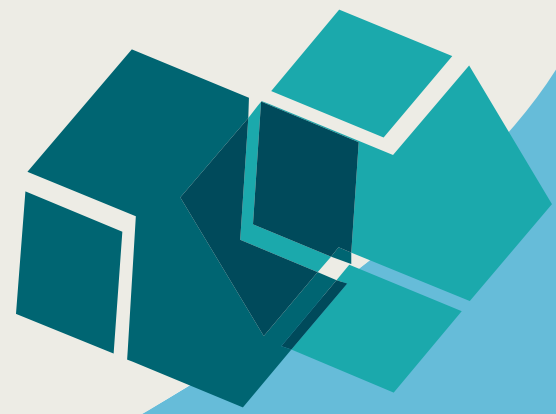




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Fostering Cohesion in Central and Eastern Europe



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## Central Hungarian Region and Budapest Agglomeration Case Study Report

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## ***Central Hungarian Region and Budapest Agglomeration Case Study Report***

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# **1 Introduction**

## **1.1 The regional context**

The Central Hungarian Region (CHR), the most prosperous Hungarian region, encompasses the Budapest agglomeration and the county (Megye) of Pest. It is home to 2,9 Million persons and covers a territory of 6919 sq. kilometres. The region generates 49% of the country's GDP (39% of which in the Budapest agglomeration alone) and 34% of Hungary's industrial production. As such, because of the strategic importance of Budapest as a European gateway, tourist centre and focal point of FDI, it is impossible to discuss the regional development situation in the CHR without framing it within a national context, which is characterised by large and constantly increasing territorial differences. With regard to all macroeconomic indicators the Central-Hungarian region has in the past enjoyed impressive growth, broken only by the financial and economic crisis of 2008. In the Budapest agglomeration (BAST), GDP/per capita increased by 25% between 1995 and 2008.

The Central Hungarian Region is by no means homogeneous. The Budapest Agglomeration and the city of Budapest and several important suburban towns in particular, form Hungary's economic core and thus, almost by default, are the most dynamic areas of the country. At the same time, many of the communities within the region more distant from the BAFT are plagued by high unemployment and characterised by low development indicators. The major regional development problems of the CHR were and remain to this day the following:

In terms of Cohesion Policy coverage, the Central Hungarian Region - as Hungary's most prosperous region despite great socio-economic disparities - lost its development area status after 2007 when it was designated a phasing-in area within the Regional Competitiveness and Employment objective.

## **2 Summary and Structure of the Report**

This report is based on interviews with key stakeholders, large beneficiaries and experts (see list of interviews). and it follows the general outline provided by EPRC. In performing the research, the UEF team consulted a number of official documents (regional development plans programme documents, reporting documents and evaluations) to the extent these were openly available. Secondary sources were also used. The collection of data was complicated and thus delayed by radical changes to the institutional framework of Cohesion Policy after 2010 (and the victory of the national-conservative government). Not only was the National Development Agency dissolved, but many policy experts left their positions for new jobs. Furthermore, despite our attempts to focus on business development it was often eclipsed by an overwhelming interviewee focus on infrastructure as this was seen as a key area of development policy as well as an area that exemplified the problems associated with CP. Nevertheless, we were able to provide significant information with regards to the Europe 2020 heading "enterprise development". An important note: our interviewees were decidedly more critical than the available evaluation reports.

The report is structured according to the template provided and will cover the areas of: 1) regional analysis, 2) assessment of performance, 3) strategic quality, 4) administrative performance and 5) conclusions. As there are overlaps between these different areas a certain degree of repetition could not be avoided.

### **3 Regional analysis, selection of Europe 2020 heading**

#### **3.1 Evolution of regional problems, regional needs and strengths 2007-2013**

With regards to development problems, Cohesion Policy priorities for the CHR in general and the Budapest Agglomeration in particular have covered a wide variety of areas. As Schneller (2000), Barta and Lengyel (2007) and others indicate, the main challenges facing the CHR stem from a paradoxical situation. While Budapest is the nation's economic centre and most prosperous area, in wider relative and European comparative terms, Budapest and its larger region are plagued by many basic development problems, some which are particular to the region itself and others which are a general problem nationally. An inadequate transportation infrastructure, large-scale suburbanisation, environmental stress and weak working relationships with surrounding municipalities exacerbate structural problems of a more general (national) level that include demographic decline, a low participation rate and a low level of innovation – particularly with regard to small and mid-size enterprises

The de-industrialisation of Budapest began already in the 1970s (Kiss 2009). The city is now characterised by a large and variegated service economy that includes finance, investment banking and tourism. Industry and logistics have developed in the Budapest agglomeration, which is linked to the neighbouring areas of Esztergom, Tatabánya and Komárom. Nevertheless, this overall picture of strength masks the fact that the CHR is also characterised by large gaps in GDP and other development indicators; the Budapest agglomeration is in fact surrounded by numerous smaller municipalities that lack many social amenities, are poorly connected to transportation and public utility infrastructures and where outmigration remains a serious problem.

Furthermore, the Budapest Agglomeration (BAFT), has also faced major challenges in responding to suburbanisation tendencies and addressing the resulting need for greater inter-municipal political cooperation and development dialogue. Budapest must resolve problems caused by the overconcentration of economic and political functions in the central city and a lack of structural/functional cohesion between the capital and its surroundings and environmental concerns. This manifests itself in problems of accessibility, poor interconnectivity, traffic congestion and a lack of overall planning coordination within the BAFT which could seriously handicap the region. Decentralisation and comprehensive urban renewal remain central priorities for BAFT. As a result, large projects with symbolic and concrete spillover effects for urban renewal were made a CP priority. In terms of employment development and enterprise support, the agglomeration in particular has pointed to a need for development in the area of business and production-oriented services, vocational training and more effective support to enterprise networks (BAFT 2007).

Budapest and the CHR are of course at a much greater advantage than other Hungarian regions as employment growth continues to be the highest here and international investment capital still overwhelmingly favours the CHR. Nevertheless, it is difficult to disentangle the actual regional priorities as contained in CHR's 2007-2013 OP from the national OPs. As Hungary's only true gateway city, local development is at once a national development issue. In terms of the Europe 2020 headings, while enterprise support was an important priority, a strategic approach to enterprise support was frustrated by fragmentation (a large number of scattered development projects in social, physical and business development with little strategic focus) and bureaucratic tendering procedures. Furthermore, it has become clear that during the 2007-2013 period, physical

investments in infrastructure marginalised investment in human capital and enterprise development.

### **3.2 Cohesion policy coverage**

In terms of Cohesion Policy coverage, the Central Hungarian Region lost its development area status after 2007 when it was designated a phasing-in area within the Regional Competitiveness and Employment objective. The remaining six Hungarian NUTS II regions fell under the category of convergence regions: Northern Hungary, Northern Great Plain, Southern Great Plain, Southern Transdanubia, Central Transdanubia, Western Transdanubia.

According to the Hungarian National Strategic Reference Framework (The New Hungary Development Plan) Hungary was allocated 25,3 Billion EUROS for the 2007-2013 period which were supplemented with 4.4 Billion EUROS from national contributions. Of this, the Central Hungarian Region received a total 1.461 Billion within the Competitiveness and Employment Objective. However, the Budapest Agglomeration and northern parts of the CHR also received considerable amounts from Convergence OPs, particularly in the areas of transportation, energy and environmental protection. As a result, capital investments in physical infrastructure were highly concentrated in the CHR as well.

### **3.3 Europe 2020 Heading: SMEs and Enterprise Support**

The overall and officially proclaimed priority of Cohesion Policy in the CHR has been competitiveness; basically every development issue in the region is tied to questions of economic viability and the maintenance of Budapest as a locomotive of national growth. As such, in addition to obvious problems of infrastructural obsolescence and a woefully insufficient regional transportation network, a lack of economic innovation and labour market weaknesses have emerged as major issues. Enterprise support and human capital have thus become a major focus for the new 2014-2020 funding period. During the 2007-2013 period, support for enterprise development suffered from the financial crisis, risk aversion, bureaucratic tendering processes and a focus on large infrastructure projects. This changed after the 2010 election; the national-conservative government has prioritised the need for developing human resources.

The importance of supporting enterprise development is highlighted by the difficult labour market situation: The low labour participation rate, low schooling levels are seen as a long term liability and threaten Hungary's economic sustainability. While wages are not high, social contributions increase the overall costs of Hungarian labour. Only one-third of the population pays into the social security and health system.. There is also an alarming degree of social exclusion and transfer and subsistence economy dependency. These are the legacies of short-sighted and short-term privatisation and economic policies after 1989; a more active retraining and labour development policy, more adequate social policies could have vastly improved the situation.

At the same time, the structure of the Hungarian economy in terms of the overall role of small and medium-sized enterprises has not changed appreciably since 1989: the situation is characterised by a few large export-oriented companies and a sizable number of SMEs and local businesses (see Figure 1).<sup>1</sup> SMEs have had a significant role in employment and the performance of the Hungarian

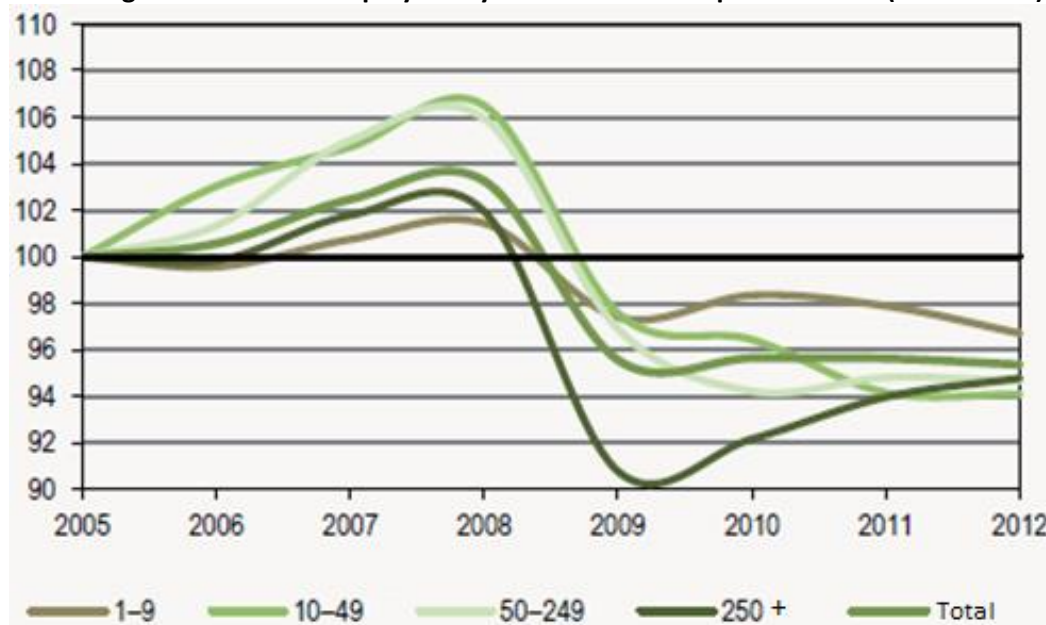
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<sup>1</sup> Businesses with less than 250 employees and that generate less than 50 Million EUR annual net income.

economy in the last 20 years. However, their innovative capacity is low. Regarding gross added value, Hungarian SMEs perform below the EU-average while they exceed EU averages in terms of employment thus raising serious productivity concerns. The basic structure of SMEs in the last decade shows minor change; they maintain a large workforce, but with low levels of capital investment.<sup>2</sup>

In 2013, there were 600,344 registered enterprises, and similarly to the 2000-2010 period, 99,9% of these enterprises consisted of SMEs<sup>3</sup> that are significant actors in all economic branches (their proportion in every branch reached 70%+). The overall number of enterprises increased by around 10% during this ten-year period while the number of firms registered as limited companies doubled compared. Within the SMEs, enterprises with 1-9 employees are the most common representing 57% of the total. The sectoral structure has not changed either in the last 5 years; the proportion around 4/5 of all SMEs operate in the tertiary sector. The proportion of businesses in the areas of agriculture, industry and building industry has increased with the size of businesses.

