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Good Intentions Meet Reality:

The Dire Consequences of Spending EU Taxpayers' Money in Hungary

"The future financial framework must not only ensure the appropriate level of expenditure, but also its quality."
European Council Conclusions, February 2013 [1]

Summary

The Clean Air Action Group (CAAG), a national federation of 121 Hungarian environmental NGOs, calls for action against the devastating effect of EU spending on Hungarian society, its economy and the environment. Inappropriate rules concerning the use of EU money, coupled with weak or non-existent enforcement of the EU acquis and national commitments, lead to the result that EU money in Hungary is reducing economic competitiveness of the country, increasing social inequalities and undermining democracy – acting thus against the EU targets. In order to improve the situation, CAAG proposes radical changes to EU spending. The European Parliament, the European Council and the European Commission must show leadership on these important issues – all the more because this phenomenon can be observed to a greater or lesser extent in all recipient countries.

EU funding to Hungary is distorting the market, it is draining money away from where it is most needed, resulting in the rise of a new oligarchy, and increasing corruption enormously. In our opinion, all these are not individual errors, which can be corrected within the present system of EU funding and the related policies, but they are inherent to the system.

During the period 2007-2013, EU funding to Hungary has been about EUR 33 billion. This enormous sum of EU taxpayers' money aimed at contributing to the achievement of the economic, social and environmental goals of the country set forth in various EU and national documents. However there is little or no indication that EU funding improved the general situation of the country in any of these fields. On the contrary, **there have been serious steps**

[1] **Conclusions of the European Council (7/8 February 2013) as regards the item Multiannual Financial Framework**, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/135344.pdf

backwards in all the main objectives of the Europe 2020 Strategy for smart, sustainable and inclusive growth. The economy is stagnating, education and innovation have deteriorated, environmental problems have worsened, and social inequalities have substantially increased.

We do not claim that that all above-mentioned problems are caused by EU funding. Naturally, other factors played a role as well. We do assert, however, that EU funding has substantially aggravated existing ills, and even created new ones.

The EU is providing financial aid to Hungary on the condition that Hungary accepts and fulfils concrete commitments in its various policies. Accordingly, in its National Reform Programmes (NRPs), the Hungarian Government made many general and quite a number of concrete commitments. However, the Hungarian government has not met many of these commitments and indeed has been doing just the opposite of what it had committed itself to. This means that although part of the EU funds are spent for the right purposes, and more or less efficiently, the harmful measures taken by the government by far outweigh these positive measures. **This is only possible because the EU makes almost no effort to enforce the implementation of the government's commitments (with the exception of the public budget deficit).**

Ceasing EU funding to Hungary is politically not an option. Neither would it be fair – not least because the more prosperous Member States benefitted much more from Hungary's accession to the EU than Hungary did itself. Each year 5-7 per cent of GDP (EUR 5-7 billion) leaves Hungary for good – mainly to the most prosperous EU MS.

To radically improve the situation, the Clean Air Action Group proposes the following.

1. Very strict EU funding criteria, including concrete, measurable indicators must be fulfilled by the recipient country on national level. The commitments under the National Reform Program and the EU acquis must be implemented. The Fiscal Compact and the European Semester are steps in this direction, but far from enough. The conditionality proposed in the Commission Communication "A Budget for Europe 2020" and in the Council Conclusions of February 2013 ("Macro-economic conditionality") is also a big step forward, but these should be further elaborated and greatly extended. The conditionality should take into account not only fiscal objectives, but many others, too, including targets in education, health, social cohesion, anti-corruption measures, the environment, etc. Indicators applied to all these fields should be as concrete as possible.
2. The conditionality criteria must be worked out in a transparent process, involving all stakeholders, and providing for these stakeholders the necessary means for participation.
3. The European Commission must have teeth! It must have the power for enforcement, if commitments are not met by the recipient MS in any field, not only in relation to macro-economic policy. It must be made clear to all MS that the common goals of the EU can be achieved only if the commitments of MS do not remain on paper, but are implemented, and implemented on time.
4. The Commission must also have the capacity to control whether MS meet these commitments in all policy areas.

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Introduction

EU funding is having a devastating effect on Hungarian society. Due to inappropriate rules concerning the use of EU money, coupled with weak or non-existent enforcement of the EU acquis and national commitments, EU funding in Hungary is reducing the economic competitiveness of the country, increasing social inequalities and undermining democracy. EU aid is distorting the market, it is draining money away from where it is most needed, it is resulting in the rise of a new oligarchy, and it is increasing corruption enormously. In our opinion, all these are not individual errors, which can be corrected within the present system, but they are inherent to the system.

The present paper analyses the underlying reasons for this derailment and examines its consequences for Hungary, and proposes fundamental changes in the EU legislation and practice concerning EU funding.

During the period 2007-2013, EU funding to Hungary totals about EUR 33 billion. This enormous sum of public money should have contributed to achieving the economic, social and environmental goals of the country set forth in various EU and national documents. However there is no sign that EU funding really improved the general situation of the country in any of these fields. On the contrary, there have been serious regressive steps in all main objectives of the Europe 2020 Strategy for smart, sustainable and inclusive growth. The economy is stagnating, education and innovation have deteriorated, environmental problems have worsened, and social inequalities have substantially increased.

