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Can the Growth Rate of Regional Disparities Be Halted?

Contributions to the Rethinking of Hungary's Regional Policy

SUMMARY: Regional disparities have increased in Hungary over the course of the last two decades, despite the declared intentions of the government as well as domestic and foreign capital injections. Even our EU membership has not brought a substantial change in this respect. A social and economic divergence began instead of convergence between the centre and periphery; the resulting differences have become salient. That raises the question: can this process be halted, is there any chance for the lagging and depressed regions to undergo a real convergence? The answer is clear; it is hardly possible without the evolution of regional policy. Namely, it is increasingly difficult to create a macroeconomic equilibrium while such a large regional disequilibrium exists. The fiscal practice of the past eight years should be broken away from, and an integrative and complex regional policy (aiming at creating individual equilibrium paths for the regions) is necessary instead of a virtual one.

KEYWORDS: regional policy, convergence, disparities, centre and periphery.

JEL CODES: R12, O47

The hope of economic convergence and social inclusion is not new in public thinking in Hungary. For nearly 200 years, from the reform period to present, the cream of our intellectual and political life (for example Széchenyi, Wesselényi, Ady, Bibó etc.) have taken an oath on the necessity of convergence and polemised about the obstacles to it, in line with the prevailing atmosphere of the period and social-economic conditions.¹

The result is contradictory; in line with the “tightening/loosening” type of economic policy on the one hand, and with the business cycles taking place in the global economy on the other hand, the macroeconomic growth rate and the extent of the deviation from the equilibrium path of Hungary varies, just as the sign and size of the output gap, while the exposure of regional performances to shocks and

disturbances has increased. Therefore, the economic policy practice that plans the possibilities of creating equilibrium and examines its fiscal and monetary constraints only at a macroeconomic level should be broken away from.

Namely, the state of meso levels that is well below the equilibrium level harms the chances of eliminating the macroeconomic-level output gap; instead of convergence² it results in divergence.

REASONS FOR REGIONAL DISPARITIES

The transition to market economy found regional differences in Hungarian society and economy in 1989. Real and latent regional disparities are nothing new. In the early and mid-1980s, with the deterioration of the competitiveness of industry, monostructural regions

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found themselves in a difficult situation (more than 20 years after the events that took place in Western Europe for similar reasons). As it is well-known, although the party and political leadership at the time was aware of these problems, it was unable to take any substantial action (instead, measures were taken for the sake of keeping up appearances). The economic and geopolitical change of direction accelerated these processes. Due to external and internal reasons, the counties availed of the opportunities resulting from the change in the room for manoeuvre differently, which made the disparities even more spectacular. In addition to the different distasteful positions and adaptability, the underlying reasons for regional disparities that are taking shape in an increasingly marked manner can be summarised (with some simplification) in four points.

Differences across regions in terms of exposure to external markets and economic structure

Over the course of the last two decades, the performance of the Hungarian economy was fundamentally determined by global economic activity as well as by the development and profit optimisation strategies of multinational companies that settled in Hungary. The growth rate of the Hungarian economy was essentially accelerated or decelerated by the performance of the USA and the EU. This explains that the output of a given area (county or region) has become more dependant on the ability to export (acceleration or deceleration of export dynamics) of resident enterprises.

The exporting ability of counties with a permanently low performance is low, and neither local consumption, nor the added value of local services are able to offset it (export of services is the least typical of these regions). The performance of counties that better accommodate

themselves to the global economic environment has grown continuously during recent years, while the performance of counties on the periphery worsened or, at best, stagnated (*see Table 1*).

Developments in investment and employment dynamics of regions also depended on the sectoral structures of regions (on the existence or lack of so-called locomotive sectors); permanently low investment was coupled with permanently low employment (although the regional dispersion of the unemployment rate somewhat declined after 2009, it was much more the consequence of higher public employment in lagging regions than of an improvement in the labour market situation; *see Chart 1*).

As a labour market consequence of the transformation that began after 1990, an unemployment slope with a direction from west to east took shape; a more than tenfold difference developed between the regions with lower and higher unemployment rates.³

The growth of the extent of the dispersion of unemployment that started from 2006 clearly indicates that employment policy had come to a dead end, paying less and less attention to employment (*see Chart 2*).

Different adaptability, innovative and resource absorption capacities of regions

The structural situation in the counties of Hungary in 1989 determined their resource absorption capacities and adaptability from many aspects. The ability of desindustrialised regions or ones that became desindustrialised to attract and retain capital and private investment was low all the way until the turn of the millennium (*see Chart 3*).