**Figure 1: Change of number of employees by business-size compared to 2005(2005=100%)**



Source: KSH, *Statistikai Tükör*, VII.(108) December 2013, p.2, figure 3

SMEs also manifest a low survival rate: for example, in 2011 less than 40% of SMEs founded in 2006 were still in existence. Nevertheless, SMEs remain present in labour-intensive sectors, and in 2012 employed a good 75% of the registered working population (2.7 Million people). In addition, the importance of SMEs lies in the fact that they were able to maintain most of their workforce during the years of crisis. Figure 5 shows that there is an inverse relation between the size of the company and the ability to preserve the workforce in the years of the crises<sup>4</sup>. According to data of the Central

<sup>2</sup> Based on data from The Central Statistical Office of Hungary (KSH), particularly the 2013 Statistical Report (3)J/8112 (Hungarian title: "Statistikai Tükör", VII.évfolyam, 108.szám, 2013 december, (3)J/8112. számú jelentés a kis- és középvállalkozások 2009-2010. évi helyzetéről, gazdálkodási feltételrendszeréről, a vállalkozásfejlesztés érdekében megtett intézkedésekről, valamint a kis- és középvállalkozások részére nyújtott állami támogatások eredményeiről).

<sup>3</sup> Source: KSH.

<sup>4</sup> It is also true that unlike larger companies, SMEs foundered until 2012 as a consequence of the crisis.

Statistical Office (KSH) the SME survival rate is highest among micro-organisations.<sup>5</sup> This rate was only exceeded by large multinational businesses with a survival rate of 47%; this result is explained by the fact that multinational organisations are less dependent on the national business environment.<sup>6</sup>

Hungarian SMEs can be characterised by a very strong and persistent territorial concentration: in 2012 45% of all Hungarian SMEs were located in the Central Hungarian region with 31% in Budapest, the remaining share of SMEs is distributed more or less evenly among the other 6 NUTS II regions.

From 2001 on, about 60% of Hungary's total business revenues were generated by SMEs, and as a result of their overrepresentation in the tertiary sector, 60% of SME revenues was realised in that sector. SMEs are particularly important in the areas of: construction, real estate, professional-scientific education, health-care, and social services where more than 90% of all employed persons work for SMEs. The most under-represented branch regarding SMEs is the energy sector. In 2012 the contribution of SMEs to exports reached its highest level since 2001 with 28% of total exports (6287 Billion HUF). The main areas of export are commerce and vehicle repair which made up some 91% of SME exports.

The major problem with Hungarian SMEs, and an issue that Cohesion Policy intended to target in the 2007-2013 period, is a lack of innovation. According to EU estimates, Hungary belonged to the penultimate group regarding innovation-related indexes at the end of the 2000s. In 2010, only 1.15% of GDP (310,2 Billion HUF) was spent on R&D. Furthermore, innovation is more concentrated within larger firms; in 2010 the R+D expenditure share of large firms was 56%, of SMEs only 25%. In addition, firms in foreign ownership spent almost ten times as much on innovation than those nationally owned.

## **4 Assessment of performance**

### **4.1 Financial performance<sup>7</sup>**

In terms of initial allocations the Central Hungary Region received 24% of all Hungarian Structural Funds support - a total of 2,206 Billion HUF or 723 Million Euros – within 8 OPs. Almost 80% of funds used were dedicated to the (KÖZOP) (Transport OP), TÁMOP (Social Renewal OP) and the KMOP (Central Hungarian Regions Operational Programmes) (see Figures 2,3).

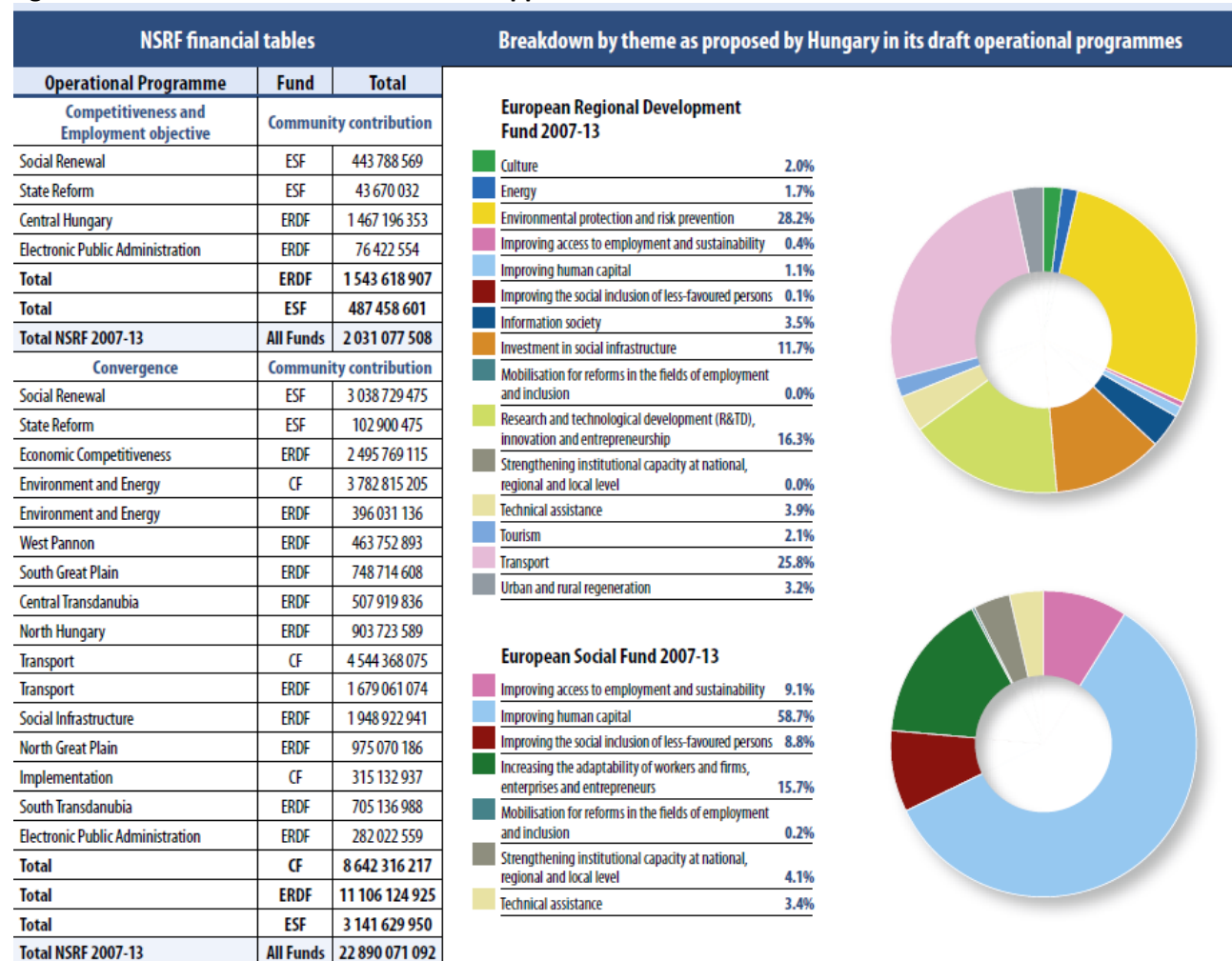
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<sup>5</sup> Only 42% of micro organisations founded in 2004 existed 5 years later.

<sup>6</sup> with more than 250 employees.

<sup>7</sup> Based largely on material available in KPMG (2013) *Értékelés a GOP pénzügyi eszközeiről* (Evaluation of the Economic Development Operational Programme 2007-2013), Budapest.

**Figure 2: Breakdown of Structural Funds Support.**



Source: Hungarian Regional Development Agency

**Figure 3: Budget Breakdowns for the 15 OPs (2007-2013); Hungarian OP acronyms provided**

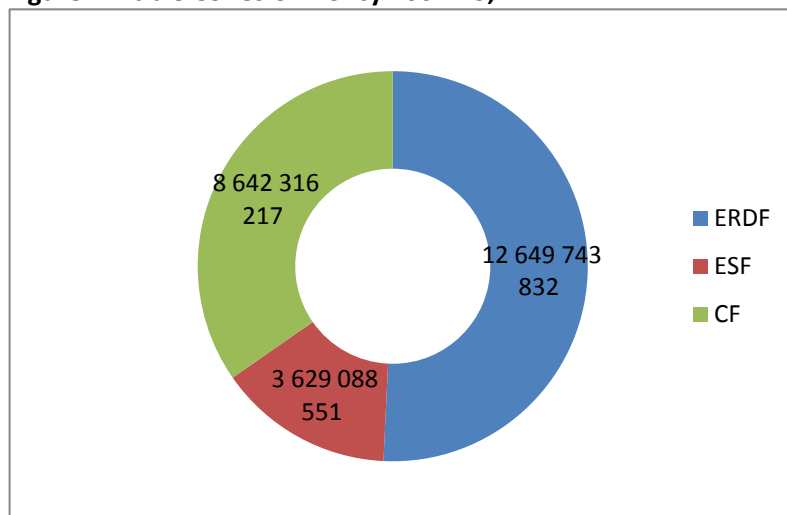
Competitiveness and Employment objective	Fund	EU Contribution (EUR)
Social Renewal	ESF	443 788 569
State Reform	ESF	43 670 032
Electronic Public Administration	ERDF	76 422 554
<b>Total</b>	<b>ERDF</b>	<b>1 543 618 907</b>
<b>Total</b>	<b>ESF</b>	<b>487 458 601</b>
<b>Total NSRF 2007-2013</b>	<b>ESF+ERDF</b>	<b>2 031 077 508</b>
<b>Convergence objective</b>		
Social Renewal TÁMOP	ESF	3 038 729 475
State Reform AROP	ESF	102 900 475
Economic Development GOP	ERDF	2 495 769 115
Environment and Energy KEOP	CF	3 782 815 205
Central Hungary KMOP	ERDF	1 467 196 353
Environment and Energy KEOP	ERDF	396 031 136
West Pannonia NDOP	ERDF	463 752 893
South Great Plain DAOP	ERDF	748 714 608
Central Transdanubia KÖDOP	ERDF	507 919 836
North Hungary EMOP	ERDF	903 723 589
Transport KOP	CF	4 544 368 075
Transport KÖZOP	ERDF	1 679 061 074
Social Infrastructure TIOP	ERDF	1 948 922 941
North Great Plain EAOP	ERDF	975 070 186
Implementation VOP	CF	315 132 937



