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Hungarian Interests in the Debate on the Future of the Cohesion Policy

Magyar érdekek
a kohéziós politika jövőjéről szóló vitában

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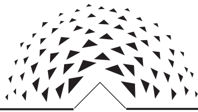
Abstract: Our analysis aims to highlight the main points of the European Commission's proposal "The Multiannual Financial Framework for 2021–2027" focusing especially on the cohesion policy and including the national interest of Hungary in the coming debate about the proposal. The paper starts with a short summary of the economic and social effects of the European Structural and Investment Funds in Hungary. Then we point out the novelties and changes for the cohesion policy proposed by the Commission's recent communication. Finally, we draw conclusions and formulate recommendations for policy makers for the coming EU-level debate.

Összefoglalás: *Elemzésünkben áttekintjük az Európai Bizottságnak a 2021–2027-es többéves pénzügyi keretre vonatkozó javaslatának a főbb pontjait, különös tekintettel a kohéziós politikára és ahhoz kapcsolódó magyar nemzeti érdekekre. Anyagunk az európai strukturális és beruházási alapok Magyarországra gyakorolt gazdasági és társadalmi hatásainak az elemzésével indul, majd kiemeljük a bizottsági javaslatnak a kohéziós politikára vonatkozó részeit. A konklúzióban pedig megfogalmazzuk a hazai és az európai döntéshozók által a költségvetési tárgyalások során szem előtt tartandó javaslatainkat.*

Introduction

The European Commission's (hereinafter: Commission) proposal titled "The Multiannual Financial Framework (MFF) for 2021–2027", which was published on 2nd of May 2018, sets out the proposed sums for the main headings of the EU budget. It includes a lot of details for implementation, however, the Member States (and the experts) are still waiting for the publishing of the draft regulation of the European Structural and Investment Funds' functioning mechanisms. The debate about the proposal will take at least two years (or more), while a compromise could be hammered out in a much longer timescale, compared to the Commission's over-ambitious plan (which aims to end it before the 2019 European Parliamentary elections). In our analysis we try to highlight Hungarian national interests, the red lines of the Hungarian government and the potential points of comprise based on the already published policy papers, national strategies and interviews with decision makers (politicians and government officials).



EU Funds in Hungary

The Multiannual Financial Framework for 2007–2013

With an indicative allocation of over 25 billion EUR during its first full-time budget period, Hungary was one of the main beneficiaries of cohesion policy in the European Union. Therefore, it offered a decisive opportunity to realize development goals and had a massive effect on the economic, social and infrastructural environment. Within the overall budget, European Regional Development Fund represented 51.77%, the Cohesion Fund share was 33.98% and the European Social Fund accounted for a moderate proportion of 14.25%.

Oriented by the aims of the Lisbon strategy and later the EU 2020 strategy, Hungary intended to implement a more focused and structured financing programme as in the previous, incomplete budgetary period. By using the available funds, it seemed possible to strengthen the existing capacities and eliminate obstacles that hamper development in the country. In line with these principles the overall objective was to increase employment and promote long-term growth through improving employability, increase the demand side in the labour force, and develop the labour market environment in one hand, while improving competitiveness and developing business environment on the other.

Unfortunately, there were some adverse circumstances which caused difficulties during implementation. The changing domestic political environment and the breakout of the economic crisis in 2008 forced Hungary to restructure its development goals and slightly re-allocate the available funds. For example, financing economic development programmes gained more importance at the expense of infrastructural projects and there was an opportunity to simplify the administrative process of funding and restructure the organizations tasked with the implementation process as well.

Overall, most of the funds were allocated to the transport operational programme (27.57%), the environment and energy operational programme (18.58%) and the social renewal operational programme (12.79%), meanwhile the economic development operational programme reached only a moderate share of funding (10.77%). Due to the efforts made by the government in the last few years of the budget period, Hungary was the first EU Member State, which absorbed the whole amount of available resources and this efficiency led to some considerable economic and social results, like the growing levels of gross domestic product (by 4.6%), consumption (by 5%), investments (by 11%) and employment (280,000 jobs were created thanks to EU funds). The incoming EU transfers resulted in external stability and a foreign exchange surplus which had enabled to decrease external debt, interest payments and domestic interest rates. The EU funded investments and consumption also meant higher tax incomes for the country which also helped to consolidate the government's budget.