As a result of the shortage of capital, the activity and market share of economic agents declined; the room for manoeuvre of those who

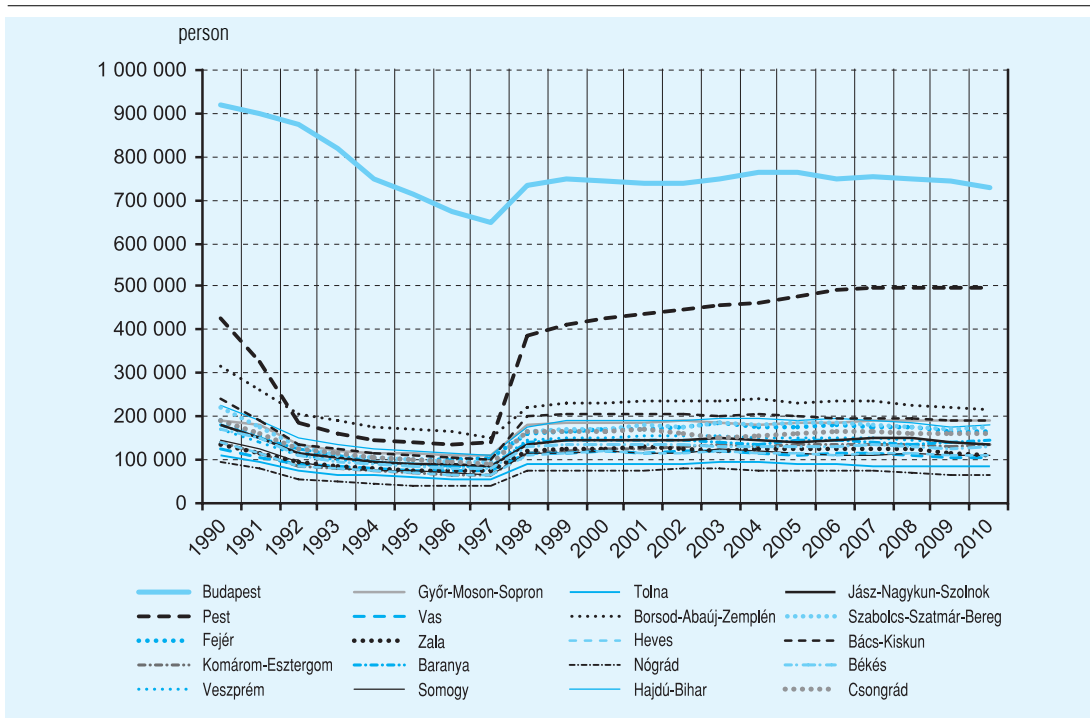
Table 1

PER CAPITA GDP AT PURCHASING POWER PARITY IN EACH COUNTY (HUF THOUSAND)
(HUF thousand)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Pest	324	394	487	643	760	894	1,035	1,309	1,493	1,678	1,816	1,949	2,018	2,233	2,317	2,157
Fejér	410	542	696	980	1,228	1,283	1,577	1,561	1,596	1,782	2,009	2,091	2,292	2,415	2,485	2,276
Komárom-Esztergom	341	471	599	716	827	918	1,104	1,397	1,561	1,997	2,282	2,497	2,426	2,738	2,795	2,627
Veszprém	339	460	543	669	795	901	1,115	1,262	1,343	1,483	1,606	1,633	1,713	1,929	1,950	1,834
Győr-Moson-Sopron	440	590	737	905	1,182	1,449	1,780	1,816	1,996	2,257	2,371	2,430	2,719	2,838	3,007	2,833
Vas	439	581	734	951	1,150	1,317	1,517	1,529	1,679	1,985	2,067	2,068	2,332	2,373	2,325	2,218
Zala	401	496	620	751	881	989	1,122	1,310	1,472	1,754	1,875	1,871	1,878	2,032	2,202	1,950
Batonya	356	433	518	662	769	868	1,005	1,122	1,258	1,401	1,516	1,584	1,702	1,834	1,906	1,815
Somogy	325	413	498	579	672	760	911	1,058	1,158	1,301	1,421	1,439	1,469	1,557	1,664	1,649
Tolna	401	497	600	690	838	978	1,092	1,206	1,342	1,345	1,457	1,512	1,593	1,767	1,912	1,910
Borsod-Abaúj-Zemplén	299	410	468	570	670	736	851	950	1,054	1,182	1,371	1,499	1,563	1,662	1,680	1,592
Heves	310	405	493	599	716	805	946	1,113	1,250	1,398	1,523	1,528	1,626	1,828	1,845	1,782
Nógrád	263	322	380	435	553	605	722	832	925	1,025	1,116	1,105	1,169	1,162	1,212	1,161
Hajdú-Bihar	353	421	521	632	741	794	963	1,126	1,249	1,435	1,564	1,620	1,698	1,805	1,888	1,807
Jász-Nagykun-Szolnok	335	419	503	620	704	745	894	1,062	1,152	1,239	1,327	1,358	1,542	1,643	1,732	1,731
Szabolcs-Szatmár-Bereg	262	327	391	474	551	598	731	847	934	1,069	1,167	1,196	1,257	1,352	1,384	1,322
Bács-Kiskun	329	425	502	602	696	769	916	1,038	1,178	1,280	1,434	1,466	1,567	1,686	1,787	1,713
Békés	338	422	507	590	673	750	893	985	1,069	1,158	1,263	1,302	1,359	1,462	1,553	1,425
Csongrád	402	503	614	737	864	947	1,110	1,195	1,327	1,465	1,607	1,670	1,744	1,891	1,983	1,974
standard deviation	50.98	71.09	98.16	140.73	187.75	223.40	271.10	244.70	261.71	329.50	349.12	375.03	402.50	432.79	441.86	402.07

