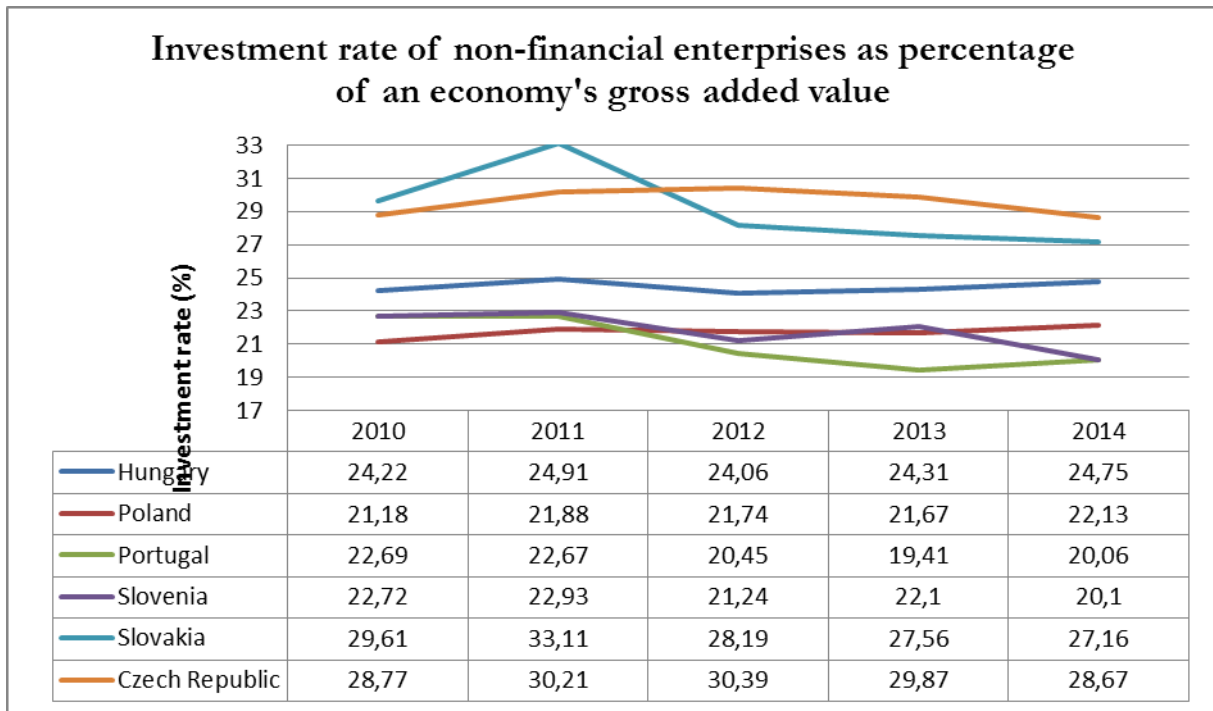




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## *Hungary among emerging European countries with the highest investment ratios*

Corporate investment is a crucial factor of an economy as well as its development. With regard to the former, complementary investment has more weight, as it facilitates the maintenance of existing capacities and operations, instead of adding to development. Development is typically the result of companies' expansion and technological development which lead, first, to quantitative and, second, to qualitative improvements. The **level of investment** is a key -- if not the most important -- macro-economic indicator tracked by each major international economic institution, as it enables them to draw conclusions on both short- and medium-term economic growth prospects as the economy's growth potential has a lot to gain from these investments. The volume of investment has an effect on competitiveness, exports, employment and incomes. The level of investment within the national economy is usually calculated as a ratio relative to the country's GDP, but when **compared to gross added value** of a given period -- as this is fortunately the method used by the Eurostat -- the indicator gives a more adequate picture of an economy's growth potential of a given period and in the medium term. This indicator shows the share of gross added value within a given period spent on investment.



*Source: Eurostat*

The above chart aptly demonstrates that this kind of “resource-recycling” indicator has been rising, albeit slowly, since 2012 in Hungary, nearing 25 percent. In case we view this figure from a regional aspect or from the aspect of European countries with a similar grade of development, **Hungary ranks as third on the list of selected countries.** The list of countries excludes Greece, as due to well-known reasons the investment rate of the country does not reach even 15 percent, and the three small Baltic states, where investment rates show significant volatility as even investment by a medium-sized enterprise can cause huge differences from one year to next. This final group of countries, made up by regional countries of a similar grade of development as well as Portugal, provides a reasonable basis for international comparison. The fact that Hungary takes third place on list is an encouraging sign. On the other hand, if we take into account GDP per capita data from Slovakia over the past decade we can come to the conclusion that even a re-investment rate of 25 percent may prove insufficient and Hungary must make further efforts to advance at least one more place on the ranking to facilitate faster convergence.



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## The expected economic effects of investment stimulated by development policy instruments

It has been repeatedly proven and stated that pro-investment development policy funds boost the volume of investment, gross capital formation and the number of jobs. However, the same positive impact cannot be always identified with regard to sales, export revenues or profits.

As a result of **EU funds**, a massive amount of Government grants has been funnelled into the economy. These have underpinned the realization of various well-defined development objectives, mainly in the field of investment, research and development as well as innovation. The funds have substantially increased demand within the related sectors, within which the volume of output and the number of jobs have duly risen. Simulations by the so-called **CGE (Computable General Equilibrium) model** by Hungarian think-tank Hétfa Research Institute show that EU funds have added 0.3-2 percent to Hungary's GDP. The size of effects typically reflects the disbursement schedule.