Despite of the favourable absorption performance and the realized impacts, a study compiled by KPMG and the Hungarian GKI on this subject determined that without EU funds the major indicators would have dropped during the period under scrutiny. In this – no EU-funded – scenario gross domestic product would have decreased by 1.8%, consumption would have dropped by 11%, investments would have fallen by 31.3% and employment would have increased only by 105,000 jobs. Without the realized foreign exchange and tax income surplus, Hungary would not have been able to handle the conditions to avoid excessive deficit procedures. Moreover, the drop of competitiveness and the outflow of labour force were also negative factors observed during this period. Finally, the effectiveness of the spending was also dubious due to the rapid pay-outs between 2013 and 2015, before the financial closure of the 2007–2013 budgetary period. These aspects highlighted some structural challenges which called for major interventions in the funding mechanisms, but the experiences also emphasized the importance of the cohesion policy for Hungary and the whole East-Central European region as well.

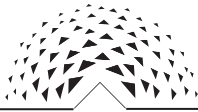
The Multiannual Financial Framework for 2014–2020

Learning from the experiences of the previous period, not only the European Union introduced structural and regulatory reforms but also Hungary determined to re-imagine its funding policy and mechanisms. With an almost equivalent budget (~25 billion EUR) but with a more focused planning period, which was stipulated by eleven thematic objectives, Hungary decided to implement a top-heavy funding system to maximise the absorption performance and to achieve positive and instant impacts from the first years of the budgetary cycle.

Therefore, there has been a governmental ambition to speed up programme-level implementation and decision-making of the incoming project proposals in order to enable the beneficiaries to concentrate on project implementation from 2018. Although the intention can have positive impacts on economic and social environment in theory, the practical experiences shown several risk factors as well.

By now, it seems that the absorption-ambitions have been realized by the government, the financial commitments had already reached an impressive 94.19% proportion within the overall budget. However, this advance brings only an absorption performance below average which means that in line with their annual financing plan the Commission has approved only 17.82% of the spending yet.

Considering the sectoral details, it seems that Hungary has been showing real intent to allocate more funding to private sector actors (mostly small and medium-sized enterprises, SMEs) as the economic development and innovation operational programme actually holds a massive share inside the total budget with a rate of 24.78% which means a considerable growth compared to the 2007–2013 period. At the same time, proportion of programmes financing the state itself has also increased, thus the public administration and civil service development operational programme is holding a 5.98% inside the overall available budget. On one hand it



should mean that Hungary makes significant efforts to reform the public sector, but on the other hand this financial intensity can establish dependence for several beneficiaries as well.

All in all, the tricky part is just coming in 2018, as Member States (hereinafter: MSs) must present mid-term results of the cohesion policy for the European Commission, until the end of 2018. Any gaps in the implementation could result in counter-measures from the Commission, not excluding financial sanctions. It is obvious that any kind of these measures will take effect under the dynamics of negotiation process which intends to determine the EU budget for 2021 and 2027 with the so-called national envelopes for Member States. Therefore, parallel to these negotiations it is essential to focus on the ongoing programmes and allocate the necessary resources for successful implementation.

The European Commission's Proposal for the EU's Budget Between 2021–2027

Size of the Budget for Cohesion Policy Instruments

The proposal of the Commission is roughly 101 billion EUR for the European Social Fund and 273 billion EUR for the European Regional Development Fund and the Cohesion Fund (on current prices). These seem to be fair numbers regarding the effects of Brexit, however, we can see some structural changes looking more closely. For example, the Cohesion Fund loses importance by falling from nearly 75 to 46.7 billion EUR which will affect heavy loss of EU funds for Portugal and Greece, as well as Central and Eastern European (CEE) Member States. However, new funds and programmes will be set up to help the MSs to assist structural reforms (reform support programme with 25 billion EUR) and attracting more investment (InvestEU Fund with 15.2 billion EUR, eg. for innovative financial instruments like JEREMIE). The Hungarian government's interest is to maintain the status quo and maximising the national envelope for the country. Therefore, it may accept the establishment of new instruments but will fight for minimalizing the cuts in the overall national pay-outs.