Chart 1

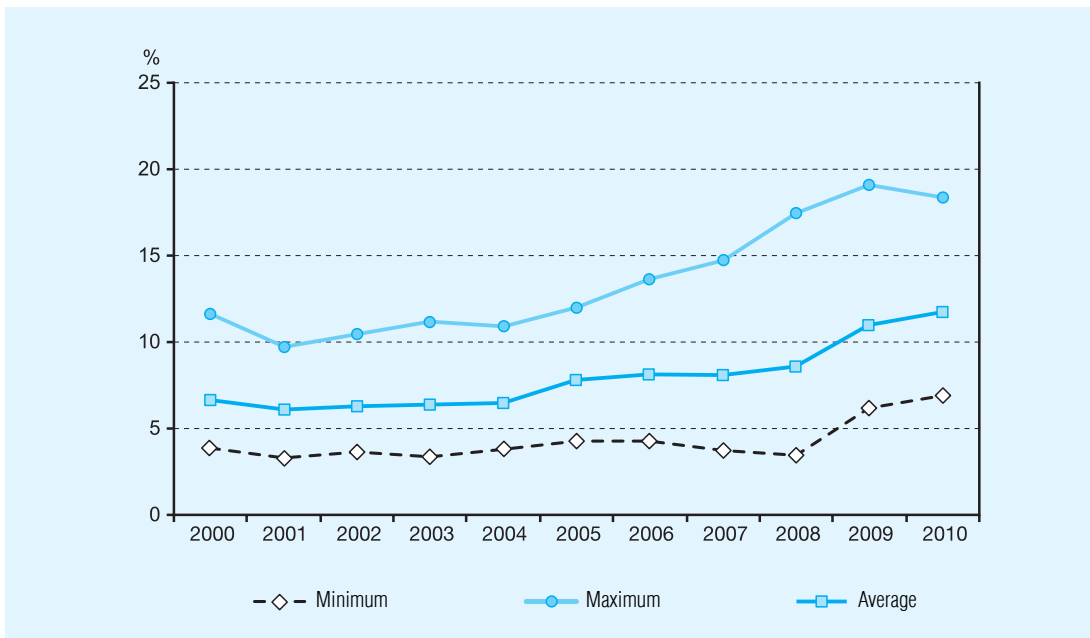
EMPLOYMENT (1990–2010)