Simulation assessments carried out by the help of the model also reveal that this massive extra demand has even slightly reduced the value of exports, and without these funds the value of exports would have been as much as 0.5-3 percent higher. This effect is believed to stem from the significant increase of aggregate demand in real terms.

The effects on the primary balance of the central government budget have varied immensely – both in a positive and a negative way -- and they have to a large extent depended on the size of parameters applied in model situations. These funds sometimes appear in the Government's balance sheet as financing demand to cover the gap between fund inflow and outflow. But the generated extra income boosted the volume of tax revenues and that in turn improved the balance. In the model's estimate, the funds are likely to have contributed 0.1-2 percent of GDP to the balance of the central government budget.

The judgements of impacts on investment, however, are rather contradictory. On the one hand, certain measures have resulted in obviously positive outcomes. For example, the evaluation of SME technology development projects revealed that one unit of funding generated a large increase: 1.38 units of extra investment. State Audit Office papers of 2015 also show positive



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changes in investment indicators. On the other hand, several studies on EU grants conclude that enterprises could have realized the majority of these investment projects also without these funds (see Béres, 2008). The assessment of various corporate performance indicators has shown that these development funds have either failed to boost or just marginally improved competitiveness. One of reasons is believed to lie in the selection process: enterprises with high investment potentials were more likely to submit tenders for projects and win them, as the entire tendering process typically addresses companies with large growth potential. Some experts who examined corporate indicators even find that as on several occasions higher inputs have resulted in an unaltered number of outputs, these funds may have even damaged the competitiveness of subsidized enterprises.

Currently available evaluations and conclusions unequivocally state that corporate grants may distort the operation of enterprises, and this opinion must be taken into account in the drafting of a development policy strategy. Experts also agree that companies tend to adjust their investment projects and the schedule of implementation to the sometimes highly but vainly anticipated announcement of tender calls for grants. Besides causing delays, grants also influence demand on other financing instruments, such as subsidized financial facilities. The delay of implementation due to the expectation of grants may sometimes be hugely negative for competitiveness. Besides the aforementioned opinions, experts agreed that funds had no or just limited impact on certain aspects of competitiveness. Several analysts highlighted difficulties stemming from the anomalies of domestic business culture, independent of the size and turnover of the company, such as the amateur, family enterprise traditions of domestic SMEs and the lack of professional management skills. Although some measures had been aimed at disseminating management skills, and these did reportedly make some occasional achievements, development policy has managed to only partially influence corporate culture and environment. The ultimate impression of experts was that the programming period 2007-2013 was incapable of changing false beliefs, practises and attitudes, despite the fact that certain studies stress the importance of developing entrepreneurial and management skills as a factor that could help contribute to a more optimal utilization of funds. (KPMG, 2013).

According to a working paper on financial facilities (e.g.: loans and loans with preferential interest rates) (KPMG, 2013), these instruments applied in the utilization of EU funding have basically



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fulfilled their role, channelling resources to end-points which would have otherwise been incapable of obtaining sufficient funds. The responses of representatives of financial institutions to economic surveys conducted by researchers were similar when it came to financial facilities. Along with the increase of the number and volume of external financial resources and the decrease of costs, these funds were also instrumental in facilitating relations between banks and SMEs as well as in helping build corporate data banks. As far as individual schemes are concerned, in the period 2007-2013 Jeremie-type funds created the largest challenges for banks and SMEs alike. Experiences showed that banks could not offer competitive products to this scheme, due mainly to the uncertainty around it, and that is why Jeremie funds were typically disbursed through financial intermediaries other than commercial banks. And as a result, the entire model has failed to be as effective as it could have been.

Long-term competitiveness makes innovation and experimenting as crucial components of economic policy measures and corporate investment. Wherever it is possible to finance smaller pilot projects from EU funding, it may be worthwhile to do so before economic policy offers a solution from fiscal resources. In case of existing funding programmes which use fiscal resources, implementation systems should be prepared to receive potential EU funds as additional resources. Certain models, however, precisely because of their innovative nature, cannot be financed from EU funding, and thus they need the backing of fiscal resources.



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### **The effect of FDI-driven investment within the economy**

In economic literature as well as in news outlets, it has become usual to write of corporate investment generated by the beneficial effect of FDI (Foreign Direct Investment). The following outcomes are generally mentioned as consequences of FDI: beneficial effects on growth, employment, economic structure, market demand, competitiveness, supplier output, technological modernization and the quality of services. Nonetheless, it is probably surprising that economic theories on the direct effects of FDI are not uniformly positive. Although some theories find a relatively large direct correlation between economic growth and FDI, this is believed to be only a temporary effect. However, hypotheses are more or less unanimous in one aspect: they agree that FDI may be a positive factor provided it manages to raise technological development level or boost employment.

Analyses also highlight the fact that FDI may result in some sort of duality within the economy, which means that local enterprises do not necessarily adopt the productivity of the foreign parent company. “As far as positive effects on the host country and the potential instruments of deeper integration are concerned, it is very difficult to influence how technology transfers and spillovers play out. The integration of existing investments must be just as important as attracting new investment.” (Sass, 2003)

To sum it up, a country can gain most of FDI if it succeeds in sufficiently integrating foreign companies, domestic enterprises can successfully join supplier chains, technology transfers enable domestic companies with competitive products to enter new markets and incoming state-of-the-art technologies, production models and innovative ideas can be spread among the largest possible number of economic stakeholders.