

LOCAL ECONOMIC DEVELOPMENT ACTIVITY IN HUNGARY

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The study deals with the practice of local economic development in Hungary and pays special attention to the role of local authorities.

According to our interpretation, local economic development (LED) involves deliberate intervention in the local economy, in the course of which both internal and external resources may be used. This intervention may be initiated by external actors (e.g. central government, the European Union, foreign investment), but the key element of the process is the involvement of local actors who fulfil this role: those entities who accept, support or manipulate the conception of external development.

The purpose of the article is to offer a brief review of the roles played by particular actors (e.g. central government, county authorities, Regional Development Associations and Councils [RDAs & RDCs]) – but principally by municipal authorities – in economic development in Hungary.

The study highlights the problems of financing and planning LED and also looks at networking practices of local actors. The tools and strategies of local authorities pursuing development are reviewed and we attempt to analyse the level of success of local economic development in Hungary.

Keywords: Local Economic Development, Regional Development, development tools, local actors, partnerships

Introduction

Firstly, we need to define clearly what is meant by “Local Economic Development” (LED), since the literature offers a wide variety of definitions.

In our interpretation, local economic development involves deliberate intervention in the local economy, in the course of which both internal and external resources may be used. This intervention may be initiated by external actors (e.g. central government, the European Union, foreign investment), but the key element of the process is the involvement of local actors, who fulfil this role: those who accept, support or manipulate the conception of external development.

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We use the term "local economic development" in a broad sense in that intervention in the local economy includes development of the infrastructure, of public utilities, human resources and business together with the creation of internal economies and the development of individual communities.

In Hungary the major economic re-structuring resulting from globalisation and the change of regime has created new tasks for local authorities. However, neither the extent of participation in economic development by domestic local authorities, nor surveys of local policies nor the changes to the tool-system used at local level have been adequately investigated in the past 20 years. Therefore, in our questionnaire, which was sent to all of the 3,134 local authorities and metropolitan districts in 2003, (to which we received 288 valid responses) we focused on issues which have only an indirect connection with local economic development. In the focus of our research, however, we put the economic development tools and practices of the local authorities of the settlements, as a result of which we can see the typical methods and intensity of local authority participation in local economic development. In fact, since 2003, there has been no further representative empirical survey on local economic development, and so for the period since then we can use only case studies.

Hungarian Local Authorities

The current Hungarian local government system was established under the Local Government Act of 1990. This Act classifies local authorities as: villages, towns, the capital city, together with its metropolitan districts, and counties (19 in number). The Act defines county authorities (County Councils) as territorial (or area) authorities, which, on the basis of their functions, are distinct from those of settlements.

For the purpose of our research, our questionnaire was sent only to local authorities of settlements. In 2003 there were 2,883 villages, 229 towns, and the capital, together with its metropolitan districts (23). Within this group, "towns" can be further categorised as towns (207) and county-rank towns (22) (Mezei 2008)

Currently, Hungary has 3,152 settlements; the capital, 23 county-rank towns, 304 other towns and 2,824 villages (HCSO 2009).

The importance of local authority initiatives

Despite all the debate among theoretical experts on the justification of external intervention in market processes and the success and effectiveness of such interventions, *Hungarian municipal authorities – in accordance with international trends – have clearly been taking the initiative in local economic development* since the political changes (Mezei 2008; Péteri 1996).

This fact is also shown in the opinions of mayors and citizens concerning the duties of local authorities in the survey of 1991. Heading the list based on the survey, we find non-obligatory local government functions, including local economic development. Further, the majority of the duties deemed most important are to do with the local economy (Péteri 1994).

Ten years later (in 2003) we also found that *the municipal authorities showed active participation to achieve their goals*. This is shown in the opinions of mayors on the role of local authorities in local economic development. The majority of the mayors (85%) voted in favour of the need for intervention. Eleven per cent said that local authorities should not be involved

with economic development (only village-leaders opted for this). Two per cent thought that settlement authorities should only play a small part in local economic development (larger settlements might play such a role, and the priority of the market and the extreme importance of basic supply should be kept in mind), whilst 2% of the mayors gave no response to the question.