South Transdanubia DDOP	ERDF	705 136 988
Electronic Public Administration EKOP	ERDF	282 022 559
Total	CF	8 642 316 217
Total	ERDF	11 106 124 925
Total	ESF	3 141 629 950
Total NSRF 2007-2013	All	22 890 071 092

Source: National Development Agency

**Figure 4: Table Cohesion Policy 2007-13,**



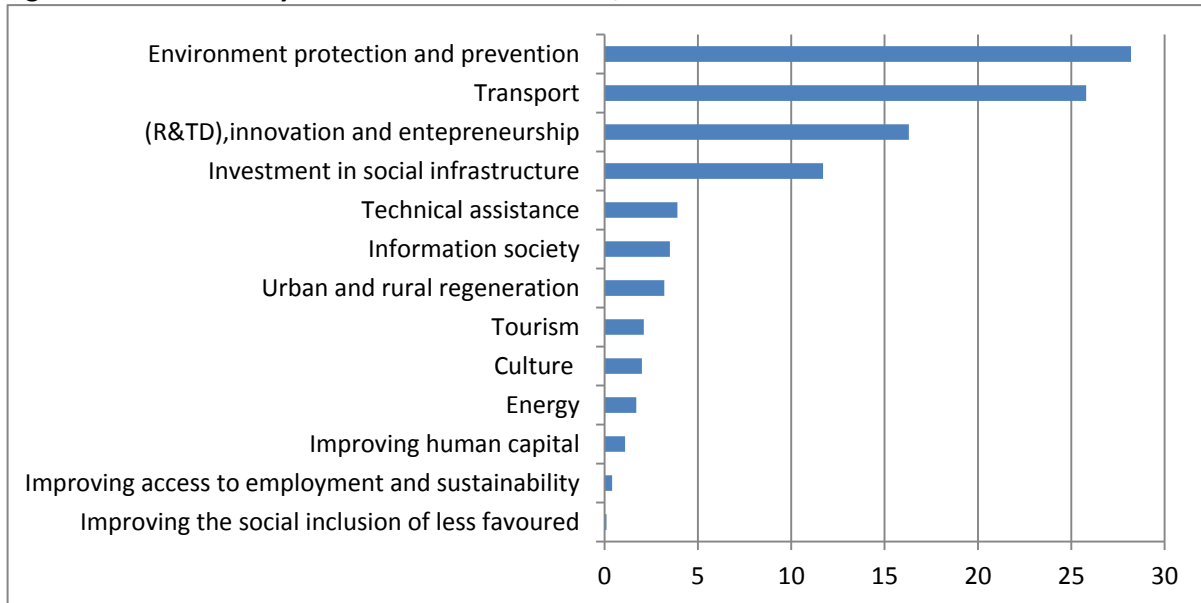
Source: National Strategic Reference Frameworks, 2008 NSFR financial table, page 51

More than half of the total 24,9 Billion Euro contribution came from the ERDF (12,6 Billion), one third (8,6 Billion) from the CF and the remaining part from ESF (see Figure 4). More than half of ERDF sources were allocated to environmental protection and transport (see Figure 5). This area, together with R&D and improving social infrastructure accounted for 80% of all ERDF funds, while the ESF focused on improving human capital (almost 60% of sources were allocated to the topic). As a result the two programmes with the strongest support are the Transport OP and the Environment and Energy OPs that absorb more than 40% of total structural funds. Both OPs intend to reach the two structural goals of the New Hungary Development Plan: sustaining long term growth and creating jobs; as the development of transport system intends to increase the mobility of workforce at national level and attracts investment and modernisation of the energy sector intends to create new jobs (see Figures 6,7).

**Figure 5: Intended and Actual Transport and Environment and Energy OP Allocations for the Central Hungarian Region**

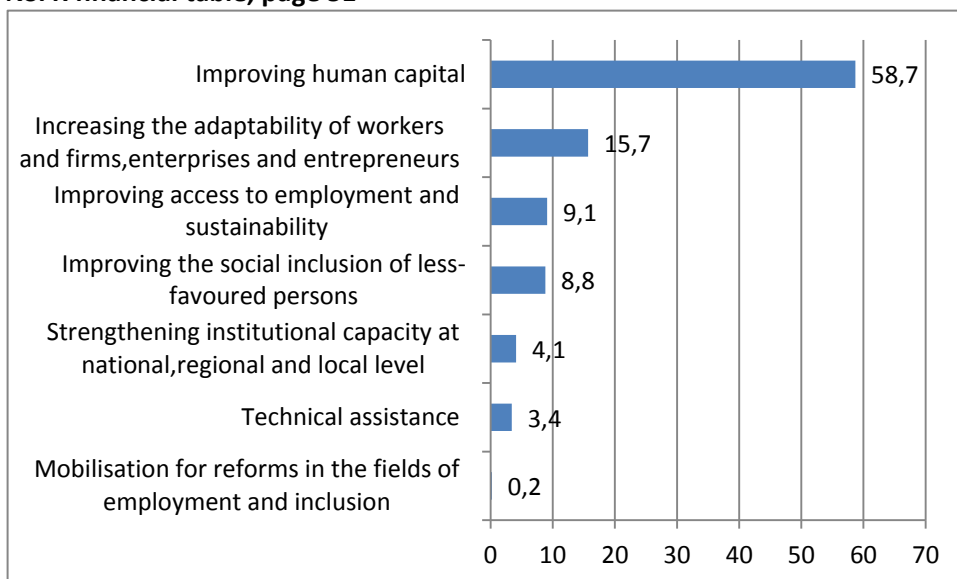
OP priority code	Intended support	Allocated support	Contracted Amount	Total support use
KEOP-1	941 955 641 898	748 634 262 247	718 911 615 497	239 987 305 459
KEOP-2	652 463 407 237	476 194 409 543	431 681 322 228	201 666 919 930
KEOP-5	212 977 411 852	105 513 324 040	88 312 471 729	34 917 883 469
KEOP-7	108 118 155 892	50 655 996 119	45 833 639 360	28 222 799 851
KÖZOP-1	648 789 087 125	480 978 512 206	387 741 249 047	245 489 525 994
KÖZOP-2	1 037 885 787 584	766 721 687 334	694 998 424 026	304 746 013 618
KÖZOP-4	51 766 561 691	36 250 616 659	35 664 952 359	28 598 342 724
KÖZOP-5	953 023 730 280	621 457 687 997	528 601 721 946	243 227 686 926
Total	4 583 739 551 596	3 286 406 496 145	2 931 745 396 192	1 326 856 477 971

**Figure 6: Breakdown by theme of ERDF 2007-2013,**



Source: National Strategic Reference Framework (2008)

**Figure 7: Breakdown by theme of ESF 2007-2013, National Strategic Reference Framework (2008) NSFR financial table, page 51**



Source: National Strategic Reference Framework (2008).

## 4.2 Entrepreneurial support

After the crises resources were reallocated to the GOP (Economic Development OP) in order to stimulate job creation. There were three main types of projects: (1) Major projects, (2) Priority projects managed centrally and where the approval of the Government is needed and most importantly for human resources and SME development (3) smaller projects emanating coming from calls. By March 2010, 7 major projects had been accepted by the EUB from the field of transport; development of road and train infrastructure and 9 that support environmental projects (waste water management, flood-protection). By the end of 2009, 358 priority projects had been approved

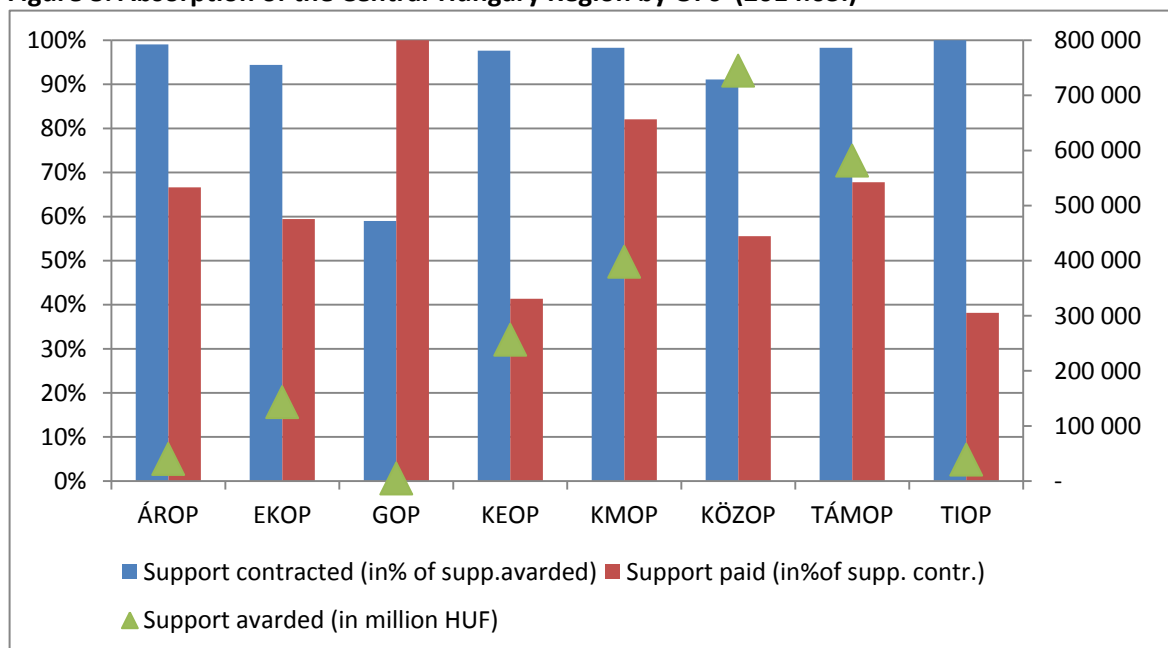
by the Government. However, implementation began only in transport, ESF funding and some regional programmes.

Smaller projects contracted as a result of calls for proposals showed most progress, especially in the last quarter of 2009. Almost half of the contracted funding fell to projects supported under the Economic Development OP (or GOP), the Social Infrastructure OP and the Environment and Energy OP. The implementation of the Jeremie scheme, the micro-credit programme supporting SMEs, seems to be the most advanced intervention in this context.

In order to decrease the negative effects of the financial crises and to reflect changes in government objectives in 2011 (e.g. entrepreneurial development and energy-efficiency became a main priority). In 2011 two packages of modifications were submitted by Hungary to the EUB. The first one included the modification of the Economic Development OP, the second one a reallocation of sources between and within OPs. The first package: Modification of the Economic Development OP, were made public on 16 February 2012, This included: (1) basic-researches (alapkutatás), and (2) “Extremely Light Infrastructure” projects as major projects feeding into the Economic Development OP. (3) combination of funds from GOP and rural development aid from the New Hungary Development Programme – ÚMVP) in order to increase employment outside of major urban areas. As a result GOP and the Regional OPs were able to finance micro businesses regardless of settlement size. In addition, regulations regarding tendering became less strict, the support applicants could demand increased, costs that could be claimed were also increased.

