

# **Derangement or Development? Political Economy of EU Structural Funds Allocation in New Member States- Insights from the Hungarian Case (tentative)**

**Judit Kalman  
CEU – MTA KTI**

# Structure

- 1. Introduction
  - Motivation, Theoretical context, Empirical context
- 2. Hungarian policy context
- 3. Data and estimation methods
- 4. Empirical Results
- 5. Concluding remarks

# Motivation & Theoretical context

**Point of departure:** how do political institutions effect government efficiency?  
How much the struggle for votes distorts economic policy/financing choices?

Searching for political and administrative factors in EU SF grant allocation in Hungary

Traditional public finance models do not capture these interactions → **POLITICAL ECONOMY OF INTERGOVERNMENTAL GRANTS:** ( Worthington-Dollery, 1998, Grossmann, 1994, Dollery-Wallis,2001, Porto-Sanguinetti 2001, Drazen 2002, Feld-Schaltegger 2005, Pinho-Veiga, 2004 etc.)

- Considerable theoretical and empirical evidences that **institutional and political factors** do interfere with decision-making, can increase the chances for **inefficient policy** outcomes
- **grants are viewed as providing direct political benefits** to both recipient and higher level government or governing party (esp. In **vote-generating visible expenditure items**) → good reason to look at infrastructure grants to LGs
- **POLITICAL BUSINESS/ BUDGET CYCLES:** manipulation of economic outcomes /instruments of economic policy surrounding elections – 3 generation of models, swing vs.core disticts etc.
- literature on **pork-barrel programs** (Ferejohn,1974, Weingast, 1984, Persson and Tabellini,2000 etc) and **rent seeking** (Tullock etc.)
- + **some literature on EU SF inefficiencies** - mostly in former Cohesion countries
- + **good absorption of EU funds considered extreme importance in CEE**, yet absorption is mostly considered quantitatively (“get100% of it from Brussels” ) not many thinking about its effectiveness → **EU SF perfect candidates for political influence-** need for further emp. research

# Empirical Context

- infrastructure financing especially prone to political considerations** and corruption due to **high visibility**, high expenditures, **lobbying** by special interests, possible control of timing and level of investments by politicians – **offering more transferable political capital** (Romp-deHaan,2005, Veiga-Veiga,2006) – yet they strongly effect long run growth prospects and productivity of a country
- **EU grants are discretionary**, difft.than usual operational grants (e.g. not all localities receive them + money can be given not directly to LG, but businesses) →more **room for political** considerations
  - **development policy today**: often opposing goals/policy tools used – tradeoff between **equity vs. efficiency** (Brakman et al., 2005; Bachtler et al., 2003; Martin, 1999) → **mixed policy both EU and national level** , i.e. grants given to **lagging regions** (EUSF) or to faster developing hubs of the economy (New Economic Geography based policies – e.g. **Lisbon goals** in the EU development policy domain)

# Hungary EU SF context: there are reasons to suspect politics & admin. aspects play some role

H: highly **centralized development policymaking** (regions only administrative role)

- 2004-06: 1. Natl. Devt. Plan – only one centrally managed ROP for all 7 NUTS2 regions, limited attention to regions
- Further centralization in the administration in 2006, natl.govt. control over EU funds

- **Lack of parliamentary control** over Nat. Devt. Agency decisions
- From 2007: **High (~50%) ratio of special large projects**, separately handled with even less control (not in my data unfortunately)
- The examined period 2004-2008 (starting with the country's 2004 EU Accession) stretches into two election cycles with general and local **elections in 2006 (scandals** within a few months, sweeping victory of opposition at the autumn local elections – so **opposing political colors of central and local govt.** at many places, first time in transition!) → **a good case for research inquiry**

# Searching for political and administrative motivations in EU SF grant allocation in Hungary

- 2004-2008 fairly **short period** yet
- **limited access to data**: first only got those from Nat.Devt. Agency who were granted EU SF, but not all applicants - first results are from these data!
- recently got access to all applications (incl. Unsuccessful ones – now started new round of research on these)

## My First Results in sum:

- **Political color similarities** (of MP and in some cases mayor) with central govt. do increase grant getting chances
- **Administrative capacity/project mgmt. experience** differences of LGs do matter
- **socioecon. controls** reflect mixed policy goals – size, PITbase but also backwardness or % of old population

# Data

A combined dataset – an asset on its own for political-economic inquiry :

- **EU SF transfers data from Natl. Devt. Office** – funded projects of all kinds (LG, business, NGO) of applicants, from **all operational programs 2004-2008**
- linked with data from the State Administration Office (TAH) database embracing **all** (n=3130) **municipal governments' budget data** (data available for up to year 2005 only)
- plus **demographic, social and infrastructure data from the territorial statistical database T-Star** of the Hungarian Central Statistical Office
- **general and local election data** for elections years 2002 and 2006 from the National Elections Office of Hungary.
- some population and minority data from the **2001 Census** in Hungary

For reasons of easier comparison across e.g. recipient municipalities, all variables are transformed to **per capita values** in the analysis. All the financial variables are shown **in thousand HUFs** and have been recalculated **at 2008 prices** using the GDP deflator.