The reasons for local authorities intervening in local economic development are (in the order of frequency of mention):

- It is the local authority which has to ensure the right conditions and support the processes based on needs analysis.
- It is essential for the solution of employment problems.
- It has an interest in revenue (local taxes).
- It has significant information, its position is satisfactory and it can coordinate processes.
- There is no better local agent since businesses themselves are too weak, lack capital and so are inadequate to help development. The main target is to improve the citizens' standard of living.
- It is closely connected to settlement development.
- It is in the interest of the community.
- It has the opportunity to play an influential role by providing the background for regulation and by its planning experience.

Local authorities cannot play a role in local economic development due to:

- the lack of necessary local government resources;
- the lack of an adequate legislative background,
- since determining the scope of authority required is problematic.

To make a decision on the question of "to intervene or not to intervene" in favour of the active side does not automatically produce "success" for the wholly or partially government initiatives as there are numerous solutions applying to method, target and achievement – which is why we shall look at the success of intervention in local economic development, the core operation supporting local initiatives and the tools of local economic development.

The success of local economic development

From the 1991 survey of LED it emerged that the majority of mayors were basically increase-orientated – that is, they wished to improve the conditions of the local community primarily by local investment (Horváth-Péteri 1993). However, a 1993 survey showed that, in respect of voluntary tasks, local authorities were involved in telephone supply, public security, the environment, gas and power supply and the fire service. The support of small and medium-sized enterprises (SMEs), the creation of jobs and the support of local economic organisations merely followed these (Péteri 1994).

In the light of this, to evaluate local authorities' local economic development initiatives, during our research in 2003, we collected, from mayors, accounts of success and failure which had had key importance in the recent history of the settlement. A total of 101 mayors reported successes and 88 failures (although these two categories were not mutually exclusive).

The categories of success stories – ranked according to frequency – were:

- Location of new enterprises, growing number of entrepreneurs, creation of new jobs;
- Realisation of infrastructure development projects;

- Realisation of successful tenders and programmes;
- Establishment of industrial parks, industrial districts or enterprise zones;
- Realisation of tourism development projects and an increasing number of visitors;
- Improvement of the local image.

The major categories of failure stories – again ranked according to frequency – were:

- A lack of new enterprises, a decreasing number of local businesses, a rise in unemployment;
- Cancelled local government projects (residents' opposition, official decision or unused resources);
- Cancelled infrastructure investments;
- Problems with the establishment of industrial parks, industrial districts or enterprise zones;
- Ageing population, decreasing number of inhabitants;
- Lack of tourism development projects;
- Poor local government funding;
- Agricultural crisis.

The *supply-side dominance of local economic development strategies in local government programmes* may be verified here – in an earlier part of this paper we mentioned the general trend in applying supply-side strategies – as in both categories (success and failure stories) the external, incoming enterprises had key importance.

It was similar during the 1994 survey, where the most important economic development targets were to introduce working capital and ease unemployment problems in both towns and villages. Here, however, as the local economic situation determines the direction of economic development, in villages, the burning question was unemployment, whilst in towns, introducing working capital was considered the primary aim (Péteri 1996).

Creating partnerships

One key of the success of local economic development is creating partnerships (Bennett-Krebs 1991; Felbinger-Robey 2001; Pálné Kovács 2004; Syrett 1997). *This practice, however, is a country-specific factor*, a world trend motivated partly by international aid, whose adoption definitely depends on the social, cultural, economic, institutional and political background of the given country (Mezei 2008).

Hungary is a centralised, unitary state, its laws basically permitting the *government and the bank of issue* to intervene in the economy (Finta 2004). *Ministries and their de-concentrated organisations* also have a central role, as they distribute resources, and so make decisions determining the direction of development in areas and settlements (Mezei 2004).

Regional Development Councils designed for planning-statistical regions practically played a money-distributing function, although, according to the law, they should also coordinate economic development agents – which they cannot achieve in practice. The departments of these Councils, the *Regional Development Agencies* played an active, initiating role in regional development. As opposed to classic development agencies, the characteristics of Hungarian regional development agencies were not only of economic-developmental nature (Somlyódyné Pfeil 2004). Currently, in the absence of decentralised development funds, the role of Councils has decreased.

County authorities are legally powerless. *County Development Councils*, as Regional Development Councils, primarily distributed money (relatively minor sums) gained from project application. Due to a paucity of resources for allocation and to county authorities functioning in parallel, county councils have become totally powerless.