Source: own editing

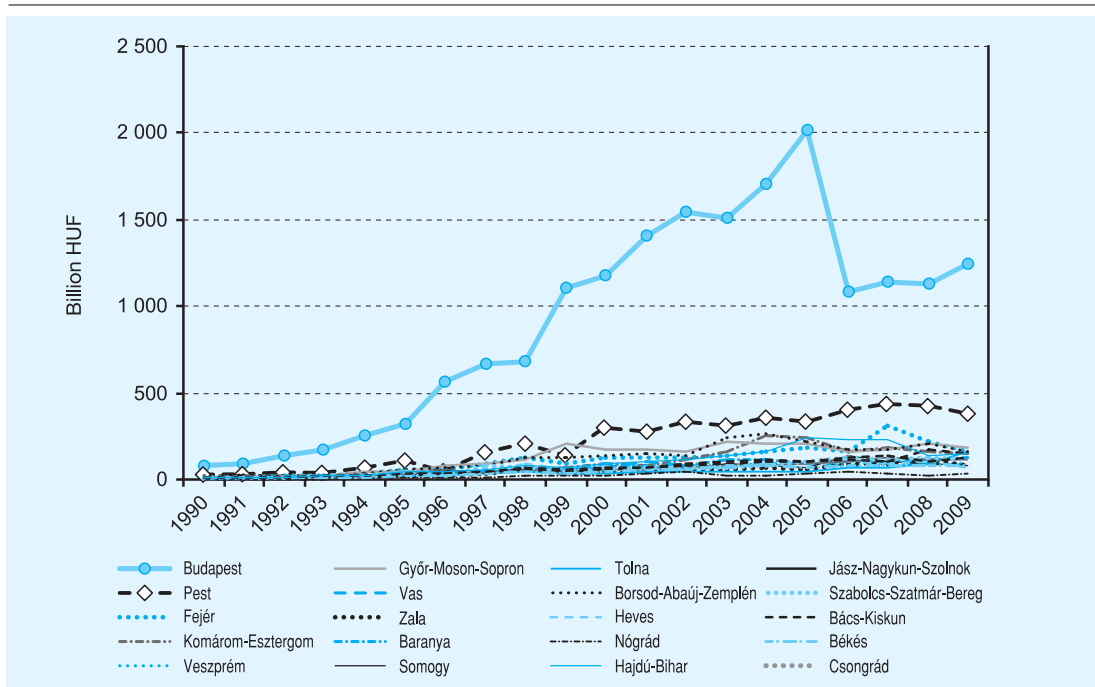
Chart 2

MUNKANÉLKÜLISÉGI RÁTA MEGYÉNKÉNTI SZÓRÓDÁSA



Source: own editing

INVESTMENT
(1990–2009, at current prices)



Source: own editing

had provided jobs by producing local products and services fell to a fraction of the earlier amounts with the appearance of multinational enterprises. Cooperation between local micro and small enterprises is incidental; the number of bankruptcies and liquidations of enterprises in regions at a disadvantage soared after 2006.

Over the course of the last two decades, significant regional disparities developed in terms of R+D+I absorption capacities and in the innovation environment.

Different mobilities and multiplying effects of factors

Not only the different starting conditions, various capital and technology attracting and absorption capacities are behind the different growth and development paths of our regions, but also various multiplying effects of input side indicators, which

determine (or determined) the absorption of resources in an endogenous manner.

This process may entail serious risks. Of these, social risks, i.e. the unfavourable ripple effects of economic conditions on society, are especially dangerous.

A typical example of this is that the human development index (HDI) declined significantly, the poverty rate and the relative poverty gap increased, the number of early school leavers increased and average life expectancy at birth worsened in the regions with lower output, which produce a greater output gap.⁴

Our analyses regarding the period of the financial crisis (2008–2009) confirm that, in a peculiar way, the downturn, the worsening of the indicators hit the regions that were already in an unfavourable situation less hard than those in a more favourable situation. This reverse effect is particularly striking in depressed regions, where household income declined due

to weak domestic demand, low entrepreneurial activity and the depressed labour market situation, and the investment activity of households and the private sector stagnated at a low level, but in absolute and relative terms its magnitude was below the national average.

Fiscal measures and the low efficiency of regional policy

The EU funds appearing in the budget of Hungary (1999: HUF 3.3 billion; 2010: HUF 706.8 billion, data at current prices) and absorption (1999: HUF 14.9 billion; 2010: HUF 804.8 billion, data at current prices) grew dynamically between 1999 and 2010.

This period of time is relatively short (therefore, considerable conclusions can hardly be drawn), but it is clear that the impact of funding received by Hungary on GDP growth is below the EU average (*see Table 2*).