Quite a number of economists and other experts are of the opinion that EU funding caused more harm than good in Hungary – in terms of its overall impact (there have been quite a number of individual projects with have been very beneficial at local the level). We do not claim that all above-mentioned problems are caused by EU funding. Naturally, other factors played a role as well. We do assert, however, that EU funding has substantially aggravated existing ills, and even created new ones.

The phenomena described in this paper are not restricted to Hungary alone. All recipient countries encounter these problems, albeit in many cases to a lesser extent than Hungary. However, in our opinion, in the absence of appropriate action, these negative phenomena might deepen more and more in all these countries.

This paper does not touch upon the Common Agricultural Policy (CAP). However, some of its conclusions are valid for EU funding in agriculture, too.

Distorted market

A large part of EU funds are given directly to individual companies. Generally this occurs according to a scheme in which companies submit applications in order to gain public funds, and public officials decide which companies will obtain grants from such public funds, and how much. (Here we do not refer to public procurement, but to cases where public procurement is not involved – we look at problems of public procurement later on in this paper).

Recent historical experience and economic theory both warn that the redistribution of public funds to individual business entities has the potential to bring about serious troubles in the markets. Therefore, in our opinion, such state aid should be restricted to public service companies (e.g. public transport). Other companies should be eligible for state aid only for

R&D and innovation, and even then, under very stringent conditions. In some cases, for example, for fostering energy efficiency or the use of renewable energy, state aid should be provided on a normative basis (e.g. lower VAT), and not to individual companies selected by government bureaucracy. Indeed, even such aid is often questionable, as it might lead to lock-in of processes or technologies which might become obsolete or even harmful over time – subsidies for biofuels being a case in point).

Hungary, unfortunately, has gained more than enough experience about the consequences of a system where market players were vying for state funds instead of competing for customers. All over the world, many economists believe that the primary cause for the fall of the Soviet Union and the countries operating similar economic systems was that the prices there did not reflect the true costs. Companies in these countries had been haphazardly subsidized by the government, based on special case-by-case decisions and non-transparent processes. In the end, no one knew how much a given product or service actually cost, as prices were very far from reflecting the reality. For example, even the price of pencils was centrally determined in Moscow, and applied throughout the Soviet Union. As a result of this system, mistaken economic decisions were being taken at all levels and all the time, which led to enormous squandering of human and material resources. For the Soviet Union and the associated former communist countries, the moment of truth came when they switched over to a market economy: this brought about immediate collapse for those industries that had been sustained earlier by the state by means of reallocating resources drained away from other sectors of the national economy. In Hungary, heavy industries and mining were such favoured activities – accordingly , the workforce employed in mining plummeted from one hundred thousand to just five thousand within a couple of years. On the other hand, certain activities, earlier practically destined to stagnate owing to cutbacks by the state, suddenly surged and started growing powerfully (e.g. the telephone companies).

In 2009, an influential business circle in Hungary created a temporary group, the so-called Reform Alliance, in order to prepare short-term proposals for economic policy. One of the background studies[2] written for the Reform Alliance pointed out that the present redistribution of funds by the state to various market players is an extremely inefficient system: “To make things worse, the calls to apply for grants often miss their goal; they do not facilitate finding solutions for the actual problems, while the funds offered generate a demand that the company concerned does not necessarily need. This trend is further intensified by companies which specialize in grant application writing, and which are interested in obtaining the offered funds but are not interested in utilizing them efficiently. … In the period between 2003 and 2006, the growth rate of enterprises that received state subsidies did not show any significant difference in comparison to companies that did not receive such grants. In fact, many of the grant-aided firms actually registered negative growth. In the SME [small and medium enterprises] category, the larger and older enterprises practically snatched away for themselves all available grants, and used them to sustain their low-efficiency operations. There were just a very small number of companies (approximately one-seventh part of all grant recipient companies) which achieved any substantial progress and whose success was at least partly attributable to the received grant.”

Several other economic experts have also called attention to the detrimental outcome of this practice of redistributing funds: namely, that it gives rise to a series of erroneous economic

[2] **Gazdaságpolitikai javaslatok a Reformbizottság számára a kis- és középvállalatok helyzetének javítására.** Összeállította: Dr. Szerb László, www.reformszovetseg.hu/hatteranyag/Realgazdasagi_Munkacsoport/KKV.doc

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decisions. Miklós Hegedűs, managing director of the influential economic consultancy GKI Energy Research and Consulting Ltd. claims that "the subsidies allocated to Hungary's business sector do not really result in any perceptible improvement of the growth potential or the much coveted competitiveness. It is a hardly refutable suspicion that a large part of the grants arriving to Hungary are just 'money going down the drain', and that, even with the best of intentions, they do not contribute to attaining Hungary's fundamental economic policy goals (growth, regional development, specialized training, etc.) but rather prolong the agony of enterprises that are unfit for survival."[3]