Chambers (of Commerce etc.) legally play a significantly minor role in economic development than is the case internationally, since there is no compulsory chamber membership, and since they are gradually being excluded from decision-making over the distribution of money dedicated to development purposes.

The system of economic development is strengthened by a number of business development funds and firms, such as the *Hungarian Foundation for Enterprise Promotion* (with a national network with local business centres) and the *Hungarian Investment and Trade Development Agency* (since 2011 the *National Foreign Economy Office*) operating with regional (and foreign) offices.

Regional Development Holdings Ltd. and its subsidiaries – also operating through a national network – provide innovative SMEs, local authorities and their associations with assistance (e.g. consulting, education, information). There are also diaries of RDH which deal with venture capital and development credits supporting innovative SMEs.

International practice showed that we should also focus on *banks and financial institutions*. No special economic development rules apply to these, and so their contribution depends only on their own business policy and value system. The national banking system, being capital-centred in Hungary, is disadvantageous. This significantly reduces the sensitivity of banks towards rural problems and local initiatives. *Savings cooperatives* are an exception, but these have a lack of capital to support local initiatives, although, with appropriate policy (supporting product development and recapitalisation) they could be made suitable to play a role as a “community bank”.

Venture capital companies are not widespread in Hungary. Local councils do not have the necessary resources to be able to establish such institutions (as in Sweden or the USA). Regional venture companies integrated in the Regional Development Holding Ltd. cannot totally substitute for this.

Universities, Higher Education institutions and research centres could be the keystones of innovation-oriented regional development. It was not at all typical of Higher Education (and research) institutions to take part in regional development before the late '90s (Horváth 2004). Currently the situation is changing as the New Hungary Development Plan is promoting the leading role of Higher Educational institutions and research centres in programmes primarily targeting the renewal of society by developing regional centres and creating the innovative, knowledge-based economy with the help of the improvement of human resources (NFÜ 2007). The New Széchenyi Plan, which is the new government's programme for European Structural Funds, also places great emphasis on innovation and science.

Focusing on *businesses and business (strategic) associations*, their role in economic development is very varied. Whilst multinational firms generally do not participate in local initiatives (there are a few exceptions) the lack of a strong Hungarian SME network and the major national firms create a special situation. According to János Rechnitzer (2007) there is a slow but positive change in this since currently several Hungarian entrepreneurs have strength-

ened to the extent that they can take part in financing PPP constructions. Local initiatives may well be able to count on these two strong pillars.

Employee integration into local initiatives is limited; *Labour Councils* cannot fully represent them and *trade unions* (with few exceptions) are powerless and do not normally contribute to local initiatives.

At international level *non-governmental organisations* (NGOs) play a key role in local initiatives; in Hungary, however, they show rather modest activity. Institutionalised civil society was practically left out of institutionalised regional development, and their dependence on central and local subsidies means a further burden.

We plan to continue examining the development of local governmental cooperation based on local businesses, since these are considered the most important partner organisations.

Our research also aims to show that the majority of local authorities ask the opinion of local business before formulating local development targets, but 92% of settlements do not have frequent and formalised partnerships. *It seems that the likelihood of close and active relationships with the business sphere grows in proportion to the size of the settlement.*

The owners and the size of local businesses do not precisely determine local economic development activity, since the mayors of the participating settlements referred to the location of multinational businesses which influenced local development targets with their own activity, and there were cases when local firms remained outsiders and did not co-operate with local authorities. The answers of SMEs totally depend on the characteristics of local society, but there are other factors also and so the categories of local businesses do not produce very precise criteria when we talk about the intensity and strength of co-operation between local authorities and local business.

To sum up, *without taking the larger towns into account, the framework for frequent, formal partnerships has not yet been established within local government in general.* Ad hoc opportunities for expressing opinions cannot adequately guarantee the full support and acceptance of local development initiatives by the local business sphere and their integration into the local economy. The practice of creating partnerships between local business and local authorities demonstrates that, in Hungary there are serious deficiencies in the area of bottom-up partnerships.

Local economic development tools

Having reviewed the local economic development concepts of certain countries, we can see that, despite different economic development regulations and institutions, local authorities and development organisations use very similar tools (Mezei 2008).