In terms of the absorption of GOP funds in the Central Hungarian Region, More than 90% of the awarded sums could be contracted (see Figure 8). In addition, Budapest itself received all of the support within the framework of priority 3. The amounts paid out in terms of OPs varied between 41% (KEOP) and 100% (GOP).

**Figure 8: Absorption of the Central-Hungary Region by OPs (2014.03.)**



Source: NDA

The impacts of the financial crisis and restrictive fiscal policy both had a negative effect on the business environment and the implementation of Cohesion Policy goals targeted at entrepreneurial development. In order to address the worse than expected economic and business climate, NHDP sources were reallocated from Regional OPs and the Transportation OP (KÖZOP) to the GOP with the aim of supporting small and medium-size enterprises. On the one hand the reallocated support targeted the most disadvantaged and less qualified enterprises. On the other hand, it aimed to preserve the competitiveness of the national economy by the improving the business climate.

Overall, the financial performance, measured in terms of actual use of funds, has been relatively good (see Table 9). There has been a clear emphasis on auditing and monitoring in order to ensure appropriate use and legitimate expenditures.

**Table 9: Framework for assessment of financial performance**

	<b>Strong (A)</b>	<b>Significant (B)</b>	<b>Moderate (C)</b>	<b>Weak (D)</b>
	Most or all funds committed, no decommitment, substantial level of payments made	Above-average commitment of funds, below-average decommitment, above average level of payments made	Average or below-average commitment of funds, above-average decommitment, payment levels below average	Significantly below average commitment of funds, and/or significantly above average decommitment, payments made significantly below average
OP				
Social Renewal TÁMOP				
State Reform AROP				
Economic Development GOP				
Environment and Energy KEOP				
Transportation KÖZOP				
Electronic Administration EKOP				
Social Infrastructure TIOP				
Central Hungary KMOP				

Economic Development was the only OP in the Central Hungarian Regions which was fully used. After a slow start in 2007 and the crisis of 2008 redoubled efforts on the part of the government to make the use of Cohesion Funds for SMEs more accessible paid off. High demand for support and more flexible rules contributed to this good result.

### **4.3 Physical performance**

In contrast to financial performance, which was based on flows of funds and their use, physical performance lagged considerably (see Table 10). In the words of one of our informants, now responsible for 2014-2020 Cohesion Funds planning at the Hungarian National Bank, the added value of EU structural funds during the 2007-2013 phase was in GDP terms at best 0,5%. During the

worst part of the crisis, in the years 2008 and 2009, this contribution to GDP was probably higher, but not sustainably so. This result was far below the government's expectation.

The expected impacts of the Cohesion Policy for the specific area of Enterprise Development were: 10% in the added value generated by enterprises and a 4% increase in the number of employees outside the public sphere by 2015. Nationally, the aim was established to create 100.000 new workplaces by 2015, around 1/3 of these were achieved by the end of 2011. 2/3 of these new jobs were attributed to the Economic Development element (GOP), 1/3 from the Regional OPs. By the end of 2011, ROP-s achieved more than 50% of the targets regarding new investments. The goal of creating industrial parks was fulfilled to 40% of that planned. As several informants pointed out, these targets of course say nothing of the real multiplier effects of investments. As such the real GDP and socially relevant impacts are much harder to measure.

One of the hindrances to better physical performance was the relatively modest focus on enterprise development and human capital in general (note: here again the point has been raised that too many resources were allocated to large infrastructure projects that mainly generated short term employment and balance-sheet effects).<sup>8</sup> As GOP and the KMOP-JEREMIE microfinance scheme targeted at SMEs started with some difficulty, in 2009 there was a need for easing the conditions for approving grants and loans; from 2009 the situation of the banks has been strengthened with a very diverse results; some of the measures were successful (Széchenyi Kártya), while the banks offering a loan portfolio with a state contribution decreased their activity. In 2009 assumptions of liabilities (kötelezettségvállalás) were signed by some 80437 beneficiaries (82.3% of all beneficiaries were SMEs), in 755 Billion HUF, and they received 42% of all sources allocated to SMEs. For 2010 there was a liability of 694.1 Billion HUF, for 70.093 beneficiaries (85% SMEs, who received 42.8% of the total). Regarding payments 83.5 % of all beneficiaries were SMEs (312.000 SMEs) to whom 576 Billion HUF was paid out. Within the framework of NHDP (New Hungary Development Plan) 11,330 SMEs has been supported, for 383.4 Billion HUF. 54% of all beneficiaries were SMEs, who received less than 1/5 of the total budget.

The most common form of financing is through bank loans, the use of capital markets is atypical in Hungary. Since the transition there were several measures made to improve the situation of SMEs. In April 2013, the "Credit Programme for Growth" (Növekedési Hitelprogram) was introduced by the National Bank. As a result of this measure, 750 Billion HUF (2.5 billion Euros) were set aside for SMEs, and total of 701 Billion HUF (2.2 billion Euros) were contracted. In the framework of this programme, SMEs were able to take out 10-year loans at a 2.5% interest rate. For the second phase of the programme 2000 Billion HUF (6.7 billion EUROS) will be made available.

**Table 10: Framework for assessment of physical performance**

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<sup>8</sup> Interview with consultant, Budapest, 28/1/14.

	<b>Strong (A)</b>	<b>Significant (B)</b>	<b>Moderate (C)</b>	<b>Weak (D)</b>
	Targets exceeded, above average for the programme as a whole	Progress towards targets on track, average for programme as a whole	Progress towards targets behind schedule, below average for programme	Progress towards targets severely constrained, Significantly below programme average
OP				
Social Renewal TÀMOP				
State Reform AROP				
Economic Development GOP				
Environment and Energy KEOP				
Transportation KÖZOP				
Electronic Administration EKOP				
Social Infrastructure TIOP				
Central Hungary KMOP				

#### **4.4 The performance of GOP (Economic Development OP) in the Central Hungarian region**

The total support received by Hungary from the Structural Funds was 9.16 Trillion HUF (that is, 30,5 Billion Euros) and 11,56% of this was dedicated to the GOP (1.06 Trillion HUF or 3,53 Billion Euros).<sup>9</sup> In the case of the Central Hungarian Region, the GOP was supplemented with an awarded sum of 168 Billion HUF (480 Million Euros) from the 1. Priority of KMOP (Central Hungary OP)<sup>10</sup> or 36% of total KMOP budget. Within the framework of GOP, 25,500 contracts were signed in total in Hungary. The GOP had 4 priorities:

- R&D and innovation for competitiveness
- Complex development of SMEs.
- Strengthening modern business environment (introduced in May 2012 with an allocated budget of 63,1 Billion HUF, (225,5 Million Euros)
- Jeremie financial tools

Furthermore, 4 indicators were defined to measure effectiveness of the GOP: 1. Added value produced by the business sphere, 2. Number of jobs created, 3. Change of e-business index, 4. Private investment generated by the project. The programme was aimed at supporting R&D activities, business innovation, SMEs, business infrastructure and enterprise development in Convergence regions. In total 25,500 contracts were signed to the end of 2013, and 95% of winner

<sup>9</sup> Note: Most of the information in this section of based on the HÉTFA Centre for Analysis reports of 2013 and 2012.

<sup>10</sup> The full title: Innovation and business-oriented development of knowledge-based economy (A tudásalapú gazdaság innováció- és vállalkozás-orientált fejlesztése).

projects in the Priority 2 (development of SME-s) were SMEs. 2011-2012 changes in the OP were mainly aimed at decreasing the risk of low absorption (and because the structural environment had changed): New activities were supported, and the target groups were enlarged. As a result of reallocations, GOP received an extra budget of 111 Billion HUF (370 Million Euros). In 2009 and 2010 the conditions had to be made less strict so that make tendering smoother for enterprises.

There is no question that at least in the case of Central Hungary, support for SMEs was made much more accessible and user-friendly, the considerably enhancing the absorption rate of funds targets at enterprise development. However, in terms of fulfilling the 4 main indicators of programme efficiency, job creation and the creation of long-term jobs in particular has been a disappointment. Our informants also claimed that there have been limited effects in terms of innovation and that much of the investment has been for short-term use or maintaining present levels of employment. In order to improve absorption rates, furthermore, a rather liberal attitude towards support seeking firms was taken.

Physical performance has been disappointing but improving. It is also likely that the overall targets set were too ambitious. There is a realisation that a more proactive grant selection and monitoring process is needed in order to ascertain the feasibility of targets and whether they are being met. While SME support has been used to virtually full extent, job creation and innovation targets have been disappointing. This could also be due to longer lasting effects of the financial crisis and economic downturn but there is a need for a more strategic approach.

#### **4.5 Added value**

The assessment of added value of the 2007-2013 Cohesion Policy period for Central Hungary varies according to the specific types of impact (see Table 11). Overall, according to the model simulation of the Strategic Report of Hungary (2012) and our informants, Cohesion Policy accounted for an additional 0.5% of economic growth over the 2007-2013 period - appreciably less than anticipated. According to Hungarian Reports and based on international experience the sustainability of these interventions has not been obvious; they may increase employment during the period of the support, but after it there can be problems regarding sustainability. According to projections, therefore, the largest effect on employment is forecast for 2015 (a growth in the number of employees of up to 2% above what it otherwise would be, but after then this effect will diminish). The effect on investment may be similar – up until 2015, rapid growth may be expected relative to a non-intervention scenario, but after, the effect is reduced and multiplier effects are modest.

One problem affecting the full exploitation of Cohesion Policy benefits for SMEs was the difficult business environment which favoured risk aversion and conservative investment behaviours, As a result of this, several measures were introduced by the Government; in 2010: a “Science and innovation” programme, business taxes have has been reduced and 10 minor taxes were eliminated. In addition several programmes were introduced from 2010 and The 2007 “Strategy for development of SMEs” defined a long-term development-direction for SMEs, but according to the evaluation of EDOP<sup>11</sup>, it could not reach their goals as the document was not officially approved by the Government and because it did not define the managing organisations, their tasks and

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<sup>11</sup> HÉTFA Centre for Analysis (2012).

responsibilities also remained undefined. In addition, from 2010, several changes were made in the legal environment to boost business activity<sup>12</sup>.

Seen from the perspective of transportation and urban development, EU-sources have been very important for the Budapest Agglomeration (BA); Cohesion Funds have been essential in covering urgent and relevant needs both for the region as a whole and for the individual municipalities, whereby large-scale infrastructural investments targeted for Budapest have almost automatically a regional impact. According to one interviewee: *“If Budapest had not had Cohesion Fund-sources, no major public investments would have taken place here”*. Indeed, If Budapest had not been able to apply for CF funds, the city itself could never implement such major projects due to budget limitations and the consequences of fiscal crisis. There is agreement that in the case of the Budapest Agglomeration, CF-funded projects nearly always reflect regional needs, the money has been put to good use. For instance, there has been a decades-long demand for the reconstruction of bridges, tramlines, metro-and suburban lines - plans based on the designs of experts but have remained in a state of limbo almost since the 1970s.