Gábor Bojár, Chairman of the Board of Directors of the famous and very successful and innovative company Graphisoft (which never asked for and never received any state aid), commenting on state aid, expressed the opinion that "the sooner the real customer pays for a given product or service, the sooner it will be ready, and the sooner it will be of good quality. Real customers demand quality and they will not be satisfied until they get that quality. State fund distributors, however, will not act like that. In the worst scenario, such fund distributors are corrupt; in a more favourable case they will use their best judgment and faith when deciding whether the quality is good enough or not. … The longer the development is sponsored through such state subsidization, the later an exacting real customer will appear. And yet, such a real customer is just as important a factor for the quality of a product as the manufacturer itself. The present practice of state aid entails enormous losses of time and financial resources, and deteriorates competitiveness to an extremely large degree."[4]

All this has been eloquently confirmed by a report recently submitted to the Hungarian parliament by the Minister for National Economy. According to the daily newspaper *Napi Gazdaság*, on the basis of the report it can be concluded that in 2009 and 2010 SME's were subsidised with HUF 1100 billion (about EUR 3.7 billion) in total, but this was in no way reflected in the performance of the SME's concerned. The SME's which received state aid did not prove to be any better than those which did not receive such aid.[5]

One of the websites assisting grant applications has very aptly expressed the quintessence of this system as follows: "The grantor will not impose any sanction on those applicants who have implemented the project in accordance with the grant agreement but have not managed to achieve the project's objectives." In contrast, the market will ruthlessly punish such enterprises. That is an enormous difference!

Unpredictable business environment

State subsidies often make company activities unpredictable, and frequently unfairly disadvantage certain enterprises. The mayor of a Hungarian city complained to CAAG that in another city, a foreign company obtained state subsidies of several billions of HUF for a green-field investment project implemented there. In contrast, a company which manufactures similar products, and which had settled earlier in the city of this mayor, had not received any such state aid…

Another, example is the grant of HUF 16,5 billion recently awarded for hotel construction by

[3] **Ki hol söpörjön?** Világgazdaság, 2008. január 23. http://www.vg.hu/index.php?apps=cikk&cikk=205138

[4] **Pénz az asztalon.** Beszélgetés Bojár Gáborral, a Graphisoft igazgatóságának elnökével. Lélegzet, 2008. nyár, http://www.lelegzet.hu/archivum/2008/02/3532.hpp

[5] **Nincs sok értelme a kkv-támogatásnak**. Napi Gazdaság, 2013. február 12., http://www.napi.hu/magyar_gazdasag/nincs_sok_ertelme_a_kkv-tamogatasnak.544937.html

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the National Development Agency,[6] the body responsible the allocation of EU funds in Hungary. According to István Kovács, General Secretary of the Hungarian Hotel & Restaurant Association, nothing justifies the building of new hotels, because even existing hotels are having serious financial difficulties.[7] Many similar examples can be cited, not only from Hungary, but other MS as well. For example, a colleague from Cyprus told us about a hotel constructed in his town with EU money. After the hotel was built, it prospered, but two nearby hotels, already functioning well for many years, went bankrupt…

Moreover, state aid granted to certain stakeholders within the economy often draw away resources from other viable and competitive activities (let us just think of the increased tax rates). This whole process can be described as "alms-giving by looting".

Already in 2006, economist Balázs Váradi (today chief researcher of the Budapest Institute) wrote a long and excellent article[8] titled "The Curse of the Eight Thousand Billion" about the dangers of EU aid. (The EU aid to Hungary in the years 2007-2013 is expected to be HUF 8,000 billion, i.e. around EUR 33 billion.) In the article, he puts forward convincing arguments to underpin his warning: if we do not change our attitude, EU aid may cause more damage in Hungary than all the benefits it brings. Unfortunately, his warning was not heeded.

Hotbed of corruption

State grants provided to companies are hotbeds of corruption and fraud. The distribution of free funds irresistibly attracts all those looking for a quick buck by illegal or semi-legal means. Earlier, one could read about such cases almost every day in the press (and, as it has been proved by several surveys on the subject, the reports published in the press are just the tip of the iceberg). Since the present government came to power, the number of such press appearances has manifestly decreased, but this does not reflect decreasing corruption and fraud, but to the changed situation of the press, the decimating of public authorities by budget cuts, the dismissal of highly qualified experts, the elimination of the factual independence of quite a number of hitherto independent institutions (public prosecutor's office, state audit office, etc.), and the substantial weakening of the NGO sector. All these undesirable changes are rather specific to Hungary today (although some of them can be observed to a certain degree also in some other recipient EU countries), but we fear that they will not be restricted to one country alone, if the EU policy is not reformed.

Nevertheless, even today from time to time, reports on "strange" state grants are published in the press.[9]

"Present development policy is financed by non-transparent redistribution. It serves only to reward those who are close to the current political power, and it is a hotbed of corruption" –

[6] **Még a Hell Energy is szállodát épít**. Turizmusonline, 2012. december 03., http://www.turizmusonline.hu/aktualis/cikk/nyertes_szallashely_palyazatok_negy_regioban

[7] **A fehér hollónál is ritkább az új hotel**. Magyar Nemzet, 2013. január 11.