Our survey showed that Hungarian settlements have different opportunities in local economic development depending on many factors, such as size and population. In consequence, *large and small settlements use different tools. It can be shown that larger towns can intervene most in the local economy (despite their critical financial position, thanks to their favourable liability portfolio and capacity). In the case of smaller settlements, regional networking and partnership may be a solution.* Since there are no model strategies, each settlement has to find its own unique solution to its particular problems (Mezei 2008).

Local economic development tools include:

- Improving local public services,
- Infrastructure development,
- Disclosure of information,
- 'One stop' business administration,
- Promotion materials,
- Tax abatement,
- Site provision, site-management,
- Setting up industrial parks and/or industrial areas,
- Business incubators, incubator houses,
- Supporting R&D,
- Establishing innovation centres,
- Business consulting,
- Promoting local products,
- Supporting local businesses' trade and marketing activity,
- Employee training/retraining,
- Subsidising local SMEs,
- Own investment (invested capital),
- Credit brokerage, loan and bank guarantees,
- Encouraging associations.

We would offer some thoughts on a few, but widely used, elements of this complex system of tools: planning, infrastructure development and tax allowances.

Planning

There are several types of plan, strategy, concept and programme which must be prepared by local authorities, a number of which are recommended or required for applications for different supporting funds and a number of plans are prepared on a voluntary basis. We postulated that, in the case of all larger and smaller towns, we would find at least one type of planning document establishing settlement development, or a minimum of one programme orienting the economic management of the authority. We also presumed that, in the case of smaller settlements, the planning activity rate would be lower.

Since the legislator has not laid down the formal, technical and professional requirements even in the case of compulsory planning documents, it is possible that those filling in our questionnaire applied the same name to different documents with completely different content or completely different quality. We cannot, therefore, determine from the number and type of documents prepared how far these are able to orient local decision-makers in reality and to what extent the frequent revision of those plans is carried out – and, respectively, the proportion of plans prepared for the desk drawer.

While a settlement development concept is available in most settlements (in 54.5%) only 40% have prepared the so-called economic programmes which are also specified by the law. Twenty-eight per cent of the settlements sampled have both types of compulsory plan, i.e., the settlement development concept and the economic programmes.

The most frequent type of economic development plan is the tourism concept (17%) and the housing concept (18%). These were also the most important tasks of central development

policy. The local authorities have also listed complex economic development plans (16%), employment concepts (10%), business development plans (7%) and marketing concepts (4%) among their economic development plans.

It is also remarkable that, among those settlements which had prepared several different plans, we find both tiny settlements and larger towns, whilst settlements with no plans at all are solely those with municipal status, the majority being tiny villages.

In future, appropriate planning will be vital to obtain EU resources, and so the solution may be to prepare complex local, economic and business development plans and job-creation programmes – to promote local support for such programmes as well to encourage the evolution of partnership.

Development of local infrastructure

Improving and extending the quality of the local infrastructure is a central issue in the obligatory tasks of local authorities and the expectations of the population. This is shown by the 1991 survey where mayors named the provision of infrastructure as the main reason for differences between settlements (Horváth-Péteri 1993), and, based on the 2003 survey, 94% of local authorities have been involved in – at least one – infrastructure development project since the political changes in 1990.

Fifty per cent of the settlements (57% of small villages and 46% of larger) could not indicate any investment activity targeted at economic development, but the majority of completed investments were connected to infrastructure development.

Forty per cent mentioned infrastructure investment projects connected with the development of public institutions, the renovation or building of roads, the supply or handling of potable water, waste-water or rain, or providing public lighting. There had been a gas pipeline development in 13% of the settlements. Increasing the development of telecommunications and IT and the building of sewage plants were each mentioned by 3.5%. Waste deposit sites and incinerators were established in 2% of the settlements.

During the period examined a popular, local state-supported initiative was establishing an industrial park. 13.5% mentioned the starting of a project to establish an industrial park or industrial area.

Tourism development, which was mentioned by 9% of the local authorities examined was also an area stimulated by central support. The majority of these investments belong to infrastructure developments.

Tax abatements for local businesses

Local authorities can influence the tax burden of local enterprises and undertakings by a combination of different eligible tax categories and the application of allowances. However, it is clear that the key element of the local taxation system is the so-called *trade and industry tax* which yields the most significant proportion of local revenue and so we have selected this tax category for investigation also.

