L_t}}
\]
Table 4.
Range of per capita GDP standard deviation and changes in relative variance

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Source: KSH.

Source: author’s calculation based on figures by KSH
5. IMPACT OF EUROPEAN UNION SUBSIDIES ON REGIONAL CONVERGENCE

The first works on economic growth were already raising 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, that economic decisions were reasonable and understandable, and that there could be no inconsistencies between 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 had been achieved; entitlements could be automatically eliminated, etc.
Conversely, we know today that it is much easier to increase entitlements than to decrease
them, and 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 ways of thinking, which are not necessarily governed by the same concepts of
public interest. The economic policies followed by them are not necessarily consistent in
space and time. While it may easily happen that some public servants 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 conditions without subsidies).
The literature makes the impact of surplus performance contingent on two factors: firstly,
on the efficiency of the operation of the system of institutions, and, secondly, on that of
utilisation.
Empirical studies and analyses also verify that, in this respect, 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).

Table 5. Impact of subsidies on increase in GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP/EU* Subsidy</th>
<th>Contribution to increase in GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portugal</td>
<td>~ 3 %</td>
<td>3.9</td>
</tr>
<tr>
<td>Spain</td>
<td>~ 1.5 %</td>
<td>2.9</td>
</tr>
<tr>
<td>Greece</td>
<td>~ 2.6 %</td>
<td>4.3</td>
</tr>
<tr>
<td>Ireland</td>
<td>~ 2.8 %</td>
<td>n.a.</td>
</tr>
<tr>
<td>Hungary</td>
<td>~ 2.1 %</td>
<td>-</td>
</tr>
</tbody>
</table>

Notes: * AGENDA 2000 (max. 4 %)
** in 2004-2006
Source: The Role of Fiscal Transfers in Regional Economic Convergence in Europe (No.1029.2009.)
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 %) have the one-time effect of increasing demand or of improving community infrastructure, and not of strengthening the economic potential of those regions. This also includes the potential of 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 domestic investments.

6. 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.

The Regional Level Convergence Programme seems to be virtual. Parts of the subsidies (depending on the type of programme) are 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 positive advances can be expected.

REFERENCES