[8] Váradi Balázs: **A nyolcezermilliárd átka**, http://www.es.hu/index.php?view=doc;15495 (Full article: http://palyazatipenz.blog.hu/2007/01/12/title_1557035, http://palyazatipenz.blog.hu/2006/11/03/miert_folyik_a_csata_avagy_a_8000_milliard_atka)

[9] See, for example:
EU-funds for tourism development investigated. http://atlatszo.hu/2013/01/30/eu-funds-for-tourism-development-investigated/
Kormányközeli cégeknek parkoltatják az uniós pénzeket? HVG, 2013. február 6., http://hvg.hu/gazdasag/20130206_Kormanykozeli_cegeknek_stoppoljak_az_unio

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writes József Papp, Professor at the Budapest Corvinus University (university of economics) and author of several studies on the topic.[10] According to his diagnosis, "It is not the market competition, the efficiency which directs the allocation of capital, but the embeddedness in [political] power. The struggle for public money – for lack of market coordination – necessarily creates overcapacities, the maintenance of which continuously eats up more and more taxpayers' money, providing even more resources for the hypocrite parasitism."[11]

A recent clear example is the company Közgép. One of the main owners of Közgép is the former university room-mate of the present Prime Minister and former Treasurer of the ruling party, Fidesz. Since Fidesz came to power, a large proportion of the EU funds for investments landed at Közgép. At the same time, a large number of persons who previously worked at Közgép or were related to it in some other way appeared in various leading positions in the state administration (including the Ministry for National Development, responsible for the allocation of EU funds) and in state-owned enterprises.

In many observers, suspicion about corrupt use of EU funds is also raised by the fact that subsidy allocations performed by the state are often counter to its own declared aims (e.g. reduction of energy dependence, giving preference to activities that create more added value).

Public procurement as synonym of corruption

One of the main territories of corruption is public procurement. According to the study Korrupció és közbeszerzési korrupció Magyarországon"[12] (Corruption and Public Procurement Corruption in Hungary), commissioned by the Public Procurement Council[13], corruption is linked to 65-75 % of all public procurement cases in Hungary. This comes at a substantial economic cost – according to Transparency International Hungary, cases of corruption increase the price of related public procurement by 20-25 %.[14] Notably, a substantial proportion of EU funds are allocated through public procurement…

Since EU accession, a new type of company has become an important player in the Hungarian economy – those specialised in writing grant applications. Applicants generally prepare their applications with the help of such a company. A person working at one of these companies describes the process as follows: "Before starting to write an application for a grant, we contract the local government to write all the public procurement tenders for them during the next one to three years. Before announcing the tender, we discuss with the financial director of the local government precisely what they want, how they would like to organise accounting related to the procurement, and who should win the tender. …It is not difficult to prepare a tender so that it will not be evident that in practice only one competitor has the chance to win. … All political parties benefit from this."[15]

Companies writing applications for grants play a serious role in corruption practices, not only in public procurement, but in general when it comes to applying for state aid.

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[10] Papp József: **A magyar csoda**, http://index.hu/velemeny/jegyzet/mcs090106/
[11] Papp József: **Szemétkosárba az Új Széchenyi Tervvel!** http://hvg.hu/velemeny/20110223_papp_szechenyi_terv
[12] **A korrupció és a közbeszerzési korrupció Magyarországon**, GKI Gazdaságkutató Zrt., http://kozbeszerzes.hu/static/uploaded/document/Korrupci%C3%B3s_k%C3%B6zbeszerz%C3%A9si_kutat%C3%A1s_Magyarorsz%C3%A1gon_I._k%C3%B6tet.pdf
[13] See: http://www.kozbeszerzes.hu/nyelvi-verziok/english/
[14] http://www.transparency.hu/sajtomegjelenesek_528?pro=5
[15] http://www.k-monitor.hu/bejelento/palyazatiras

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There have been many concrete proposals by individual experts and by various organisations (including NGOs[16]) for measures which could reduce corruption, including corruption in public procurement, but the government and the parliament have implemented practically none of these proposals. On the contrary, changes have been implemented, both in the institutional system and the legislation, which have significantly increased the risk of corruption, including the risk of corruption in public procurement.

The latest example of such a measure is a provision in the new Civil Code, accepted by the Hungarian Parliament on 11th February 2013. The old Civil Code explicitly stated that all financial data about state and state-related (including local governments) institutions are public. According to the new Civil Code, these institutions do not have to disclose any financial data which they consider a "business secret". According to the Hungarian Civil Liberties Union, this change makes it possible for the state and local governments to hide their contracts and important information on investments, which might lead to the substantial growth of corruption practices.[17]

It is impossible to eliminate all this corruption, and an enormous effort is required to even reduce it somewhat in the present circumstances. One of the main reason for this is that the present system of allocation of EU funding stimulates corruption. National measures are certainly indispensable to confine corruption, but substantive results can be achieved only if the EU system of funding is radically reformed at the same time.

Naturally, we do not criticize public procurement *per se*. Public procurement is indispensable in our societies. What we do criticize are the improper regulations and the institutional system, which lead to irresponsible decisions and enormous corruption. We also criticize the European Commission's approach, because, in our opinion, it does not take the necessary steps to oblige the Hungarian Government to implement adequate rules and well functioning institutional systems.