At the time of the 2003 survey, 80% of settlements took advantage of levying the trade and industry tax, and some 72% of settlements issuing the local trade and industry tax, which

makes up 58% of the sample settlements, indicated that they used different types of tax allowance.

The majority of settlements obviously chose the supply-side strategy in the course of their economic development activities. This means that their primary target is to increase the attractiveness of their settlement for external investors, and so it is not accidental that the tax exemption (fiscal immunity) and the different tax allowances provided for “new arrival” businesses are generally preferred solutions. The tax allowance provided for SMEs in second place and the so-called capital investment tax allowances in third place are targeting, besides attracting new businesses and enterprises, the maintenance of existing businesses and the support of their developments. In fourth place are the different tax allowances targeting designated industrial areas, which are applied in the first place by larger and smaller towns, mainly by those already having industrial parks with infrastructure.

However, the above proportions are influenced by the requirements of the EU which permits investment and development tax allowances – focusing on SMEs.

A local, national law, in accordance with EU requirements, limits the use of an earlier, widely used economic development tool, the allowance of local trade and industry tax. In consequence, local decision-makers were forced to give up the most widespread, but at the same time the least effective, form of business attraction (Mezei 2008). This means that the adjustment of trade and industry taxes had to be completed by 2008 at the latest.

Summary

We examined several aspects of economic development practices in Hungarian local authorities. *Settlements use the opportunities deriving from the legal background and connected with the municipal conditions to a different extent depending on their size, potential and management.* We have seen that different factors may be emphasised in the development strategy of different settlements and they may use different tools in order to achieve their targets. Some local authorities are more active in the initiation of economic development intervention and in the creation of partnerships connected to these, and these local governments achieve fairly spectacular results. Some other local authorities, on the other hand, cannot demonstrate any progress since the political changes. While settlements of the former category are mainly larger towns, we can state that, in every size category, we can find local authorities participating actively in local economic development. The lack of initiatives connected with local economic development is rather characteristic of settlements with lower populations.

Finally, our research verified our hypothesis that *mainly the larger settlements and towns had available the tools for facilitating classical economic development investments, and smaller settlements could participate in special economic development initiatives within the limits of their opportunities.* In their case, regional networking and partnership may be a solution – starting at planning and finishing with the implementation.

We consider it important for local economic development to become universal in the future in order to create a local system of conditions adapted to international practice, both regarding the needed community resources and the freedom and opportunities of vital local economic development actors.

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INSTITUTIONAL CAPACITY AND REGIONAL ELECTRICITY MARKET IN SOUTHEAST EUROPE

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The implementation and benefits of regional electricity market (REM) in Southeast strongly depend on institutional capacity in these economies. At the same time, the appropriate level of institutional resources is crucial for SEE countries in order to benefit from the REM. The first step of institutional reforms is the establishment of national regulatory agency in the field of energy. All SEECs have adopted the EU reform model and established formally independent regulatory agencies, but the same model copied on those implemented in developed economies obviously is not a guarantee for an effective regulatory process. The failure of regulation in many less developed countries is the result of underestimation of the importance of the institutional capacity and institutional differences across countries, while the process of unbundling has made the regulatory task even more complex. The barriers for the regulator's independency can be related to a shortage in human and administrative resources, a lack of political support for the reforms and regulator's close connections to regulated industry.

The second step of institutional reforms necessary for building REM considers regional cooperation and regional institutional activities. SEE countries have implemented the harmonized, uniform approach influenced by EU Directives in the energy sector and this approach requires extensive subordination of national interests. Harmonization is especially important in order to attract private investors because they will invest only if there is a high degree of certainty about transmission network access, regulatory transparency and predictability. Therefore the common regulatory framework within the region with the coordination of regional planning would create benefits for all the SEE countries.

Key words: institutional capacity, Southeast Europe, regional electricity market, regulation

Introduction

In the context of actual economic and energy crises when energy issues have become crucial development topic, the paper focuses the issue of regional electricity market in Southeast Europe. The electricity sector in Southeast Europe has gone through extensive economic reforms and the establishment of the regional electricity market has been an important step. In October 2005 the Treaty establishing the Energy Community was signed as the only legally

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