There are numerous underlying reasons, such as

- the “storm of ideas” experienced during the allocation of funds;
- the greater part of funds (60–65 per cent) had the one-off effect of increasing demand and improving community infrastructure, instead of strengthening economic potential; also, the so-called soft projects repre-

sent a high share. By contrast, the cohesion policy of the EU aims at making low-performance regions catch up. Consequently, funding is only efficient if it generates additional output (compared to the situation when no support was provided).

Empirical examinations and analyses confirm in this respect as well that significant disparities exist (in parallel with positive examples, low absorption efficiency is not rare);

- funds were awarded on the basis of political interests; a considerable portion of them were not spent on investment that contributes to long-term convergence, thus their effect is also weak;
- the funds are not additive but are of a substituting nature. In most cases, funds did not appear as additional resources, but replaced earlier private or public investment (Kocziszky, 2010).

The lagging and depressed regions of Hungary fell in a trap because the efficiency of fiscal measures in recent years was low (due to their softness and their level below the sensitivity threshold); capital injections proved to be insufficient to generate real convergence (a much higher fiscal impetus would have been necessary to do so).⁵

In recent years, not only the macro- and mesoeconomic conditions of the real and

Table 2

THE IMPACT OF FUNDING ON GDP GROWTH				
Country	GDP/EU funding* (%)	Contribution to GDP growth (%)		
		1989–1993	1994–1999	2000–2006
Portugal	~ 3	3.9	4.6	6.1
Spain	~ 1.5	2.9	3.1	4.2
Greece	~ 2.6	4.3	5.6	6.1
Ireland	~ 2.8	n.a.	8.9	8.6
Hungary	~ 2.1	–	–	1.2**

Notes: *AGENDA 2000 (max. 4%)

** between 2004–2006 (*source*: own calculations)

Source: The Role of Fiscal Transfers for Regional Economic Convergence in Europe (No.1029.2009)

nominal convergence of the regions of Hungary, but the harmony between sectoral and local economic policies as well as the underlying moral background were also missing. Some of the programmes had virtual effects; the funds were spent on “political visualisation”.

An economic policy that uses only fiscal and monetary instruments is inadequate for addressing regional problems because the various shocks affect the counties to a different extent.

CONSEQUENCES

The above described reasons collectively and their mix resulted in the evolution of significant disparities, an increase in the disparities and the sustained lagging of certain regions, their loss of chances to catch up as well as the development of states of depression; compared

to the EU average, per capita GDP at purchasing power parity in the lagging regions is practically stagnant (see Chart 4).

Over the course of the last two decades, three growth clusters developed as a result of territorial-level social and economic disparities (see Chart 5). The position of counties has been consolidated over the course of the last eight years, passage between groups ceased to exist, and shifts within a given group are also minimal.

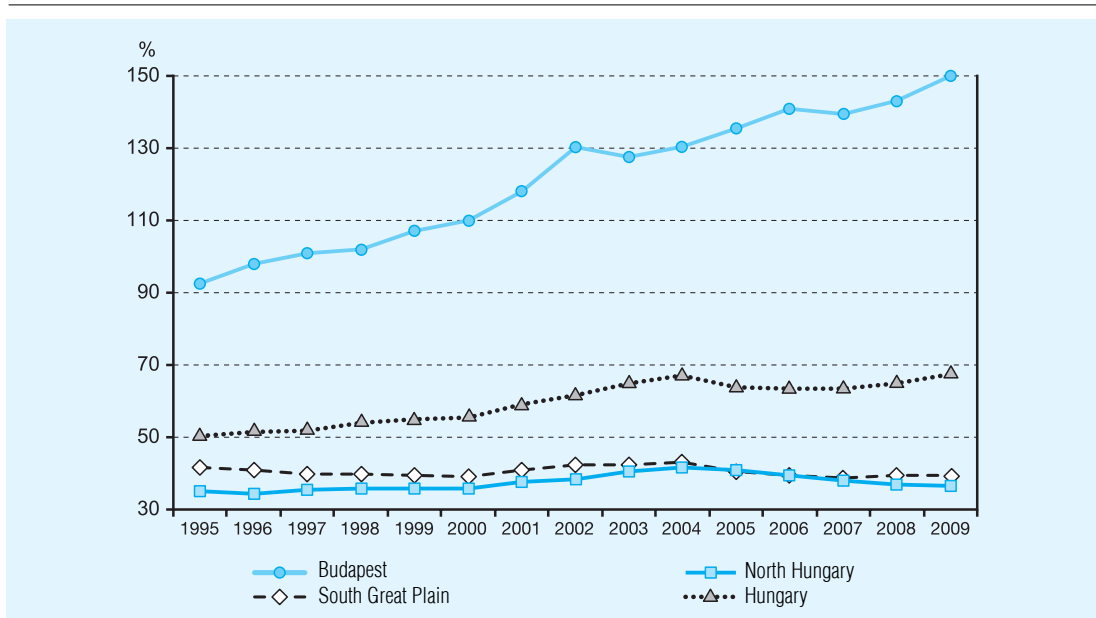
The central role of Budapest and its above-EU-average performance (which seems to be less influenced by the economic cycle) remain unchanged, while the majority of Hungarian regions drifted to the periphery, and their situation continued to deteriorate to some extent from 2005 on.