No new jobs

Although one of the main stated purposes of EU funding was job creation, the employment ratio in Hungary is very low not only in comparison with EU15, but also with EU10. Years of EU funding has not changed this situation. In fact, a report by the State Audit Office on the effects of state aid on employment, published in July 2012, came to the following conclusion: „Although between 2004 and 2010 HUF 1850 billion [nearly EUR 7 billion] of EU funds were spent for creating jobs, the employment rate drastically deteriorated." [18]

This statement does not come as a surprise. A cursory glance at the practice of appraising

[16] See, for example:
A jog- és intézményrendszer módosításának lehetséges irányai a zöld gazdaságélénkítés érdekében, http://www.mgszt.hu/index.php?option=com_docman&task=doc_download&gid=61&Itemid=17
Lehetséges a hatékonyabb adóbehajtás,
http://www.levego.hu/hirek/2011/09/lehetseges_a_hatekonyabb_adobehajtas
Miként szorítható vissza az adócsalás?
http://levego.hu/hirek/2013/01/mikent_szorithato_vissza_az_adocsalas

[17] **Baj van az új Ptk-val. 3. rész: Titokban tarthatóak a közpénzköltések**.
http://ataszjelenti.blog.hu/2013/02/14/baj_van_az_uj_ptk-val_3_resz_titokban_tarthatoak_a_kozpenzkoltesek

[18] **Jelentés a hazai és uniós forrásból finanszírozott, munkahelyteremtést és -megőrzést elősegítő támogatások rendszerének ellenőrzéséről,** Állami Számvevőszék, 2012. július, http://www.asz.hu/jelentes/1288/jelentes-a-hazai-es-unios-forrasbol-finanszirozott-munkahelyteremtest-es-megorzest-elosegito-tamogatasok-rendszerenek-ellenorzeserol/1288j000.pdf

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funding applications for "job creation" reveals the faultiness of the entire system. The broader ramifications of funds allotted for "job creation" are never examined. For example, on several occasions, state aid was given to shopping malls for the creation of new jobs, but no questions were raised during the decision-making process about the number of jobs the funding would eliminate in small shops – in this case, it is highly probable that more jobs were eliminated than created.

Local governments on the brink of bankruptcy

Many local governments in Hungary are on the brink of bankruptcy, indeed some of them already are bankrupt. One the main reasons is that they made investments which they would have never done, if they had been investing their own money. But they were happy to apply for EU money and make these investments (e.g. stadiums, wellness centres). Afterwards, in many cases, the same local governments were unable to finance the operation and maintenance of these new entities. Generally they are unable to finance amortization costs either. Speaking about the results of their examination of the use of EU funds by local governments, the President of the State Audit Office, László Domonkos said the following: "When they implement an investment, they do not consider how much it will cost to maintain and operate it during the next 10 to 20 years. Regarding the whole period, it might be that the EU funds cause more harm than good."[19]

Dubious investments

One of the main driving forces behind spending EU money is the endeavour of the government to spend every last cent, rendering the efficiency of spending much less important. Coupled with corruption and other factors, this leads – among others – to investments which are not really necessary, or do not represent the most efficient way to spend public money in a given period of time. Furthermore, even if the investment can be justified, it is often implemented in a very wasteful manner.

The construction of the new, 4th metro line in Budapest is a striking example of an investment which in itself is causing more harm than good, and what is more, it has been implemented wastefully. This extremely expensive development, co-financed by the EU, has been draining away the money from the renewal of the existing public transport system, which is now on the verge of collapse due to the lack of financing. What is more, education, health care and other public services are also suffering, because metro construction is swallowing up too much money. In addition, one could be forgiven for having the impression that every possible measure was taken to make the investment as costly as possible. For example, some of the stations are so close to each other, that on the surface it takes only 3 or 4 minutes to walk from one to the next.

The CEE Bankwatch Network has collected many similar examples of EU-financed irresponsible investments in various countries of Central and Eastern Europe.[20] Open Europe

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[19] **Bekeményít a számvevőszék**, MTI-Eco, 2012. december 27., http://www.napi.hu/magyar_gazdasag/bekemenyit_a_szamvevoszek.540898.html

[20] See e.g. http://bankwatch.org/billions/. A lot of other related materials can also be found on the website www.bankwatch.org.

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also compiled long lists of wasteful use of EU money in various MS.[21] All these cases indicate that the European Commission does not have enough capacity to control the efficiency and usefulness even of large investments financed by EU money.

Opportunity cost ignored

The EU is funding certain activities which it considers development ("principle of additionality"), while it does not fund other activities, however important they may be, because they are not considered development by the EU. For example, motorway construction is subsidized with EU money, but higher salaries for teachers or health care staff are not – although the latter are much more important for Hungarian society and the implementation of Europe 2020 Strategy. The problem is aggravated by the requirement for national co-financing, leaving even less resources for the sectors vital for the real development of Hungary, such as education and health services, a trend which is detrimental for the Hungarian economy and makes the whole EU less competitive.