For analytical purposes, the **city of Budapest**, local governments of capital districts and **counties** are deliberately **left out** of the dataset, due to **their very special status** in the institutional and budgeting structure.

## EU grants in Hungary 2004-2009 application ratios

	No. of applications	No. of supported appl.	% supported	Required grant amount ( mn EUR)	Paid grant amount (mn EUR)	% paid/required amount
<b>All</b>	<b>61821</b>	<b>14860</b>	<b>24</b>	<b>18 881,60</b>	<b>3966,6352</b>	<b>21</b>
Municipalities	7464	1444	19	3 351,29	167,2521	5
ROP by municipalities	5376	871	16	1 704,96	102,7986	6
Small and medium size companies	299921	12107	4	2 760,71	657,50168	24
Big companies	983	457	46	3 517,91	527,13786	15
LHH	6667	2472	37	1 325,11	272,57559	21
<b>Budapest</b>	<b>12133</b>	<b>5142</b>	<b>42</b>	<b>5 172,10</b>	<b>1402,5815</b>	<b>27</b>

-in **election year 2006** not only more applications (24%→48%) were successful, but also higher portions of the required amounts were granted (21%→34%)

- strikingly high in the case of local government applications (19%→73%)

and paid/required from 5%to 35%)

	Election year (2006)					
	No. of applications	No. of applications supported	%of supported applications	Required grant amounts (EUR)	Paid grant amounts (EUR)	Percentage of paid/required amount
<b>All</b>	<b>7008</b>	<b>3350</b>	<b>48</b>	<b>320269511</b>	<b>108202766</b>	<b>34</b>
<b>Municipalities</b>	107	78	<b>73</b>	2349375	815218	<b>35</b>
<b>RCP by municipalities</b>	0	0	<b>0</b>	0	0	<b>0</b>
<b>Small and medium size companies</b>	3394	1318	<b>39</b>	206007065	64489434	<b>31</b>
<b>Big companies</b>	92	52	<b>57</b>	9465406	3385065	<b>36</b>
<b>LHH</b>	999	562	<b>56</b>	34351326	14975910	<b>44</b>
<b>Budapest</b>	1993	744	<b>37</b>	155237950	57012864	<b>37</b>

# Research design – first stage

## Searching for political and administrative motivations in EU SF grant allocation in Hungary:

For checking what is affecting *the chances for grant receivals* I use *probability model (probit)*

thus **dependent variables** were **binary (1,0)** variables:

- **gotgrant\_all**, if any (govt. or business, NGO) kind of applicant has received money from EU funds throughout all the years of 2004-08,
- **gotgrant\_LG** if the local government has received grants across all EU SF operation programs,
- **gotgrant\_ROP** if any applicant from a certain municipality has received funds from the EU SF Regional Operative Program (ROP)
- **gotgrant\_LG\_ROP** if the local government itself has received funds from the ROP

I model central government behavior as a function of (1) **variables reflecting benevolent intentions** (social welfare improving development policymaker in this concrete case) and (2) political **variables related** with the public choice idea that policymakers are having **re-election interests** too in grant allocation process.

# Model

- $Y(0,1) = \text{constant} + P + A + S + R + Z + \varepsilon$
- P vector of political variables
- A vector of administrative capacity vars.
- S vector of socioeconomic controls
- R region dummies
- Z year dummies
- E error term

## Explanatory variables :

**Political influence+admin. variables:** main interest, driven by hypotheses from literature review and interviews

- **political affiliation** : testing **same political color** loyalty (color of MP/ mayor same as central govt.) vs **swing** voter hypothesis (closeness of elections, MP elected in 2<sup>nd</sup> round)
- **lobbying capacity** : MP and mayor **terms served, times reelected**
- **administrative capacity**: previous findings, policy papers and interviews suggested its importance, also due to heavy EU bureaucracy needs

2 kinds of measures – ratio of higher educated population,  
previous EU funds experience (from 2004-06 period)