Investment figures show much higher exposure; the decline in 2004–2006 seriously affected the centre, while the counties on the periphery (practically: 16) were hardly affected.

Chart 4

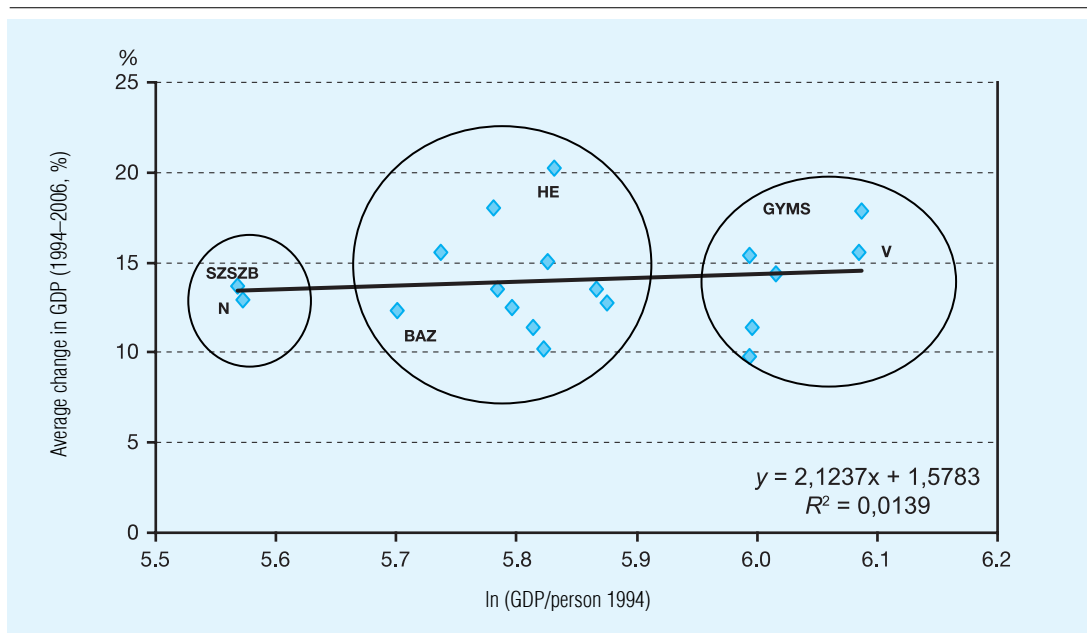
CHANGES IN REGIONAL GDP IN HUNGARY

(per capita GDP at purchasing power parity, EU-27=100)



Source: own editing based on CSO Eurostat data

CONVERGENCE CLUBS OF HUNGARIAN COUNTIES



Source: own editing

DESIRABLE DIRECTIONS OF THE PARADIGM SHIFT

► Regional policy is an integral part of economic policy. Therefore, any economic policy that addresses regional policy separately is partial, i.e. its efficiency is inevitably limited. The aggregate of county and regional concepts and policies may only function if it is also in line, in addition to sectoral policies, with fiscal and monetary policies. A precondition of this is the creation of awareness in economic policy and economic strategy.⁶

Equilibrium, stability and sustainability elements should appear in a differentiated manner in the system of objectives of regional policy (depending on the region).