Revenue Side of the Budget Proposal

The Commission is proposing a reform in the budget's revenue side. Next to the traditional resources (customs duties, VAT- and GNI-based contribution), new contributions are proposed such as 20% of the revenues of the Emissions Trading System (of the CO_2 quotas), tax on non-recycled plastic packaging waste and (in the future) a rate applied on a Common Consolidated Corporate Tax Base. A common tax base is a long-standing proposal, which could be seen as

a forerunner for a common EU-wide tax rate. In spite of this, the Commission's proposal could be accepted even by the MSs which are seeing the tax policy as 100% national sovereignty, as long the Commission is not vindicating rights for taxation on the European level and not influencing the EU-level competitiveness of the MSs.

Structure and Content of the Cohesion Policy's Budget

In the Commission's communication of 23rd of February 2018 (COM(2018) 98 final) three different kinds of cohesion policy scenarios are set:

- The first is the continuation of the previous system (with support for all European regions with some adjustment).
- The second: "Support for less developed regions and cohesion countries only", which would exclude all "Western European" regions (including the former East Germany).
- And a third, "Support for cohesion countries only", which excludes Spain and Italy, as well.

The original principle on which the regional policy and cohesion policy of the European integration is based is the territorial and social cohesion of Europe, not Eastern Europe. Therefore, this European policy must cover the whole European Union and must give a European level "service" (public good) for the people of Europe and should not exclude any country or people from its eligibility. This would harm the much emphasized European value added, the cohesion and solidarity between regions and Member States. That is why the 2nd and 3rd scenarios should be firmly rejected by every Member State.

Eligibility of Regions

The regional eligibility categories, which are the basis of fund allocation, are still not officially published. The non-official and leaked information (based on the 1st scenario's graph on page 11 of the above-mentioned Commission's communication COM(2018) 98 final) is suggesting that the status of NUTS 2 regions – whose GDP (in PPP) is less than 75% of the EU average – will be maintained as per the definition for "less developed regions", however, the more developed region's category would start at 100% of the EU average which creates the transition region range between the 75–100% threshold. This would be a significant change in the regions' categorization. This change would place around 28 regions to the transition category, which are currently (for the 2014–2020 period) in the more developed category. Among the affected regions are 8 French and 6 German regions (but no Hungarian). One special Hungarian request seems to be accepted by the European Commission: the separation of the Central Hungarian region into the more developed Budapest (~150% of the EU average) and the less developed Pest (county) region (~60% of the EU average).

ERDF, ESF & CF

The already mentioned significant cut of the Cohesion Fund would hurt all cohesion countries, most of which will fight for a less draconian cut, including Hungary. Not just the countries with the less developed regions are protesting, but European institutions as the Committee of Regions as well. The cohesion policy altogether suffers a 10% cut compared to the previous budgetary period of 2014–2020 (adjusted by a yearly average 2% inflation).

Table 1
Allocation of EU funds

Billion EUR (current prices)	**2014–2020***	**2014–2020 (adj.**)**	**2021–2027*****
ERDF	199	228.6	226.0
ESF	84	96.5	100.0
Cohesion Fund (incl. CEF)	75	86.1	46.7
Altogether	357	410.4	372.7

* The Commission's homepage: Data of European Structural and Investment Funds.
** Own calculation with data adjusted by a yearly average 2% inflation (14,87%).
*** The Commission's proposal.

Asylum and Migration Fund

A new policy instrument proposed by the European Commission is aiming to help the MSs to effectively manage migration flows, including asylum seekers, legal migration and integration, irregular migration and return. This fund (10.4 billion EUR) would take over and finance partially national responsibilities which in the face of migration pressure in the Mediterranean Basin could be an acceptable proposal. However, the Commission wants to develop and attach to the fund a Common European Asylum System which will face harsh criticism from several Member States, including Hungary, and that could be one of the biggest debates of the coming months (or years). The objective of the integration of legal migrants into the society was included to the objectives of the Structural and Investment Funds (mostly ESF).