**Socioeconomic controls:** explain only some portion of success, supposed to reflect development policy goals

- **Size** (ln population, size categorical)
- **sub-national financial autonomy**/budget-constraint (percentage of own revenues), important for EU co-financing needs too
- **economic position** (Personal Income Tax base)– a good proxy for economic status (localGDP nonexistent) + a revenue for the LG too
- **variables reflecting need**
  - ratio of dependent population (**young, old**)
  - Ratio of **Roma** population
  - HDI**: estimated Human Development Index (Csite-Nemeth,2007)
  - LHH** – proxy for **backwardness**:municipality belonging to the special program for 33 least developed small regions
- **regional position – dummies for the 7 NUTS2 regions**
- **Year dummies**

# 1. Table Variables used in the analysis and their expected signs

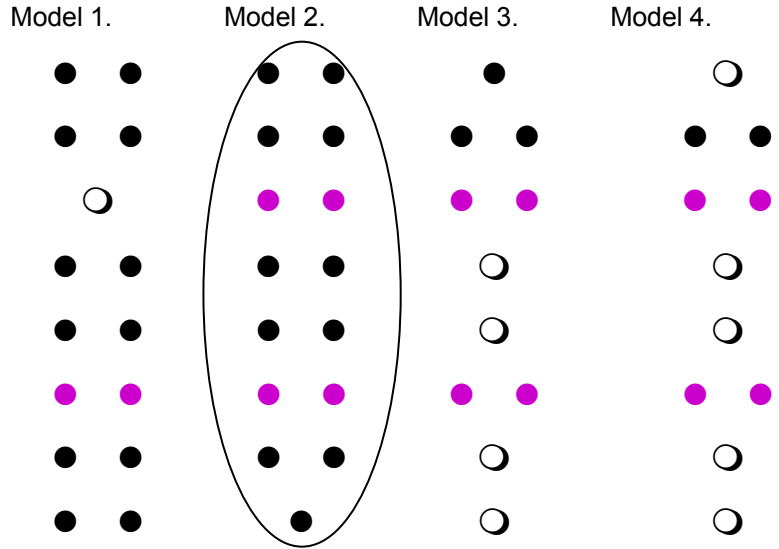
<b>dependent vars.:</b>	
<b>applicant from municipality received EU funds</b>	
<b>applicant from municipality received EU ROP funds</b>	
<b>Local Government received EU funds</b>	
<b>Local Government received EU ROP funds</b>	
<b>Explanatory vars.:</b>	<b>Expected sign</b>
<i>political vars.:</i>	
<b>MP same color as central government 2002</b>	+
<b>mayor political color same as central government 2002</b>	+
<b>MP same color as central government 2006</b>	+
<b>mayor political color same as central government 2006</b>	+
<b>closeness of 2002 parliamentary elections</b>	-
<b>closeness of 2006 local elections (% diff. 1st and 2nd)</b>	-
<b>closeness of 2006 parliamentary elections</b>	-
<b>MP got elected in the second round of the election 2002</b>	+
<b>MP got elected in the second round of the election 2006</b>	+
<b>MP reelected for more than 1 term 2002</b>	+
<b>MP reelected for more than 1 term 2006</b>	+
<b>Number of terms Member of Parliament reelected 2006</b>	+

<i>Admin. /institutional capacity</i>	+
any applicant received funds from NFT, first cycle of EU funds, 2004-06	+
LG received funds from NFT, first cycle of EU funds, 2004-06	+
ratio of local population with higher education	+
<i>Socioecon. controls</i>	+
ln population	+
ln per capita local personal income tax base	+
% of young population	+
% of old population	+
% of own resources in LG budget	+/-
size indicator	-
Munic. Belongs to special program for the least developed 33 small regions (LHH)	+
+ year and region dummies	

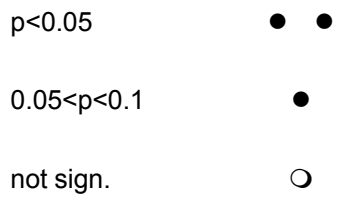
# Probit estimation results political variables

all 4 years 2004-08

- closeness of 2002 parliamentary elections
- MP got elected in the second round of the election
- MP same color as central government 2002**
- MP reelected for more than 1 term 2002
- mayor political color same as central government 2002**
- MP same color as central government 2006**
- MP reelected for more than 1 term 2006
- mayor political color same as central government 2006**



Signals:



Models:

1. **Any applicant** receiving EU SF grants and political colors 2004-2008
2. **Local Governments receiving EU SF grants and political colors 2004-2008**
3. Any applicant receiving EU **Regional OP** grants and political colors 2004-2008
4. **Local Governments** receiving EU **Regional OP** grants and political colors 2004-2008

# Robustness checks

- Several models have been tested with different sets of political and socioeconomic control variables as well as year and regional dummies and also a restricted version without any political variable.
- **Full sample + sub-samples** by **size** - a usual suspect, plus population came out always strongly and positively
- A kind of sub-sampling is given by the **various dependent variables (all, LG, ROP\_all, ROP\_LG)** themselves.
- checked allocations from the **Regional Operative Program** separately - that is supposed to have traditional regional disparity/convergence focus, yet, rumors claim the ROP allocations to be the most politically driven
- To capture more insights on the politics, I **split data** for *different periods pre- and post-election, election year* too

# Probit estimation results on political variables split to before and after election periods

	first cycle 2004-05				election year 2006				second cycle 2007-08			
	Model 1.	Model 2.	Model 3.	Model 4.	Model 1.	Model 2.	Model 3.	Model 4.	Model 1.	Model 2.	Model 3.	Model 4.
closeness of 2002 parliamentary elections	●	● ●	●	○	○	● ●	●	○				
MP got elected in the second round of the election	●	● ●	● ●	● ●	○	● ●	● ●	● ●				
MP same color as central government 2002	○	● ●	● ●	● ●	○	● ●	●	●				
MP reelected for more than 1 term 2002	● ●	● ●	○	○	●	○	○	○				
mayor political color same as central government 2002	● ●	● ●	○	○	● ●	○	○	○				
MP same color as central government 2006									● ●	●	● ●	● ●
MP reelected for more than 1 term 2006									● ●	● ●	○	● ●
mayor political color same as central government 2006									● ●	○	○	○
closeness of 2006 local elections									○	○	● ●	● ●
closeness of 2006 parliamentary elections									● ●	● ●	● ●	● ●
MP got elected in the second round of the election 2006									● ●	● ●	● ●	● ●
number of terms MPs reelected 2006											● ●	● ●
received funds from NFT												

Signals:  
 p<0.05    ● ●  
 0.05<p<0.1    ●  
 not signific    ○

Models:  
 Model 1. Receiving EU SF grants and political colors 2004-2008  
 Model 2. Local Governments receiving EU SF grants and political colors 2004-2008  
 Model 3. Receiving EU Regional OP grants and political colors 2004-2008  
 Model 4. Local Governments receiving EU Regional OP grants and political colors 2004-2008

# Major results – Partisan model reinforced

- strongly significant (at 1%) results, showing that *if **political color of the Member of Parliament from a certain locality is the same** as the incumbent **central** government, the **chances for getting from EU SF grants are increased with +2-8%** across all models and different specifications (highest effects **for LG projects** funding chance, and especially for the years 2004-05 and election year 2006, where it reaches +8% more chances*
  - ***color similarity of the mayor** does not behave so well\*, was in most of the cases **insignificant** /negative yet, in the probit models for all recipients all OPs (gotgrant\_all) and the one for LG receiving grant from any OP (gotgrant\_LG) it was significant, and *raises chances for the municipality to get central investment grants by +4 - 9%.**
- \* *Majority of mayors runs independent*, that explains odd behaviour of this variable!
- *These results fit with the **partisan (loyalty) model***

# *Swing voter hypothesis – not confirmed:*

- Cannot be accepted**, the **closeness proxies behave oddly**, across models for all recipients or LGs and even for different time periods seem either **significant, but not with the expected negative sign** or not even significant.
- exception: ROP allocations in years 2007-08, especially where LGs are recipients - suggests that after the scandalous and for the incumbent disappointing 2006 local elections, both kinds of political tactics could have been in operation at the same time (??)
  - Yet, the dummy variables for the **MP getting elected in the second round** of elections (which is another **sign of close race**) **behave well (sign.)** - these **results need caution** and **further investigation**, perhaps recoding or using a different proxy for swing voters (e.g. the density at the cutpoint used by Johansson, 2003)

## Major results - Lobbying, Admin. capacity

- Contrary to my expectations, the dummy variable proxying **lobbying capacity** (MP\_long) if the **MP** is elected for **more than one term** was **not positive!**, though almost always **significant**—this *needs further checking + data on mayor terms needed + further research on lobbying*
- **EU project bureauc. needs + admin diffs. matter!**  
→ **administrative capacity** of a local government:  
*proxy: ratio of local population with higher education*  
+ for data 2007-08 **earlier EU funds experience** from the first cycle of **2004-06** → *both were* **strongly sign.**  
**and +** (except election year 2006!, when admin. Capac. is not signif. – further sign for “other” aspects?)