Lack of regional policy cannot be substituted with high-sounding programmes and a dumping of programme compilations.⁷

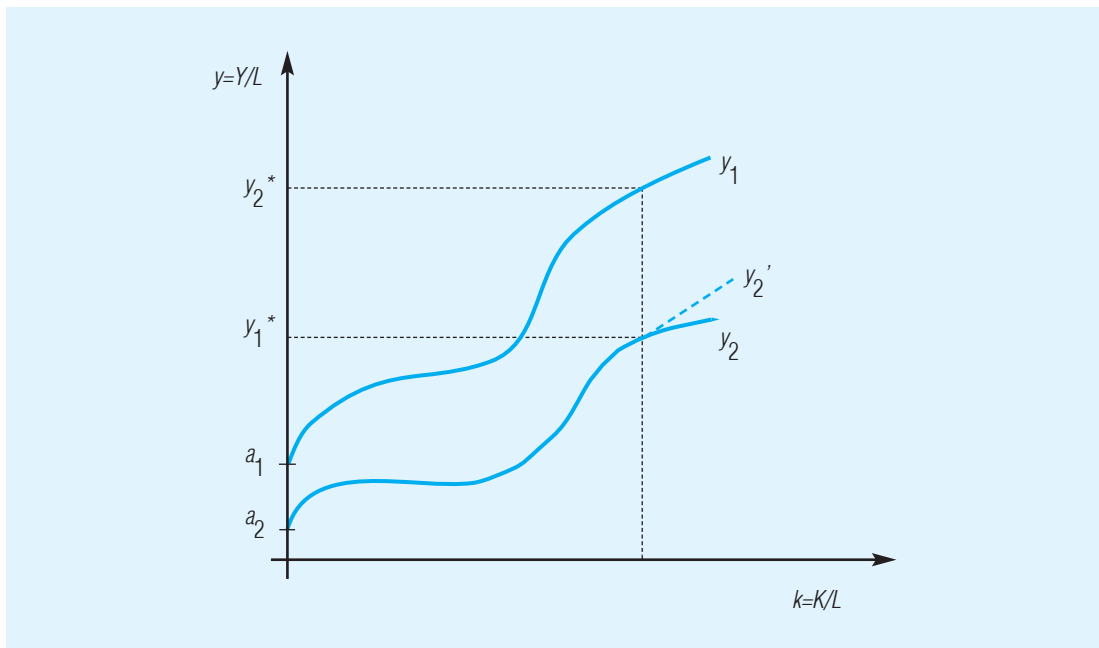
► Regional policy should build differentiated equilibrium paths.

In the past decades, practice did not confirm the mainstream theories regarding the equilibrium paths of the macro- and mesoeconomies. These theories start from the hypothesis that the market creates equilibrium automatically, or at least generates it.

In real life, macro-level shocks and noises intensified at a territorial level (due to the asymmetry of transmissions), whereas the smoothing effects of the fiscal and monetary policies subsided.

The theories that belong to the mainstream ignored the fact that the meso levels have their own growth paths, which makes the probability of absolute convergence doubtful. In the future, regional policy will have to take it into account consciously, and will have to create the circumstances for conditional convergence, which sets the own equilibrium growth path of the given territorial unit as an aim. Namely, there is a chance for absolute convergence between two regions starting from different

REAL VS. CONDITIONAL CONVERGENCE



Source: own editing

per-unit output states (a_1, a_2) and following different growth paths if the region in the less advantageous situation (y_2) produces a higher growth rate (y_2') (see Chart 6).

Recognising this in itself and then elaborating a differentiated regional policy accordingly would mean a significant step forward compared to the practice of previous years (which had a partial attitude). Consequently, (as in many other cases) there are no recipes and standard solutions, and even in the case of a policy that is consistent and that bridges political cycles, the poverty trap can only be avoided as a result of a lengthy and time consuming process.

More emphasis than earlier should be put on the expansion of demand and supply relying on the local economy.

In the most disadvantaged regions, in order to overcome the lack of capital and knowledge, much more attention should be paid to the methods of reusing local values (abilities) in expanding local demand and supply. The expla-

nation is obvious, and can be explained by the following correlation:

$$S_b + K_g = K_v + K_s$$

where

S_b represents the savings of the region,

K_g is the credit demand of the economy of the region,

K_v is the capital requirement of the enterprises resident in the region,

K_s is the capital requirement of the structural changes, technology transfer and human potential of the region.

In a state of grace, there is a balance between the capital requirement of the growth rate and the amount of capital available.

The credit demand of the economy of the region (K_g) may be satisfied from the working capital ($K_g^{1'}$) as well as from budgetary sources ($K_g^{2'}$). Limited working capital (in most cases) means that the conditions of endogenous technological growth do not exist (or are very

tight); therefore, growth relying upon internal resources should have a bigger weight.

