

# EU funding: A recipe for ruining the environment and the economy

**A much larger share of the EU aid to new member states should be used for improving the environment and reducing fossil fuel use. In these countries generally the energy efficiency of buildings is low, public transport services are deteriorating, bicycle infrastructure is lacking, waste minimisation and waste recycling is often in its infancy, the agriculture is very much based on intensive methods with high energy use – just to mention some of the most striking problems. The argument for not providing more funding to improve the situation in these areas is that “the EU funds are needed first of all for helping the economy”. Recently there has been some research on the efficiency of the use of EU funds in Hungary. A new study as well as the opinion of several economic experts clearly shows that the use of EU funds has largely a detrimental effect for the national economy, too!**

According to some prominent personalities of Hungary’s business sphere, the funds of Hungary’s Economic Development Operational Programme (EDOP) should be doubled for the entire 2007-2013 period because it has not been sufficient that additional HUF 111 billion (more than EUR 400 million) were regrouped to “economic development” from the EU funds in 2009. Evidently, all possible measures must be taken in order to modernize the structure of Hungary’s national economy and to improve the competitiveness of Hungarian enterprises, both in the short and in the long run. However, it is questionable whether the proposed regrouping of funds into the EDOP does in fact serve this purpose.

What is the EDOP? In essence, it could be described as a scheme under which companies submit applications in order to gain public funds, and officials paid from public money decide which companies will obtain grants from such public funds, and how much.

Both recent historical experience and economic theory show that the redistribution of public funds to business entities brings about serious troubles in the markets. 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. Even the price of pencils was centrally determined in Moscow, to be applied throughout the Soviet Union. 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 showing the reality. As a consequence of this system, mistaken economic decisions were being taken at all levels and all the time, which, among others, 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 the market economy: this brought about immediate collapse for the industries that had been sustained earlier by the state by means of reallocating resources drained away from other sectors of the national economy. (Heavy industries and mining were such favoured activities in Hungary; accordingly, the workforce employed in mining plummeted from one hundred thousand to just five thousand over a short period of 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 the economic policy. One of the background studies written for the Reform Alliance pointed out that the present redistribution of funds by the state to various market players is a system of extremely low efficiency: “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 being even further intensified by the firms which specialized 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 make use of such grants. In fact, many of the grant-aided firms actually registered a negative growth. In the SME 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 aids.”

Several other economic experts have also called the attention to the detrimental outcome of this practice of redistributing funds: namely, that it gives rise to a series of erroneous economic 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 they only prolong the agony of enterprises that are unfit for survival.” Gábor Bojár, Chairman of the Board of Directors of the famous and very successful company Graphisoft, commenting on state aid, stated 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.”

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!

Moreover, the state aids granted to certain stakeholders of the economy often draw away

resources from other activities that are viable and competitive (let us just think of the increased tax rates). This whole process can be described as “alms-giving by looting”.

Such subsidies often make company activities unpredictable, and it is not rare that they unfairly disadvantage certain enterprises. The mayor of a Hungarian town complained to me recently that in another town a foreign company obtained state subsidies of several billions of Forints for a green-field investment project implemented there. In contrast, an enterprise which manufactures similar products, and which had settled earlier in the town of this mayor, had not received any such state aid... A lot of similar examples can be cited from other countries, too. For example, a colleague from Cyprus told me 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...

This practice of redistribution necessitates vast administration efforts, 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 Hungarian public administration, today it is the rapidly swelling 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 the Hungarian society as much, as the costs incurred by having so much fewer qualified young experts working on the elaboration of the tax reform, on the theme of deregulation, or on the control and regulation of monopolies, i.e. as the costs of the damage caused in the event that these laws and decrees are only prepared slower and in poorer quality on account of that” – writes economist Balázs Váradi in his excellent article titled “The Curse of the Eight Thousand Billions” (the EU aid to Hungary in the years 2007-2010 is expected to be eight thousand billion Forints). He also puts forward convincing arguments to underpin his warning: if we do not change our attitude, EU aids may cause to Hungary more damage than all the benefits they bring.

Besides, state grants provided to companies are also hotbeds for corruption and fraud. The distribution of free funds will irresistibly attract all those who aim for quick enrichment by illegal means. We can 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 represent just the tip of the iceberg). In many observers the same suspicion may be aroused by the fact that subsidy allocations performed by the state often go counter to its own declared aims (e.g. reduction of energy dependence, giving preference to activities that create more added value).

It is at least a mistake to say, as some business representatives do, that the funds regrouped into the EDOP create new resources for the Hungarian economy, for even until now all other types of EU aid have also served the economy. For instance, the subsidies granted to railway development from the Transport Operational Programme, or the funds allocated to the construction of sewage treatment plants from the Environment and Energy Operational Programme have brought contracts and orders for the enterprises, and even the education activities financed from the Social Renewal Operational Programme have trained workers and

professionals partly for the Hungarian companies (hopefully at a high standard). In fact, all EU grants allocated so far must serve economic development, because all such subsidies were required to promote the implementation of the Lisbon Strategy (the primary goal of which is to make Europe the world's most dynamically developing knowledge-based economy by 2010). If the EU subsidies allocated to Hungary have not been spent by the Government for such purposes up till now, then the EU could rightly claim these funds back...

EU financial means should not be used directly for subsidizing certain economic actors but rather for funding tasks that are indispensable for a healthy economic development but are not performed by the market on its own. Such tasks include environmental protection investment projects, required by the European Union, which cannot be implemented from private capital on a purely market basis (e.g. the construction of sewage treatment plants and waste handling facilities). The improvement of public services (e.g. education, healthcare, public transport) and the energy efficiency enhancing renovation of buildings (first and foremost the buildings of public institutions) also belong into the group of such indispensable tasks, which may provide a secure and predictable market for Hungarian enterprises. (However, even in this case, the subsidies should not be paid to individual companies but rather to the users – i.e. to the proprietors of the buildings –, who will then select from among the enterprises operating in the market the ones they will contract with for the work.) Research and development has been, and still is, an important and continuously under-financed activity in Hungary. Since it involves excessive risks for market players, it would be necessary and justified to take over a larger portion of these risks from the enterprises.

Lots of meaningful measures can be taken in order to improve the competitiveness of Hungary's economy. (These possible steps include, among others, the transformation of the current system of public procurement, the simplification of the Hungarian tax system, or the consistent application of sanctions against unfair economic activities.) The practice of distributing public funds to companies, however, is certainly not one of these meaningful measures. On the contrary: it is a sure recipe for wrecking the Hungarian economy.

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