EU funding is provided for new investments, but as a rule, it is the operation and maintenance of existing infrastructure and institutions which poses a problem. Quite a number of new roads have been built with EU money, while the existing road system has been deteriorating at an increasing rate. New educational and cultural institutions have been created, while the quality and services of the existing ones is continuously declining, due to dwindling financing by the state. The Hungarian Government has just decided to construct a new museum complex in Budapest funded by the EU to the tune of HUF 120 billion (about EUR 400 million), while existing important museums are laying off a large proportion of their staff for financial reasons.

The user is paid

In many cases, instead of the "user/polluter pays" principle, "the user/polluter is paid" principle is applied in the use of EU funds. For example, according to a study by the Institute for Transport Sciences, road transport receives a public subsidy (including environmental and health costs) equalling to up to 10 % of GDP. [22] In spite of this, new roads are built by public (EU and national) money, instead of making the users pay for the cost of these investments. The same applies, for example, to subsidies for investments for waste water treatment and solid waste treatment: the user is paid with public money.

The question in all such cases is not whether the investments concerned are necessary or not. The question is who should pay for these investments: the general public or the user/polluter? In our opinion, it is economically unsound and socially unjust to finance such investments with public money: This leads to a waste of resources, and in fact punishes those most who benefit the least from such investments.

The problem is exacerbated by inappropriate rules about the assessment of the investment prior to its implementation. For example, in transport, the cost-benefit analysis method recommended by the European Commission generally shows much greater benefit before the

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[21] See. e.g. **Another 50 Examples of EU Waste**, 10 November 2010, http://www.openeurope.org.uk/Content/documents/Pdfs/top50euwaste2010.pdf

[22] **The social balance of road and rail transport in Hungary**. Institute for Transport Sciences, Budapest, 2010, http://www.levego.hu/sites/default/files/social_balance_transport_hungary_20110131.pdf

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investment is implemented than the real benefit observed after the investment is completed.[23] Another flaw in the rules is that it is not required to assess real alternatives which might be economically and/or environmentally more advantageous.

The new oligarchy

According to the scientific advisor of the Sociological Institute of the Hungarian Academy of Sciences, Imre Kovách, a new phenomenon in the relations between the political and business elite of Hungary has developed. Introducing a new study of the Institute on the topic, he states the following[24]: “The main reason the business elite started to be involved in politics, and to side with political parties and persons, is the fact that Hungary joined the EU, from where thousands of billions of Forints started to flow to us. It was already worth influencing the allocation of this money, and it became possible to get substantial financial resources as winners of applications for grants.” Further, he explains how this oligarchisation (i.e. the rise of influential business circles with a negative effect on political decisions) is extremely harmful for Hungarian society. He also refers to other studies, which have proved that countries with strong oligarchies drop behind in innovation, and this leads to the economic and political downfall of these nations.

Practically no business circle steps up (at least not openly) against this new oligarchisation. The reason is obvious: all companies hope to get some public money some time, either directly or indirectly (as subcontractors of other companies). This further undermines democracy in the country.[25]

In fact, as has been proven in many countries all over the world, the availability of “free” money is an enormous driving force for elite business groups to fight for that money, no matter what the cost for society.[26]

60 % for growth and jobs?

In spite of all the problems caused by the present system of EU funding, the Hungarian Government has announced that it will radically increase the size of EU funds allocated for the “Economic Development Operational Programme” (EDOP): in the period 2007-2013, 16% of EU funds were allocated to EDOP, while during the period 2014-2020, 60% is to be allocated for this purpose. What is EDOP in reality? In essence, it is a scheme under which companies submit applications to gain public funds, and officials paid from public money decide which companies will obtain grants from such public funds, and how much. In other words, EDOP is the worst system for distributing EU funds and is associated with most of the ills described above.

There is an almost general consensus among Hungarian economists and business people that the main problem within the Hungarian economy is the lack of capital. We tend to agree with

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[23] See, for example: **Vélemény a BKRFT költség-haszon elemzéséről**, http://www.levego.hu/sites/default/files/kapcsolodo/BKRFT-velemeny_0901.pdf

[24] **Egyre többet mutatnak magukból a magyar milliárdosok**. Népszabadság, 2013. január 23., http://nol.hu/archivum/20130123-alig_ismerjuk_az__elitunket

[25] For more detailed description of this situation, see e.g.: Papp József: **Orbán reménytelen harca**, http://www.komment.hu/tartalom/20111118-velemeny-orban-imffel-szembeni-harca-a-fidesz-kepmutatasa-miatt-remenytelen.html

[26] For references on international literature on the topic, see: Váradi Balázs: **A nyolcezermilliárd átka,** op.cit.

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this opinion. However, practically nobody in Hungary (or, for that matter, in the European Commission) has examined what the most efficient way of increasing capital within the Hungarian economy might be.

According to an important study by the World Bank[27] , the preponderant form of capital in every country is intangible capital, i.e. “human capital and the quality of formal and informal institutions”. Furthermore, the share of intangible capital is much higher in rich countries than in poor countries. According to the study, intangible capital “includes human capital, the skills and know-how embodied in the labor force. It encompasses social capital, that is, the degree of trust among people in a society and their ability to work together for common purposes. It also includes those governance elements that boost the productivity of the economy. For example, if an economy has a very efficient judicial system, clear property rights, and an effective government, the result will be a higher total wealth and thus an increase in the intangible capital residual.”