National Co-Financing and Other Regulations

The Commission proposes to increase the level of national co-financing of the EU funds (details are expected in the beginning of June 2018), which could lead to budgetary imbalances in the cohesion countries, in the case it would be increased significantly (40% of national co-financing level is the latest 'non-official' proposal of the Commission) and without a phasing-in period. The recent proposal foresees new eligibility systems, which could include other indicators than GDP/GNI (e.g. unemployment level), and that could make it more sophisticated, however, in the same time less transparent.

Conditionality

European Semester

In the last Multiannual Financial Framework (for 2014–2020) the MSs already accepted the general rule of macroeconomic conditionality which means that the coming financial framework could include such measures. The attachment of the pay-outs of the EU funds to the European semester will be maintained (similar to the ex-ante conditionality) and further strengthened. The European semester will serve as a basis for the programming, planning and monitoring of the funds at the start, for the short-, mid- and long-term.

Rule of Law Mechanism

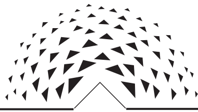
The Commission is proposing the introduction a new "rule of law mechanism" to strengthen the EU budget and to protect it from financial risks linked to generalised deficiencies in the rule of law. "The new proposed rules would allow the Union to suspend, reduce or restrict access to EU funding in a manner proportionate to the nature, gravity and scope of the rule of law deficiencies." Under current regulations sound financial management is pre-condition for the national institutions handling EU funds. The new proposal is aiming the "proper functioning of the judiciary and the prevention and sanctioning of fraud or corruption".

As a general rule, the "rule of law" is a precondition of the accession of any Member State to the European Union. And the EU has existing mechanisms to force its Member States in the case of violating this European value. The introduction of such a new mechanism in principle seems acceptable and could be included into the Treaty on the Functioning of the European Union (hereinafter: Treaty), but the reason to "hide" it into the EU's budgetary proposal is questionable and could be hardly productive. At the same time, it shows a real need by the European institutions (and probably by a group of Member States) to stiffen control over EU funds to increase efficiency and to prevent misuse of EU taxpayers' money.

Conclusion and Recommendations

The economic and social effects of the EU cohesion policy on Hungary (and other CEE Member States) is considerable (as percentage of the GDP), and they (in some cases) create a certain level of dependency for the national economies. This is why, among other (political, social and development) factors, the changes of the cohesion policy's rules and budget are of great importance to Hungary.

The allocation mechanisms set out in the Commission's proposal (with some adjustments) could be acceptable for the Hungarian government, because a 10%



cut for the cohesion policy instruments (due to Brexit) could be explained for the public without much difficulty. However, it is highly recommended that the Policy continues to finance all regions, without excluding any part of the MSs. That could be a red line for a lot of national governments and regional lobby groups. The eligibility criteria of the policy and the setting up of new funds (such as Asylum and Migration Fund) could be part of the negotiation process between the parties.

Hungary will mostly focus on the allocations to the national envelope, the level of co-financing and maintaining the national sovereignty of the institutional system handling EU funds in Hungary. Increasing national co-financing from one year to another from 15% to 40% would be nearly unmanageable for some Member States, leading to the violation of the budgetary prescriptions of the European semester or severe cuts in government spending that might cause social unrest. The ongoing conditionality to the European semester is acceptable, however, the rule of law mechanism would be very hard to hammer through all the MSs' governments, and not because the values it is based on could be violated, but because such a measure does not belong a budgetary proposal, but to the Treaty.

We recommend the European decision makers to reconsider the inclusion of the "rule of law mechanism" into the MFF, the gradual increase (phasing-in) of a higher level national co-financing and the continuation of the cohesion policy for all European regions focusing on the least developed ones under strict regulation, which should include the mandatory compliance with the rulings and recommendations of the European Public Prosecutor's Office and OLAF.

At the same time, we recommend the national governments (including Hungary) to join the European Public Prosecutor's Office, to fight for maintaining the previous level of EU funding for the less developed regions, and to accept harder macroeconomic and (result-oriented) ex-ante condition in exchange of "freer" (less bureaucratic) allocation of the Funds inside the MSs, which includes that they have to endeavour to form national responsibility of the funding mechanisms and the pursuit of improper use of funds.