One interesting note was made by interviewees: Unlike CF-projects, ESF projects do not always reflect regional needs, since the whole tendering system in this case tends to be very bureaucratic, and often administrative and formal criteria are taken into consideration instead of professional ones. Experts argue that Budapest would also need many more smaller projects, for example regarding the provision of barrier-free access to public facilities. Above and beyond this, additional value was provided by the 2007-2013 phase in terms of a learning process (see below). Dealing with the complexities of strategic approaches to regional development as well as interagency cooperation is seen as an important step in developing more efficient project development and management practises.

**Table 11: Framework for assessment of programme performance: added value**

Added value	Strong (A)	Significant (B)	Moderate (C)	Weak (D)
Financial	Substantial financial partnerships in operation - pooling of private and public co-financing	Substantial financial partnerships in operation but dominated by public resources	<b>Limited leverage of additional funding, mostly public and at project level</b>	Availability of additional funding severely constrained
Strategic	CP programming principles now evident across all domestic policy systems  CP objectives and priorities comprehensively and explicitly incorporated into domestic strategies (e.g. RTDI, business support etc.)	CP programming principles apparent in domestic policies most relevant to CP priorities  CP objectives and priorities given explicit reference in relevant domestic strategies	<b>CP programming principles only apparent in CP strategies</b>  <b>Limited explicit reference or implicit reference to CP in relevant domestic strategies</b>	CP programming principles only apparent in CP strategies  No reference to CP in relevant domestic strategies
Operational	CP systems for project generation, appraisal and selection have produced innovative approaches that are now embedded across domestic policy system	<b>CP systems for project generation, appraisal now evident in some specific domestic policies</b>	Some elements of CP systems for project generation, appraisal and selection evident in a limited number of domestic policy systems	CP systems for project generation, appraisal not fully operational or not used outside of CP programmes

<sup>12</sup> The main areas of the changes affected the processes of authorities, the law for public procurement, taxing rules, and simplifying the regulation of accounting.



Accountability	<b>Extended use of CP monitoring, reporting, financial management and evaluation requirements across domestic public policy system</b>	Use of CP monitoring, reporting, financial management and evaluation requirements in some domestic policies	Use of some elements of CP monitoring, reporting, financial management and evaluation requirements in a limited number of domestic policy systems	CP monitoring, reporting, financial management and evaluation systems not fully operational or not used outside of CP programmes
Democratic	Increased consultation, partnership-working structures in policy-making, derived from CP partnership principle	Increased consultation, partnership-working structures evident in some domestic policies	<b>Partnership-working and consultation associated with CP, limited evidence of structures but some elements evident in a limited number of domestic policy systems</b>	Partnership-working, consultation in CP weak, not in evidence outside of CP

Added value measured by numerical targets is clearly disappointing. Accountability has operated according to high standards, but a strategic and less bureaucratic approach to implementation is still lacking. This has been a major recognition by the policy actors who attribute new, more effective approaches to a learning process. Again, a major added value has been the learning process and the realisation that Economic Development, and Enterprise Support in particular, cannot flourish as part of CP if overall business environments and business cultures are not taken into consideration.

## 5 Strategic quality

This is perhaps the weakest aspect of CP in Hungary. While the evaluation reports tends to put a more positive light on strategic aspects, our informants have been almost unanimous in their criticism. In addition, it is emphasised that strategic quality also has clear administrative and procedural components and thus cannot be easily separated from management. The problem lies in a lack of ability to deliver a tendering and tendering support mechanism that can achieve maximum synergy effects. Some of the reasons for this will be elaborated below.

In terms of the analytical base of the 2007-2013 Cohesion Policy for CHR and Hungary as a whole, a rather accurate and comprehensive set of data were used to perform SWOT analyses and a regional diagnosis of priority areas of action. The main development goals of the CHR were related to physical infrastructures (inter- and intra-urban transportation in particular), human resources (including enterprise development) and environmental quality indicators necessary for enhancing competitiveness.

The actual programming phase went relatively smoothly. However, there was a large gap between the general strategic goals as indicated in the basic programming documents – which were comprehensive – and the actual implementation. All our interviewees concur in that no workable regional strategies and synergy effects are possible at the NUTS 2 level without a commensurate level of regional institutionalisation – this is lacking in the Hungarian case where the trend has been to recentralisation and national coordination of all regional programming and toward project competition between municipalities. Thus, the fact that the Central Hungarian Region had very little coordinating capacity and that cooperation within the BA is similarly weak results in a highly fragmented pattern of project development, particularly with regard to smaller projects of local

impact. As a result, municipalities within the BA end up competing against each other for individual measures that are not strategically related, often despite close proximity, resulting in a costly and wasteful duplication of investment.

Enterprise support, which was a major competitiveness target, suffered considerably because of a fragmented and complex approach to tendering. Given the difficulties facing businesses during the crisis and the fear of poorer absorption rates, the conditions for tendering were eased but without commensurate quality controls in order to ensure that money would be spent on viable projects.

### **5.1 Strategic aspects and problems of an institutional, administrative nature<sup>13</sup>**

Although in 2008 Hungary was one of the best performing countries regarding CP absorption, the strategic development and implementation of CP in the CHR and in Hungary as a whole were hampered by serious institutional shortcomings (see Table 12). According to the independent evaluation of the State Audit Office (ÁSZ), the root causes of the low level of strategic focus included the issues raised below.<sup>14</sup>

The main criticism appearing in both in the most recent (2013) as well as previous evaluations is that from 2007 on the realisation of Cohesion Policy was subordinated to the dictates of political will rather than to the strategic considerations that had informed the national framework; the general aim has always been to reach the most spectacular and well-communicable results instead of ensuring real effectiveness. According to Perger (2009) the actual political interventions in the Cohesion Policy process have always been obvious; the direct political interventions has been ensured by the organisational and regulatory system. For example the government commissioner, participating in the coordination of implementation, the FIT being chaired by the Prime Minister, that enabled to the Prime Minister or the Commissioner to intervene even at a project level that was a common scheme. According to Perger (2009) the political impact is obvious in the choice of Monitoring Committee members; the composition of NGO representatives is determined by the Government.

The 2013 evaluation points out that the lack of strategic evaluation and controlling mechanisms has been compensated with change of the legal system. Indeed, research (e.g. Bartha, Matheika and Gyukics 2010) and our interviewees have pointed out that high absorption rates themselves are the goal, and indicators used for measuring effectiveness, usually output indicators, are not proper tools. While the overall programming was indeed strategic in nature, the actual implementation in the case of the Budapest Agglomeration was less than satisfactory. A major weakness with regard to regional implementation was the treatment of Budapest as an isolated unit instead of as a part (or the centre) of a much larger agglomeration and regions. As a result, the Budapest and surrounding municipalities could not take advantage of synergies by tendering together, but in fact competed with each other for the same grants.

Transportation was another key example of the difficulties of implementing Cohesion policy in Hungary according to a strategic approach. With an EU contribution of 7.090 million EURs<sup>15</sup> plus a

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<sup>13</sup> ÁSZ-jelentések.

<sup>14</sup> [http://palyazat.gov.hu/intezmenyfejlesztesi\\_ertekelesek](http://palyazat.gov.hu/intezmenyfejlesztesi_ertekelesek), AAM Consulting Zrt (2013).

<sup>15</sup> <http://palyazat.gov.hu/kpih>.

domestic contribution of 1 904 618,996 million HUF the TOP enjoyed the largest budget among the 15 Operational Programmes identified in the New Hungary Development Plan for 2007-2013, a.k.a. the National Strategic Reference Framework of Hungary<sup>16</sup>. In the meantime, in the summer of 2008, the Commission suspended interim payments in the TOP, as the OP Annual Report was rejected on the grounds of not containing any indicator values.

**Table 12: Assessment of strategic quality**

Strategic quality	Assessment of strategic quality			
Specific indicators	Strong (A)	Significant (B)	Moderate (C)	Weak (D)
Programming process	Processes clearly defined and implemented well	Processes clearly defined and implemented adequately	<b>Processes defined, but implemented inadequately</b>	Processes poorly defined and implemented inadequately
Negotiation and approval	Efficient and speedy negotiation and timely approval	Minor delays in negotiation/approval	<b>Major problems with negotiations but minor delays in approval</b>	Major problems with Negotiations, significant delays in approval
Quality of programme documents	Well-structured Documents, clear strategic focus	<b>Programme documents with some deficiencies in strategy</b>	Programme documents without a clear strategic focus	Programme documents with major deficiencies in strategy
Treatment of specific policy heading	Detailed, explicit reference to policy heading in programme strategy, adjusted to and appropriate to regional socio-economic context, strong links with related strategies	<b>Explicit reference to policy heading partially adjusted to regional socio-economic context</b>	Explicit reference to policy heading, limited adjustment to regional socio-economic context, limited reference to related strategies	Limited/implicit reference to policy heading, not adjusted to regional socio-economic context, no reference to related strategies

The programme strategy was produced according to indicators developed through measured SWOT analyses that took into consideration various Cohesion Policy target areas. However, the overall strategy was very much subject to central government agendas and political interests. Centralisation has led to a lack of sensitivity to local needs as and has subsumed them within more general national goals.

A complex tendering system and lack of support (e.g. orientation and guidance) for potential grant-seekers made for a slow start. This situation improved somewhat but is still not satisfactory. In addition, the lack of a truly regionalised grant negotiation and approval process made the selection of projects with a territorially strategic focus, for example on specific firms in urban networks, almost impossible.

The overall quality of the documents was satisfactory. The documents themselves do suggest that a strategic approach is understood.

After the initial slow start, the Hungarian government and responsible agencies strove to enhance the importance of enterprise development and support within CP. One strategic way this was attempted was to combine support to SMEs with research, training, rural development objectives, etc.

<sup>16</sup> "Új Magyarország Fejlesztési Terv" in Hungarian.

## 6 Administrative capacity

In part 5.1 we will provide an overview on the structure of the administrative system and its improvement before and during the 2007-2013 period based on available literature and interviews, while in part 5.2 we evaluate the system from administrative capacity's point of view based on literature and the interviews we conducted.

### 6.1 Building up the institutional system before 2007

Between 2004 and 2006, 6% of the overall sum received from the Structural Funds - (670 Billion HUF or 2,1 Billion EUROS) were spent on building up and strengthening the administrative capacity for the future programming period including monitoring, communication, IT systems, and accounting. According to the leader of the (NDA, coordination MA), there was a huge need for strengthening these capacities both from a quantity and quality point of view. As a result of PHARE-projects the number of employees working in coordination (at (former) NDA and the ministries) increased by 40-50% by 2006. As a result, a relatively complicated institutional system was developed with members involved in managing, implementing and evaluating the Cohesion Policy.<sup>17</sup> Between 2007 and 2013 several changes took place (see 5.2), in Table 5 we will provide the latest organizational structure of actors in 2013. The former National Development Council was merged with the NDA after 2010 when the Second Fidesz government assumed power. The coordination of planning and implementation and managing functions were then delegated to the NDA. From 2006 to 2010 the NDA functioned as a centralised governmental agency but with the reforms of Orban's government the NDA came under the supervision of the Minister for National Development and thus much more susceptible to political control (see Figure 13, Table 15).