From all this, too, it can be clearly concluded that the planned allocation of EU money in the period 2014-2020 will in all likelihood further reduce the capital available for the Hungarian economy.

Less or more public spending?

The European Commission is continuously urging Hungary to reduce public spending. In its recent press release, the European Commission stated that “keeping the deficit below the 3% of GDP Treaty reference value in a durable and balanced manner, as recommended by the Council, will require additional steps. These should preferably be on the expenditure side.”[28]

A large proportion (about 3% of GDP) of public expenditure in Hungary consists of EU funds. A further substantial part is made up of co-financing for these EU funds. As shown above, EU funds (to put it mildly) do not necessarily finance activities which are the most important for the Hungarian society. As both the European Commission and the Hungarian Government is eager to spend the appropriated EU funds to the last cent, the only way to reduce public spending is to cut expenditures serving basic public services (i.e. reduce the wages of teachers and health care personnel, decrease funding for public transport etc.).

In short, on the one hand the EU is urging Hungary to reduce public spending, on the other hand it is providing more money for public spending. It seems that the left hand does not know what the right one is doing.

Inefficient use of state administration

This practice of redistribution necessitates a vast administration effort, and drains away masses of well-trained and talented specialists from (more) meaningful jobs, just at a time when other domains of the Hungarian public administration badly lack such qualified professionals (which is often reflected in the poor standard of Hungarian law codification work). “Within the Hungarian public administration, today it is the rapidly swelling

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[27] **Where is the Wealth of Nations? Measuring Capital for the 21st Century**. The World Bank, Washington, D.C., 2006, http://siteresources.worldbank.org/INTEEI/214578-1110886258964/20748034/All.pdf

[28] **Commission’s mission to Hungary encourages continued progress in fiscal consolidation while paying more attention to raising growth potential**. 28/01/2013, http://europa.eu/rapid/press-release_MEMO-13-38_en.htm

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bureaucracy of national development and the associated intermediary grant-distributing entities that promise the most EU-compliant jobs, with frequent travels to Brussels and with prospects for much better paid career opportunities there. Thus, from among the young lawyers and economists who choose state administration as their future professional field, the most promising young talents, with the best knowledge of foreign languages, apply for such jobs. And those who go there obviously will not go to work at the Finance Ministry, the Ministry of Justice or the National Office of Economic Competition. Therefore, each and every capable and competent 24-year-old grant application evaluating specialist will cost Hungarian society as much as the costs incurred by having fewer qualified young experts working on the elaboration of the tax reform, on deregulation, or on the control and regulation of monopolies, because of the cost of the damage caused in the event that these laws and decrees are prepared more slowly and are of a lower quality on account of that."[29] All this is compounded by the high fluctuation rate of highly qualified personnel at the National Development Agency: after about two years of working there, many of them leave to become application writers with much higher income and much less responsibility. This further enhances the general process in which enterprises are not competing for the costumer, but for public funds.

National commitments not fulfilled

The policy of the Hungarian Government should conform to the EU acquis, including the Europe 2020 Strategy. Accordingly, in its National Reform Programmes (NRPs), the Hungarian Government made many general and quite a number of concrete commitments. However, the Hungarian government has not met many of these commitments and indeed has been doing just the opposite of what it had committed itself to. This means that although part of EU funds are spent for the right purposes, and more or less efficiently, the harmful measures taken by the government by far outweigh these positive measures. In the following, we will clarify this statement with some examples, referring to the National Reform Programme 2012 of Hungary[30] *(quotes from the NRP are in italic).*

"Europe 2020 strategy 4th National target: increasing the share of those having completed tertiary level education or equivalent to 30.3 per cent within the population aged 30-34 and reducing the share of early school-leavers (those without education or training in lower secondary education) to 10 per cent within the population aged 18-24."

In fact, due to the elimination of many of the state-financed places for those entering higher education, the number of new students in 2012 dropped by about 30,000 in comparison with the previous year. Due to these cuts, a further drop of 15,000 new students occurred in 2013. At the same time, universities have lost a large proportion of state subsidies, leading to a substantial deterioration in the quality of their work.

"Europe 2020 Strategy 5th National target: Reducing the poverty rate of families with children, the number of people living in severe material deprivation, and the number of people living in low work intensity households by 20% each (reducing the above numbers by 450 thousand people by excluding overlapping figures)".

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[29] Váradi Balázs: **A nyolcezermilliárd átka,** op.cit.
[30] **National Reform Program 2012 of Hungary**, http://ec.europa.eu/europe2020/pdf/nd/nrp2012_hungary_en.pdf

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In fact, several significant measures were taken by the Government which led to the growth of the number of people living in poverty as well as to the substantial increase of social inequality. These measures included the introduction of the flat-rate income tax, support for repayment of foreign currency loans, reduced taxes on luxury cars, a general reduction of the price of heating fuels, and cuts in free university places (as mentioned above).

"Annual Growth Survey 5th priority: Modernising public administration".