# Work in progress

- First estimations, model specification is to be refined – still some questions (Perhaps inclusion of some further variables?, depending on data availability)
- With recent access to **data on all those who applied**, not only successful, funded projects – **plans for new analysis**
  - exploring ways to do analysis, build diff. model on **actual amounts, not only binary** gotgrant. vars.
  - **Do matching** (successful, unsuccessful, not even applied?) **and use some diff.in diff technique?**

# *Socioeconomic and need indicators in EU grant allocations*

- *were expected to have some role - picture is quite mixed in my findings*
- **EU grant reciprocity chances increase with size** (In population variable is strongly significant with high positive coeffs./marg. effects, size indicator is negative due to coding) – **not a surprise**, is also true even in the case of the Regional OP grants, - a clear sign of **growth enhancement policy dominance!**, but has its **administrative reasons** too!

- **EU grant reciprocity chances also increase along better off economic position** (measured by the *per capita Personal Income Tax base*) Reasons are probably similar to that of size mentioned above – (though loses its significance from election year 2006 onwards in all size categories, yet keeps its positive sign)
- **demographic need variables** : percent of **young** school-age population is significant and positive, whenever it comes to **local government projects**, either overall or from ROP (which is as it should be), but usually loses its significance in other models with different dep.vars.
- percentage of **old** population is always **strongly significant and positive, adding to grant reciprocity chances** across all model specifications and sub-samples - a finding contradictory to what I have previously found in my research for Hungarian national investment grants for municipalities (Kalman,2007),

- **ratio of own resources in the LG budget** (*decentralization measure – important also for EU co-financing needs!*) usually did **not** even come out **significant**.
- Where it did, it has opposing signs, i.e. negatively effecting chances for grants in certain cases, and positively in some others (e.g. ROP funds receipt of LG – here at least it is rewarded if a local government tries hard and become less grant dependent) - reflects **policy goals seem to be mixed indeed**, but **needs further checking with amounts** as dep.vars, not only these binary gotgrants
- proxy for **backwardness** (LHH - municipality belonging to the special program for the least developed 33 small regions) - most of the cases it came out **significant and positive**, though **after 2006 it is more ambiguous** + seems to affect the chances of the smallest places, while not always sign. for the larger ones. = **presence of some equity considerations** in H. development policy
- Region dummies did not seem to add much information – further explorations needed

# Policy implications – very preliminary

- **Grant schemes inefficiency**
  - **Room for politics, rent-seeking - My estimations can only underestimate real political influences and rent-seeking (large projects handled separately, pre-agreed tenders?, investments by munic. enterprises? )**
- As long as **grant dependence** of Hungarian **local governments**, **strong effect of political factors and lobbying is likely to remain** → **reform of local own revenues/local govt. structure and financing** seems crucial + **mgmt. of devt. Policy?**
- **Devt. Policy goals indeed mixed and quite unclear**: most of **EU funds allocation in H. seem to favor most developed, well-off places** – i.e. growth enhancement, overall convergence of the country seems to be the target, not so much of the backward regions within the country (o.k., especially by NEG and ‘Lisbon agenda’) - but a proper evaluation is beyond the goals and limits of this paper

# Contributions + future possibilities

- Topic : **political motivations present** in central governments' EU Structural fund allocation decisions in H. + **administrative capacity does matter!**
- Interesting for academia and policy sphere too
  - a new contribution to the **political economy** of intergovernmental grants + broadening **multi-level governance literature** + policy research on **Structural Funds allocation** – with a **case of a transition country/new CEE member state**
  - Intuitive results
    - **Relevant for other countries** – the point is not about blaming H. governments
    - results are in line with and **add to previous empirical finding** with respect to Hungary (Csizse-Felföldi, 2006)
    - **links** nicely to the already more researched **cohesion literature** on EU15 emphasizing the **role of institutional environment**
    - **Provide grounds for comparison** (old vs. new EU member states etc.,) and/or generalization → plans for CEE comparative research
  - Continue this research **with data on unsuccessful applicants**
  - **Qualitative** info (focus groups, interviews, case studies) **could add** a lot and enhance results ( not done due to research funding but planned!)
  - Rent seeking needs further research, though measurement is problematic

# Thank You!

Comments very welcome

[judit.kalman2@gmail.com](mailto:judit.kalman2@gmail.com)

[kalmanj@ceu.hu](mailto:kalmanj@ceu.hu)