**Figure 13: Management and implementation structures**

Programme management	Responsible body	Notes
Managing Authority	<b>National Development Agency (NDA)</b> <sup>18</sup>	Central
Certifying Authority	<b>Auditing Authority within the Ministry of Finance</b>	Central
Audit Authority	<b>Audit of European Funds (DGAEF)</b> <sup>19</sup> , <b>State Audit Office of Hungary (ÁSZ), Government Control Office</b> <sup>20</sup>	Central
Intermediate Bodies	<b>15 IBs, see Table 15</b>	Central
Other Bodies (e.g. at regional or local level) <sup>21</sup>	<b>Monitoring committees (MC)</b>	Central

The most spectacular aspect of institutional change was the establishment of the NDA by concentrating all managing authorities to one institution in 2006. NDA in co-operation with the ministries concerned is responsible for the planning and implementation of the entire New Hungary Development Plan as well as for performing managing authority functions with respect to all operational programmes. Managing Authorities are also incorporated into the NDA. The Managing Authority of the operational programme is responsible for the orderly, efficient and successful use of

<sup>17</sup> their tasks were defined by the New Hungary Development Plan (2007).

<sup>18</sup> Nemzeti Fejlesztési Ügynökség in Hungarian.

<sup>19</sup> EUTAF in Hungarian.

<sup>20</sup> KEHI in Hungarian.

<sup>21</sup> In addition National Development Council (NDC) Development Policy Steering Committee was also founded and eliminated since then.

assistance provided for the individual operational programmes (OP). All managing authorities operate as independent departments of the National Development Agency.<sup>22</sup> The tasks and responsibilities of intermediate Bodies (IB) and the IB-s itself has also been redefined within the 2007-2013 period (see 5.2).

Between 2007 and 2013 the Managing Authority (NDA) was in charge of setting up the Monitoring Committees to oversee each individual OP. There was one MC for ROP (Regional OP) and each region was also assigned a sub-MC. The MCs were in charge of supervision of the OP-s, around half of their members consisted of political actors, and another half of NGO-s. The chairpersons of the MCs are defined by law<sup>23</sup>; and it is chaired by the person appointed by the Member State, the prevailing member of the Development Policy Steering Committee responsible for the programme area concerned. In the New Hungary Development Plan the members of the MCs were defined very clearly. They included representatives of Managing Authorities, Ministries involved in implementation, IBs of the OPs concerned, Development Councils, One representative from the municipality, two representatives from the National Council for the Reconciliation of Interests, one representative from an NGO from the field of environment protection, one representative of NGOs from the field of Equality of chances regarding Roma, gender and the disabled, representatives from professional organisations in the topic. Although the IB-s had the right to be present on the MC-s meetings, the

The Government Control Office (KEHI), ÁSZ and DGAEF provide controlling authority functions in case of every OPs. The KEHI is governed by the Minister responsible for the organisation of Public Administration. Audit of European Funds (DGAEF) was established in 2010 as an autonomously operating central budgetary organisation within the chapter of the Ministry for National Economy and is in charge of carrying out audit authority tasks regarding European Union and other international funds determined by the Government. They ensure that the controlling process is based on the international standards, the coordination of controlling at national and EU-level, controls projects based on sampling. The Certifying Authority is a separate organisational unit (National Authorizing Office) of the Ministry of Finance. The Certifying Authority for all operational programmes is financed by the Structural Funds and the Cohesion Fund and works as a separate organisational unit.

Between 2007 and 2013 the Managing Authority was in charge of setting up the Monitoring Committees to oversee each individual OP. There was one MC for ROP (Regional OP) and each region was also assigned a sub-MC. The MCs were in charge of supervision of the OPs. The chairpersons of the MCs are defined by law<sup>24</sup>; is chaired by the person appointed by the Member State, the prevailing member of the Development Policy Steering Committee responsible for the programme area concerned. In the New Hungary Development Plan the members of the MCs were defined very clearly. They included representatives of:

- Managing Authorities
- Ministries involved in implementation
- IBs of the OPs concerned

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<sup>22</sup> For the detailed system of the managing bodies see Table 15 .

<sup>23</sup> 1083/2006/EK 64. Art 1. Paragraph.

<sup>24</sup> 1083/2006/EK 64. cikk 1. Bekezdés.

- Development Councils
- One representative from the municipality
- Two representatives from the National Council for the Reconciliation of Interests
- One representative from an NGO from the field of environment protection
- One representative of NGOs from the field of Equality of chances regarding Roma, gender and the disabled
- Representatives from professional organisations in the topic

Around half of the members of MCs are from NGOs, and the other half is made up of political actors.

## 6.2 Assessing administrative capacity during the 2007-2013 period

This section is based on available literature, such as the mid-term and ex-ante evaluation reports regarding the institutional system of Cohesion Policy in Hungary. It also is based on interviews conducted with representatives of the National Development Agency (MA), IBs, the Hungarian National Bank and beneficiaries<sup>25</sup>. There is a lack of synchronicity between changes in formal institutions at the level of policy-making and the persistence of older informal institutions (rules of actions, beliefs etc.) at the level of everyday culture (Tatur, 2004). In addition, the search for new policy mechanisms is often accompanied (ironically) by an extreme politicisation of policy issues, social fragmentation as well as ideological polarisation.

Although there is no question in the literature that administrative systems are a key factor in the effective distribution of EU resources, the analysis of relations between the two is quite underdeveloped. On the one hand, the indicators used for measuring effectiveness do not measure real but rather a “pseudo” effectiveness as they usually measure absorption rates or are based on estimates generated by macroeconomic models. The former is not a sophisticated and proper tool because it is obvious that spending a certain amount of money does not guarantee that the money is spent well; according to several sources good results can be achieved independently of the real financial contribution to the strategic aims. Achieving proper absorption is a necessary but not in itself sufficient element of real effectiveness. The statistical analysis of macro-economic indicators (increase in GDP/capita, decrease of unemployment rate) can be also regarded as uncertain as these cannot take into consideration “added values” that can be also an important, if not the most important element of the achievements and they can be affected by several external factors. According to Perger (2009, 2010) the institutional system should be evaluated both from an EU and a national perspective as national and EU objectives do not fully overlap. The main question is the relation between the EU’s strategic aims and national policy objectives and whether fulfilling EU objectives contributes to or hinders the achievement of national goals.

Administrative capacity during the 2007-2013 period is characterized by a decidedly mixed record (see Table 14).<sup>26</sup> Although there were remarkable changes in the system between 2007 and 2013,

<sup>25</sup>ZÁRÓ ÉRTÉKELÉSI JELENTÉS a 2007-2012 időszak végrehajtási funkcióinak értékeléséről, AAM Consulting, 2013.

Értékelő Jelentés, Az ÚMFT projekt kiválasztási eljárásainak értékelése, Ernst&Young, 2010.

Evaluation of the project selection procedures under the New Hungary Development Plan (ÚMFT).

ZÁRÓ ÉRTÉKELÉSI JELENTÉS a szabályozási kööttségek értékeléséről, 2012, AAM Consulting.

<sup>26</sup> As Perger (2009) points out, the institutional structure was of a special and mixture regarding the two main aspects of evaluation of institutional systems; the level of integration and centralisation. Although the institutes were not integrated into the national institution system and financial integration took place neither as rules and laws for EU

the system still remained problematic from an administrative capacity point of view. First we will review the main changes, than the most urgent problematic issues mentioned by the interviewees and the literature also. The Strategic Report of Hungary (2012) lists three main area where positive changes took place since 2007. Firstly, a reconsideration of the legal environment took place in which rules regulating the EU-s financing were melted into one law<sup>27</sup>; and one handbook has been made by the ministry<sup>28</sup> in order to improve transparency of the legislation, law on public procurements has been simplified) tendering became less complicated, deadlines shortened, that was also mentioned by almost all of our interviewees as an improvement.

A second major change/improvement was in the administrative system itself where many CP functions were centralised within the National Development Agency ; more and more MA functions have been provided centrally.<sup>29</sup> Tasks of MA-s and IB-s has been redefined: IB-s received more freedom in concrete technical issues regarding tenders. As a result of defining the responsibilities precisely duplications decrease, and performance of each actors became measureable. In order to decrease fragmentation and inefficiencies intermediary bodies were set up by concentrating intermediary functions to a few bigger institutions (15 instead the previous 22). As a result each OP has one IB: like ESZA and MAG Zrt. In order to make the performance of the IB-s measurable, the SLA system was introduced in 2012 that aimed to make both institutions and employees interested in the effective implementation process. Although the introduction of the SLA system was evaluated as a success by the NDA, its response at IB-s was completely the opposite. According to the leader of the biggest IB, the introduction SLA as he called it ironically “the NDA’s intellectual product” that wanted to be “more bureaucrat than actual bureaucrats” affected them very negatively both from financial and from accounting point of views and makes the way of operating of all IB-s contraproductive.

A third improvement is that of electronic procedures that have made the tendering system became more paperless and user-freindly; e-signature and electronic application has been introduced. Simultaneously an electronic surface of the NDA has been set up and modernized where applicants can get up-to date information regarding their projects.

Although the system improved a lot compared to its situation in 2006, it suffered from several structural problems, that decreased effectiveness significantly, and that were mentioned by almost each interviewee. The main causes of problems came from that the system still remained over-bureaucratized, and there was constant fear from a possible audit at every levels (NDA and IB-s also) which has resulted in an **excessive risk-avoiding** modus operandi. As a result of this fear of chastisement and/or rejection of internal operating procedures, neither the National Development Agency nor IB-s were able operate in a flexible manner.<sup>30</sup> Also, delays were caused by a lack of self-

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resources and national ones were different - the system could be regarded as a semi-centralized one. In addition, an inverse institutional integration took place in which the national institutional system was conditioned by institutions that were created for receiving and administering EU funds.

<sup>27</sup> 4/2011. (I.28.) Korm. Rendelet.

<sup>28</sup> 24/2011. (V. 6.) NFM utasítás.

<sup>29</sup> for example: evaluation and monitoring, communication.

<sup>30</sup> As one of our interviewees from NDA says “we tried to play a 120% safe game (...) we wanted to be doubly sure of everything”.

confidence and a heightened fear of making mistakes, providing false information, etc. As a result beneficiaries had to wait for extended periods for responses to tender and project related queries, as nobody from the intermediary bodies wished to reply without consulting with their colleagues. From a strategic point of view, risk-avoidance did not contribute to building up an administrative effective system. Also a consequence of the risk-avoidance is that staff at IB and MA levels spend a relevant part of their job with administration: according to our interviewees **the system of auditing** is extreme as it involves 700-800 operations yearly from the DGAEF, the ÁSZ and the European Commission and requires much time and energy.