Public administration has suffered an enormous setback during recent years: quite a number of public authorities (National Public Health Service, environmental inspectorates, etc.) were decimated to such an extent that they are not able to fulfil their tasks as required by EU and Hungarian legislation.[31] A striking example of the routing of the state administration are the changes in the environment inspectorate. 80 % of the employees (highly trained, experienced staff) in the Chief Environment Inspectorate were laid off, and part of them was not replaced at all, and the rest was replaced by young, inexperienced personnel. The new head of the Inspectorate had no previous experience at all in state administration, nor in environmental affairs, and she came from business circles with shady background.[32]

According to the National Reform Program, "modernising public administration" includes anti-corruption measures, but in fact – as mentioned above – in recent years the Government took several measures which fostered increased corruption.

There are many similar cases of profound contradiction between the commitments and deeds of the Hungarian Government – concerning health care, innovation, simplification of the tax system and other fields.

We believe that, in the long run, fulfilling the above-mentioned commitments are as important as, for example, eliminating the excessive public budget deficit. In spite of this, the European Commission has no real means to enforce these commitments.

All this means that the EU is spending EU taxpayers' money to improve the situation somewhat in all these areas, while the Hungarian Government is doing everything it can, not only to eliminate these improvements, but to make things far worse.

Far-reaching consequences

The present system of EU funding and lack of EU enforcement have already had dire consequences for Hungarian society: they greatly contributed to an ailing economy, increased social inequity, growing social tension, great popularity of extremist ideas (the neo-Nazi party received 17% of the votes during the national elections in 2010, and, according to a recent survey, 30% of students in higher education would vote for this party in the next national elections[33]), destruction of democratic institutions, enormous corruption, collapsing education and health systems, and a weaker civil society. All this is causing rising anti-EU sentiment, even in politically moderate circles.

[31] See: **Austerity measures forced on Hungary harming European citizens**, 23 January 2013, http://www.levego.hu/en/news/2012/01/austerity_measures_forced_on_hungary_harming_european_citizens.

[32] See the article **Személycserék, gyanakvás: mi folyik a környezetvédelmi főhatóságnál?** in the economic weekly HVG, 23 March 2013, http://hvg.hu/gazdasag/201312_a_kornyezetvedelmi_fohatosag_mukodesi_zavar

[33] **Tarol a Jobbik, az egyetemisták körében az LMP veri a Fideszt**. Népszabadság, 2013. február 16., http://nol.hu/belfold/20130216-tarol_a_jobbik

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Naturally, we do not assert at all that all these problems are due to EU funding or EU accession. Other factors played their role, too. But we do assert that EU funding greatly contributed to the aggravation of existing problems and even created new ones.

What should be done?

Ceasing EU funding to Hungary is politically not an option. Neither would it be fair, not least because more prosperous Member States benefitted much more from Hungary's accession to the EU than Hungary did. Each year 5-7 % of the GDP leaves Hungary for good – mainly to the most prosperous EU MS (see the table below)!

Gross National Income (GNI) as percentage of GDP in Hungary

Year	2004	2005	2006	2007	2008	2009	2010	2011
GNI/GDP (%)	94,1	94,1	92,8	92,3	93,5	95,0	95,3	95,0

Source: KSH (Hungarian Statistical Office)

In order to radically change the situation described above, the Clean Air Action Group proposes the following:

To radically improve the situation, the Clean Air Action Group proposes the following.

1. Very strict EU funding criteria, including concrete, measurable indicators must be fulfilled by the recipient country on national level. The commitments under the National Reform Program and the EU acquis must be implemented. The Fiscal Compact and the European Semester are steps in this direction, but far from enough. The conditionality proposed in the Commission Communication "A Budget for Europe 2020" and in the Council Conclusions of February 2013 ("Macro-economic conditionality") is also a big step forward, but these should be further elaborated and greatly extended. The conditionality should take into account not only fiscal objectives, but many others, too, including targets in education, health, social cohesion, anti-corruption measures, the environment, etc. Indicators applied to all these fields should be as concrete as possible.
2. The conditionality criteria must be worked out in a transparent process, involving all stakeholders, and providing for these stakeholders the necessary means for participation.
3. The European Commission must have teeth! It must have the power for enforcement, if commitments are not met by the recipient MS in any field, not only in relation to macro-economic policy. It must be made clear to all MS that the common goals of the EU can be achieved only if the commitments of MS do not remain on paper, but are implemented, and implemented on time.
4. The Commission must also have the capacity to control whether MS meet these commitments in all policy areas. Capacity could be freed up by eliminating EU control of individual projects and programmes (see below).
5. The Commission should have the right to decide only about funding of those individual projects which have international dimensions (international research programs, cooperation of NGOs, etc.).

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6. The EU should give all EU funds destined for national purposes directly to the national governments, without any requirements for the concrete use of these funds, i.e. each national government should decide for itself. The European Commission should not concentrate on controlling individual projects or groups of projects, but on the overall performance of the country. In any case, Commission staff do not have the capacity to look at individual projects in detail, so tasking the Commission with controlling projects is asking the impossible.

András Lukács
President of Clean Air Action Group

The Clean Air Action Group, founded in 1988, is a national federation of Hungarian environmental NGO's. It is a member organisation of the European Environmental Bureau and the European Federation for Transport and Environment. András Lukács is also a Vice-President of the Steering Committee of Green Budget Europe.