It is obvious that an equilibrium growth path of one's own can hardly be attained without changing the unmoral conditions that evolved around state interventions and without better coordination with sectoral policies. Both depend largely on the intention of the government. Let us hope that there will be adequate determination and energy for this.

► A precondition of successful regional policy is the consolidation of moral conditions.

There is hardly any chance for creating the conditions of sustainable regional convergence without terminating the moral hiatuses; without moral renewal, even a well-intentioned economic policy builds on sand. The presumably corrupt practice of funding that evolved in recent years is unsustainable. Only a regional policy that is really transparent, the input and output side indicators of which are equally transparent and the results of which are really sustainable can be successful.

NOTES

¹ "How would it be possible to raise Hungary from poverty?", asked István Széchenyi in his letter to Miklós Wesselényi in 1830 (Széchenyi, 2004).

"Ferry country, ferry country, ferry country: Even in its most capable dream it only rambled between two shores: from East to West, some preferred to return. Why did they lie that the ferry is a bridge? Oh Potyamkin, you oily-handed holy man, you only cheated Tsarina Catherine. Idealists and ill-doers united, built strongholds of air stones of falseness, shouted with joy to the world that Europe was built under the Carpathians.

The Great Humbug did not harm Europe; they believed the lie at home. They kept on telling us that Europe is here, we prepared for civilized life, pulling ourselves ahead with strained nerves." Endre Ady, *Budapesti Napló*, 15 October 1905. (Ady Endre összes prózai művei. 7. kötet (Collective prose works of Endre Ady, Vol. 7), Arcadum Adatbázis Kft.).

² The general concept of convergence (Magyar Nagylexikon, Budapest, 2000) allows a wide interpretation. Economists and within that the scholars of regional sciences defined two interpretations of convergence.

The first definition considers the decline in the differences between selected social-economic indicators as convergence, which practically indicates the

decrease in the extent of the dispersion (σ convergence). According to the second interpretation, over a longer-term growth path convergence means catching up (β convergence). Therefore, the latter (the sustainable, i.e. long-term convergence) is more important than the former.

³ In January 2011, the number of employed – in the 15–74 age group – amounted to 3,743,000, exceeding the value one year earlier by 0.5 per cent (CSO, 2011).

The number of unemployed aged 15–74 was 487,000, i.e. 8,000 more than one year earlier. The unemployment rate, which was 11.5 per cent, was essentially the same as one year earlier (the unemployment rate of men and women amounted to 12.0 and 10.9 per cent, respectively).

⁴ The human development index was determined on the basis of the GDB, the statistical life expectancy and the educational level.

⁵ There is no material change at the top or in the lower third of the ranking of the human development index (compared to 2000). According to year 2009 data, the positions of Budapest (0.8739), Győr-Moson-Sopron County (0.687) and Fejér County (0.669) remained unchanged, while the situation of

Nógrád (0.600) and Szabolcs-Szatmár-Bereg Counties (0.587) continued to worsen by a few percentage points.

⁶ With the collapse of the socialist planned economy (?) (we threw out the baby with the bath water), strategic planning also ceased to exist for the most part. The new government seems to demonstrate more determination in seeking harmony between market and government developments.

⁷ As a result of the programme compilation wave that took place in the last fifteen years, nearly 14 thousand pages of regional development programmes were prepared, which are extremely heterogeneous in terms of their objectives, contents, messages, effects, standard, degree of elaboration, fund requirements etc. Taking stock of them is rendered difficult by the following:

- Although the documents are open to the public, accessing them is not so simple, in spite of the fact that theoretically they are archived by several proprietors of sources (for example, by the regional devel-

opment councils and their work organisations, by VÁTI Hungarian Non-profit Ltd. for Regional Development and Town Planning as well as by the Prime Minister's Office, in addition to those who elaborate document). The availability of the documents on the Internet is extremely poor (as opposed to, for example, the practice in Austria or Germany); 50 per cent at a regional level, and even lower, around 25 per cent, at a county level; it hardly reaches 15 per cent in the case of documents related to micro-regions (September 2008 figures). Readers sometimes have an impression that there is a close correlation between the publicity and quality of programmes; those who prepare weak plans and those who have them prepared are no willing to make them public. Obviously, it also means that even today in most cases the projects match the programmes only formally; due to lack of accessibility, those who submit projects do not know the programme or only know its catchwords.

- The follow-up of the programmes and even more so of their effects is methodologically accidental, and relevant data are incomplete.

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