The second main reason of ineffective operation was **internal tensions and a lack of cooperation** that are an issue at every institutional level: In the period before establishing the NDA, the workforce of the NDC consisted of underpaid civil servants who had no experience in project management, but they had to do project managing tasks for the same salary as before, so they became overburdened. In addition the laws on state-organisations did not enable flexible human-workforce management, so they could not improve their numbers in the amount they had to. The tension was at the first period intra-organisational, but by establishing NDA it became inter-organisational; between the NDA and the ministry, as the NDA did not belong under the strict regulation of public servants.

In addition neither ministries nor NDA offer enough training programs, competitive salaries moreover there is a huge pull-effect coming from the EU-organisations and the business sphere that offer competitive salaries. As a result the **high turnover of staff** at each level has always been a major problem mentioned by almost all of our interviewees. In the short-term the problem may be solved with the appropriate methods of the selection process and training but on the long-term these measures do not work at all. The present leader of NDA-coordination MA estimates the annual fluctuation at NDA to be around 30-40% while at the ministries 60-70% per year. According to the former director-general of NDA the most problematic issue is that employees fluctuating consists mostly of the seniors-who should train the newcomers- and newcomers-who could bring in new perspectives, and who possess the technical and project management knowledge needed.

### 6.3 Conclusions

- Although the system has been simplified within this period<sup>31</sup>, procedures have remained excessively bureaucratic and non-transparent.
- There is no actor in the system who appears to be sufficiently committed to achieving the strategic goals of Hungary's national development plans and strategies.
- Partnership and social compliance are formal elements of the system: According to one interviewee at NDA when structuring and making up the OPs the IBs, NGOs and professional organisations had the possibility to express their opinions. The formal requirements of partnership were met but it depended on the actual political will if the opinion of the organisations was incorporated into the OP.<sup>32</sup>

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<sup>31</sup> Simplification consisted of reconsideration of (1) legal environment for 2011 (including regulations on tendering, improving transparency, and deadlines became shorter).

<sup>32</sup> Interview with policy maker, Budapest, 6/3/14. (Interviewers opinion: The interviewee was very cynical regarding the topic. As he said: "We were obligated to ask them, but not to actually take into account their opinion, so they were asked.").



- As a result of weak central coordination, development programmes has been realised in atomised programs, no synergies, no harmonisation between national and EU sources and between Structural and CF. As a result duplications occurred with no synergies. As the latest evaluation points out EU's horizontal measures could be reached only on a formal level.

Finally, all our interviewees concur in that no workable regional strategies and synergy effects are possible at the NUTS 2 level without a commensurate level of institutionalisation – this is lacking in the Hungarian case where the trend has been to recentralisation and national coordination of all regional programming and toward project competition between municipalities. Thus the fact that the Central Hungarian Region has very little coordinating capacities and that cooperation within the BA is similarly weak, results in a highly fragmented pattern of project development, particularly with regard to smaller projects of local impact. As a result, municipalities within the BA end up competing against each other for individual measures that are not strategically related, often despite close proximity, resulting in a costly and wasteful duplication of investment.

**Table 14: Framework for assessment of administrative capacity**

Administrative performance	Specific indicators	Assessment of administrative performance			
		Strong (A)	Significant (B)	Moderate (C)	Weak (D)
Management	Structures	Clear allocation of tasks	Clear, formalized allocation of competencies and responsibilities but operational weaknesses	<b>Partially formalized allocation of competencies and responsibilities. Significant operational weaknesses</b>	Unclear or largely informal allocation of competencies and responsibilities. Major operational weaknesses
		Strong, open intradepartment communication, with good use of formal and informal channels and periodic review	Good intra-departmental communication but limited openness. Use of formal and informal channels	Modes of intra-departmental communication. Emerging formal channels for dialogue and decision-making	<b>Poor intra-departmental communication. Lack of formal and informal channels for coordination</b>
		Stable structures and responsibilities throughout the programme period	Largely stable structures. Minor internal reorganisation	Some instability, with episodic reallocation among ministries or implementing bodies	<b>Unstable structures with frequent/substantial reorganisation of responsibilities among ministries or implementing bodies</b>
	Human resources	Sufficiently qualified and experienced staff available. Low turnover	Staff available with some constraints in qualification, experience or turnover	<b>Staff available, but major constraints in qualification or experience, or turnover</b>	Severe lack of sufficient and qualified staff
		Well-developed HR management system. Effective performance assessment and staff development	Developed HR management system. Operational weaknesses in performance assessment and staff development	<b>HR management system with limited performance assessment and staff development functions</b>	No HR management system
		Administrative adaptability	Flexible mechanisms for ongoing adaptation and use of staff experience	Some mechanisms for adaptation, partly using staff experience	<b>Cumbersome, inflexible mechanisms for adaptation</b>
Project preparation and selection	Project generation	Sufficient demand, high quality of project applications	Sufficient demand, quality of project applications needing improvements	<b>Mostly sufficient demand with some delays, project applications of low quality</b>	Low demand
	Project appraisal and selection	Defined criteria, including well-developed and applied quality criteria, short decision times	Defined criteria with deficiencies in quality criteria, partly long decision times	<b>Mostly defined criteria, lengthy procedures with focus on formal criteria</b>	Lack of defined criteria for appraisal and selection
Financial management	Processing of payment claims	Clearly defined and quick processing of payment claims, efficient checks	Clearly defined processing of payment claims, partly multiple checks and delays	<b>Defined processing of payment claims. Frequent delays. Multiple checks</b>	Processes not clearly defined. Major processing problems
	Financial	Strategic approach to programme	Measures in place to manage	<b>Passive approach, case-by-case</b>	No management

	(de)commitment	management to avoid decommitment	financial flows to avoid decommitment	<b>response to decommitment</b>	mechanisms for decommitment
	Financial management and control	<b>All systems effective</b>	Some systems partially effective	Some systems ineffective	All systems ineffective
Monitoring and reporting	System of indicators and monitoring procedures	System and procedures fully operational, with coherent indicator system	System operational, procedures established, but not fully operational; some indicator weaknesses	<b>System exists but is only partly operational; indicator and procedural weaknesses</b>	No monitoring system
	Availability of financial, physical and procedural data	High-quality and comprehensive data, easily available and used for programme management	<b>Good quality data, with some gaps, and/or imperfect procedures</b>	Partial data available, mostly cumbersome procedures	No data available
Evaluation	Evaluation reports	Developed evaluation system with regular reports	<b>Ex ante, interim and/or thematic reports produced</b>	Only ex ante report(s) produced	No reports produced
	Evaluation methods and culture	Evaluation embedded. High level of capacity and utilisation	<b>Evaluation system established, good capacity but utilisation is mixed</b>	Evaluation undertaken but capacity constraints or limited utilisation	Evaluation is not considered useful. Limited or no capacity

**Table 15: Assignment of the operational programmes to Managing Authorities, New Hungary Development Plan**

Responsible Managing Authorities	Operational programme(s) of responsibility	Intermediate Body
NDA Department of Economic Development Programmes MA	Economic Development OP	MAG Zrt. (Magyar Gazdaságfejlesztési Központ Zrt.)
NDA Department of Transport Programmes	Transport OP	KIKSZ Zrt (Közlekedésfejlesztési Zrt.)
NDA Department of Human Resources Programmes MA	Social Renewal OP, Social Infrastructure OP	ESZA Zrt. (Társadalmi Szolgáltató Nonprofit Korlátolt Felelősségű Társaság)
NDA Department of Environmental Programmes MA	Environment and Energy OP	NKEK, Nemzeti Környezetvédelmi és Energia Központ Nonprofit Kft
NDA Department of Regional Development Programmes MA	West Pannon OP	<ul style="list-style-type: none"> <li>Nyugat-dunántúli Regionális Fejlesztési Ügynökség Közhasznú Nonprofit Kft.</li> <li>MAG Zrt. (Magyar Gazdaságfejlesztési Központ Zrt.)</li> </ul>
	Central Transdanubia OP	<ul style="list-style-type: none"> <li>MAG Zrt. (Magyar Gazdaságfejlesztési Központ Zrt.)</li> <li>Közép-dunántúli Regionális Fejlesztési Ügynökség Közhasznú Nonprofit Kft.</li> </ul>
	South Transdanubia OP	<ul style="list-style-type: none"> <li>Dél-Dunántúli Regionális Fejlesztési Ügynökség Közhasznú Nonprofit Kft.</li> <li>MAG Zrt. (Magyar Gazdaságfejlesztési Központ Zrt.)</li> </ul>
NDA Department of Regional Development Programmes MA	North Hungary OP	<ul style="list-style-type: none"> <li>Észak- Magyarországi Regionális Fejlesztési Ügynökség Kft</li> <li>MAG Zrt. (Magyar Gazdaságfejlesztési Központ Zrt.)</li> </ul>
	North Great Plain OP	<ul style="list-style-type: none"> <li>MAG Zrt. (Magyar Gazdaságfejlesztési Központ Zrt.)</li> <li>ÉARFÜ Észak-Alföldi Regionális Fejlesztési Ügynökség Közhasznú Nonprofit Korlátolt Felelősségű Társaság (ÉARFÜ Nonprofit Kft.)</li> </ul>
	South Great Plain OP	<ul style="list-style-type: none"> <li>DARFU Dél-alföldi Regionális Fejlesztési Ügynökség Nonprofit Kft.</li> <li>MAG Zrt. (Magyar Gazdaságfejlesztési Központ Zrt.)</li> </ul>
	•Central Hungary OP	<ul style="list-style-type: none"> <li>Közép-dunántúli Regionális Fejlesztési Ügynökség Közhasznú Nonprofit Kft.</li> <li>MAG Zrt. (Magyar Gazdaságfejlesztési Központ Zrt.)</li> </ul>
NDA Department of Public Reform Programmes MA	<ul style="list-style-type: none"> <li>State Reform OP</li> <li>Electronic Public Administration OP</li> </ul>	MAG Zrt. (Magyar Gazdaságfejlesztési Központ Zrt.)
NDA Department of Co-ordinating MA	Implementation OP	

Overall, management and implementation have functioned relatively well in terms of assuring a process of project application, selection and funding, but the bureaucratic and centralised character have negatively affected the quality of CP delivery by focusing on formal, administrative rather than substantive criteria for project selection.

At first hesitantly, given the economic crisis and the difficulties associated with tendering and project support applications. The administrative complexity of the application process as well as restrictive conditions attached to the use of support for SMEs proved to be a veritable disincentive. This was addressed after 2009, partly by easing restrictions, partly by creating new areas of potential SME support in association with Regional and Social Infrastructure OPs. As a result, the absorption rate measure in contracts signed increased appreciably. However, many substandard projects were also approved in order to enhance the absorption results.

Over time, the implementation has become more concentrated and professional. The legal environment has become more transparent as rules regulating the EU-s financing were melted into one law and one guidance handbook provided. Tendering became less complicated, deadlines shortened, that was also mentioned by almost all of our interviewees as an improvement. A second major change/improvement was in the administrative system itself where tasks of MA-s and IB-s were redefined: IB-s received more freedom in concrete technical issues regarding tenders. As a result of defining the responsibilities precisely duplications decrease, and performance of each actors became measurable.

## 7 Conclusions

### 7.1 Programme achievements

The overall assessment of CP performance is that of an improving planning and programming process, progress in administrative capacity, a clear and reliable system of financial control - but weak implementation. As such, the CP 2007-2013 fell rather short of its goals. If mere absorption and accountability were the main indicators of achievement, Hungary could be deemed to be a good performer. However, judging by a strategic implementation and a long-term approach to job creation and regional development, the overall results have been disappointing. In addition, there is dissent as to whether the strategy for 2014-2020 will be well served by centralisation and the simultaneous delegation of Regional Development tasks to the NUTS 3 (county) level. As one of our informants directly commented: there is a risk that little will change because Hungary is “not strong on long-term planning for some reason”.

Examples of the shortcomings of the CP period are revealed in random samples from evaluation research. KOPINTO-Tárki (2010) has estimated that for every 50,000 Euros of CP support one job has been created in Hungary. However, it is not clear that these have been long-term jobs or work in higher value-added sectors. Furthermore, although the Project Generating Facility Project (PGF) received EU funding for preparing major projects, these were not well-elaborated for the period of 2007-2013 resulting in delays.<sup>33</sup> At the level of regional and enterprise development projects, EU funding as applied in Hungary has not always rewarded the most professional or deserving but rather those who meet the formal and administrative requirements of the application process.<sup>34</sup>

Furthermore, the centralised system of project applications was heavily criticised, since the National Development Agency was not aware of local needs (such as the kind of development specific settlements need). In the eyes of our informants, this resulted in a minimal level of effectiveness and the realisation of a high number of superfluous projects. It is also seen as problematic that decision-makers have a short-term perspective; they always want to reach prompt and spectacular goals that are not always the most profitable in the long term causing the conflict of long-term and short-term goals with the victory of short-term goals usually.

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<sup>33</sup> In Hungarian: „Pályázat Előkészítő Alap” PGF aimed to prepare around 100 (mainly major) projects in Hungary (including the reconstructing of the railway and the wastewater networks) in line with the EU development goals in the 2004 - 2006 period.

<sup>34</sup> As one of our VÁTI and National Bank informants suggested, the Hungarian process of project selection appeared to be a “hurdle-race” based on a tendering-method where applicants are required to meet several administrative, legal and financial requirements and the winner is not necessary the best one from a professional point of view.

Although long-term concepts and strategies were rather well-planned, one problematic issue was that the goals of national and EU strategies were not reflected within all specific OPs or individual projects reinforcing the impression that Hungary has tended to focus on the numerical rather than strategic targets. During the implementation and tendering of the programs, professional aspects were not properly taken into consideration.

A great deal of effort (for example by VÁTI) was put into efforts to harmonise strategies with the OPs and programmes by writing guidelines and directions for the tendering system. But it bore no results since: (1) the changes proposed were too complicated and (2) there was apparently no political will/interest in improving the whole system.

Finally, government intervention and shifting government priorities created uncertainty and reduced continuity. Between 2007 and 2010 the project tendering and evaluation process went smoothly, but between 2010 and 2011 it was abruptly stopped because of the change of government. As a result, tenders faced evaluation procedures lasting more than one year and because of the delays, bank loan agreements were annulled, permissions expired, costs increased, and many tenders needed to be rewritten entirely, resulting in the failure of several projects.

Nevertheless, and despite these shortcomings, CP has played an important role in facilitating major development projects that have been crucial to the Central Hungarian Regions. This not only involves transport and urban development but also human resources and business development. After a slow start, enterprise support as part of CP has become more sophisticated and place-sensitive through coupling with regional and rural development, scientific research, health and areas supported by other OPs.

## **7.2 Administrative capacity**

In terms of administrative capacity, the experiences of the period of 2007-2013 were indeed challenging - involving a rapid process of adaptation – and very rich in developing greater critical sensitivity towards the complexity and requirements of Cohesion Policy, especially with regard to large projects. As a result, tendering, application and selection processes could be streamlined somewhat if not yet totally to the satisfaction of beneficiaries.

As mentioned above in Part 5, the Strategic Report of Hungary (2012) lists three main areas where positive changes took place since 2007. In order to decrease fragmentation and inefficiencies, intermediary bodies were set up by concentrating intermediary functions to a few bigger institutions (15 instead of the previous 22).

Thus, overall strengths include: the work of the central National Development Agency and of other implementing bodies are seen to be satisfactory, both from a professional and an administrative point of view. Electronic procedures have progressed; all data are put on the NDA's electronic system, EMIR, where applicants can follow the actual state of their tenders through the whole evaluation process. The deadlines for tender evaluation have also accelerated since 2007.

The main weaknesses are: the tendering process remains cumbersome, there is a lack of appropriately trained staff at more local levels to deal with different tendering, a lack of appropriate project preparation and a lack of cooperation for the realisation of strategic goals.

### **7.3 Strategic quality**

A major - perhaps the more important - weakness of Cohesion Policy implementation in the case of CHR has been the strategic aspect. There is, in fact, a crucial lack of a process that can assure the linking of strategic goals with individual projects. One of the main reasons for this is the arbitrariness of political intervention, both in terms of setting priorities and in administrative terms. Political intervention has also been responsible for situations where, for example, in 2012 the government tried to speed up tendering in order to compensate for the underuse of resources. In order to withdraw as much EU funds as possible, projects were accepted that were in fact totally unnecessary. The Municipality of Budapest estimated the proportion of rushed projects to be around 10 percent.

Another issue that hindered a greater strategic approach was the sharp competition on the tendering and contractors' market - particularly with the onset of the financial crisis - since EU-financed projects are practically the only ones that bring profit. Tender writers and contractors fight with all their might when it is about winning a project; for example they often slow down the procedure with years by appealing against the results of tendering. In short, strategic aspects of CP are diminished because the Hungarian tendering system

- is too bureaucratic, unnecessarily overregulated by public procurement processes and tendering that generates a competition in prices rather than quality.
- makes it impossible for OPs to promote integrated developments based on local needs, as winning projects became atomized and accidental rather than integrated (for example a settlement applies for grants for renewing a car mechanic shop and developing touristic areas in the same street)
- often hampers the harmonisation of developments since issues of liability within the projects are very chaotic; project leaders tendered for projects that were not needed (for example for building a kindergarten in an aging settlement) and nobody was in charge of monitoring whether the project was required or not.

### **7.4 Lessons learned**

All interviewees agreed that the Hungarian law for tendering is a common problem for all OPs, and it needs to be urgently revised. One reflection of this is the fact, mentioned above, that several measures have been undertaken in order to improve financial and overall implementation.

On the more positive side, tendering will not be compulsory in case of regional development projects. In addition Regional Operative Programs will be realised within the framework of integrated regional developments which our informants think is favourable since it defines the concrete responsibilities of the actors. In the field of education sources will be allocated centrally - based on the central assessment of the needs of all schools in Hungary - instead of tendering, which will improve the effectiveness of source allocation (i.e. there will be no school renovations in settlements where there are no schoolchildren).

There were also changes made to the administrative system which are ambiguous in terms of their reflections of “learning processes”. A centralisation process has taken place as a response to what was perceived to be a fragmented and inefficient process. This could be seen as a further impediment to a strategic approach (see above). However at the level of the National Development Agency centralisation involved bringing the tasks of Managing Authorities and Intermediate Bodies under one roof - for example, for the purpose of evaluation and monitoring, communication, etc. At the same time, tasks of MAs and Intermediate Bodies were redefined and the Managing Authorities within the NDA were put in charge of strategic aspects of implementation. Additionally, IBs received more freedom in concrete technical issues regarding tenders.

Furthermore, in order to optimise administrative and financial performance, an Audit of European Funds (DGAEF, in Hungarian: EUTAF) was established in the summer of 2010 as an autonomously operating central budgetary organisation within the Ministry for National Economy and is in charge of carrying out audit authority tasks regarding European Union and other international funds determined by the Government.

Electronisation: The whole tendering system moved towards a paperless process and e-signature and electronic applications were introduced. Simultaneously, an electronic platform where applicants could get up-to date information regarding their projects was set up and updated by the NNDA.

## **7.5 Outlook for 2014-2020**

According to interviewees, the institutional conditions for the next period of Cohesion Policy are generally not yet well-developed. There has certainly been a measure of institutional learning and much greater acknowledgement and consensus regarding the weaknesses of previous practice. The sensitivity toward local needs has increased – here the NDA was rather aloof as it was a centralised organisation, but transferring this sensitivity into practice requires a much greater level of institutional capacity at the local level.

During the next funding period the EU will be much stricter on ex-ante conditionality on both macro-economic and programme levels. In 2007-2013 there were 7 different Operative Programmes (ROP) for the 7 NUTS II regions of Hungary, but from 2014 the task of regional development will be allocated to 21 NUTS III microregions (counties). And this will be one of the big issues for 2014-2020 – how to strengthen the local level through partnerships, place-based development strategies, integrated territorial investments, etc! There is no real regional level at this point and there is little reason to expect a new one any time soon.

Managing authorities have been integrated into the ministries but central coordination still remains. Regional development programmes will be decentralised; municipalities will be in charge of implementation. A problematic issue is that municipalities do not have capacities for programming the planning either from a professional or from quantity of human resources point of view at the moment. The strengthening of the municipalities’ workforce began 2 years ago, but establishing implementation capacities is still missing. Although it is a very urgent issue, the process has been slowed down by bureaucracy.

Finally, Hungary has to deal with and reconcile two partially mismatching concepts informing national development policy for the new period: the first one is based on the “Development of



Hungary 2030 - National and Regional Development Concept” (Nemzeti Fejlesztés 2030-Országos fejlesztési és területfejlesztési koncepció) adopted in December 2013 which aims: “to help Hungary to become one of the leading economic and intellectual powerhouses of Central and Eastern Europe within the next sixteen years”<sup>35</sup> by fulfilling the following aims:

- economic growth ensuring productive employment
- the establishment of a sustainable geographical structure
- the blocking of the demographic decline of the Hungarian population within a reasonable period of time
- the creation of a healthy and open society
- the preservation of natural resources and assets as well as the protection of the environment.

The other strategic concept of Hungary aims at the extensive development of the economy; the government of Hungary intends to spend 60% of the support coming from the Cohesion Fund on the development of the economy (including regional development, employment, support of small and medium enterprises and the development of the info-communication sector). The emphasis on/dominance of economic development means that other areas such as transport and education will become underfinanced.

For the next period projects are generally not yet well-prepared. Managing authorities have been merged with ministries and central coordination still remains. At the same time, regional development programs will be decentralised; municipalities will be in charge of the implementation. A problematic issue is that municipalities do not have capacities for programming and planning from a professional or from a human resources standpoint. The strengthening of municipal staff began 2 years ago, but establishing implementation capacities is still lagging. Although it is a very urgent issue, the process has been slowed down by bureaucracy.

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<sup>35</sup> <http://www.kormany.hu/en/ministry-for-national-economy/news/the-development-concept-for-2014-2030-to-turn-hungary-into-the-region-s-hub>

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