Cohesion Policy, innovation, twin transitions, territorial competitiveness and divide

Financial Institutions Matter for Cohesion Policy

Challenges to achieve growth and positive impact on local economies
in Hungary (2007-2013)

- extended abstract -

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Financial intermediation plays a central role in economic growth and social progress (Mérő, 2003; Imreh, Kosztopulosz, Mészáros, 2007), its depth and the proper operating of its functions to promote real economic performance have a severe stimulating effect (Schumpeter, 1980; King-Levine 1993; Merton, 1995; Mérő, 2003; Kay, 2015). At the same time, financial institutions have limited capacity to meet the needs of the real economy in terms of their risk-smoothing functions and bridging the incentive problems. The malfunctioning of these functions, leading to imperfections in the dissemination of information in the financial markets, leads to market failures in financing the economy. Information asymmetry, can cause distortions in macroeconomic growth and can easily amplify the regional inequalities as well; therefore, their exploration is essential for development policy. Furthermore, following the lessons of the crisis in 2008, government interventions became critical to address market failures based on economic theories regarding the changing role of the state (Farkas 2017a, 2017b).

To achieve growth-promoting effects of financial intermediation processes and to handle the failure of some intermediation functions, due to their multiple effects and consequences, the intervention is not sufficient with isolated monetary and fiscal policy instruments. These policy instruments need to be applied in an integrated development strategy framework, considering territorial aspects (especially while correspondingly changing the "spatially blind" nature of these two policies mentioned above) and also at EU level to ensure better cohesion effects of the EU’s development funds. So, based on the facts that financial intermediary system has crucial impacts on national economic growth, territorial cohesion and on local economic development as well, financial instruments and their intermediary institutions could play a greater role in EU’s cohesion policy and especially in territorial development as well. In order to manage these funds towards the intended development objectives and target groups, creating an adequate policy mix is essential. This can also reduce the territorially and socially blind feature of the financial sector and the financial intermediary system.

In recognizing these widespread effects of the financial intermediary system since 2010, the financial instruments have become increasingly important tools for delivering the European Union's cohesion policy. In the areas in which the supported activities generate income (enterprise development, business support, infrastructure development, research and development), financial instruments should be applied (EC 2010). Their aim is to support enterprises and non-profit organizations which face obstacles accessing commercial banking products and are unable to obtain adequate financing from the financial market. When applying for a traditional loan or capital support their shortcomings include an insufficient collateral background, being too young, seed or startup phased units, even when having predictable cash flows, conscious management attitude, and a well-prepared entrepreneurial approach.

The presentation aims to give a brief overview about the financial instruments' role in development policy in the EU and, as a Central- European emerging country, to highlight the special features of the Hungarian delivery system (2007- 2013), and to identify the risks and challenges on local economic development in the current EU development period (2014-2020).

The background research was based on the analyses of the Hungarian strategic development policy documents (Partnership Agreement, Operational Programmes) and the activity data of the institutional system, which handled the repayable funds between 2007-2013 and which was reported by the Hungarian Development Bank. The literature review was focused on three key issues: the financial intermediary system's pro-cyclical impact on the economic processes and its growth generating effects; the territorial differences which can be directly caused by the uneven regional distribution of financial flows; and the policy goals of the European Commission and their delivery in the Hungarian development policy.

As, similarly to the international conditions (ESPON 2019), regional data below the regional level are not available in Hungary for the period 2007-2013 in connection with the use of financial instruments of the cohesion and structural funds, I also made a qualitative research to evaluate the territorial impacts of the EU's financial instruments in Hungary between the 2007-2013 period. Within this framework the qualitative data collection and analysis has been carried out using the Delphi -technique and the development of a "hybrid" version of it, due to the COVID-19 pandemic in the first half of 2020. As part of this, I searched for consensual expert opinions and conducted a total of 20 expert interviews, followed by an opinion poll. In all cases, the interviewees were anonymous and the respondents covered the civil sector, the financial sector, other private sectors and the public and municipal sectors (including experts from the European Commission) too.

On this basis, 10 consensus statements have emerged, highlighting, for example, the fact that the geographical proximity of financial intermediaries, while facilitating, is not the most important factor in the successful disbursement of repayable funds. The ability of the target groups to access resources is much more important. The research also revealed that in the period 2007-2013, financial instruments in Hungary mainly resulted in the development of the financial intermediation system and a greater diversity of financial intermediation institutions and financial intermediation opportunities. At the same time, it was a false assumption that the level of territorial development should be a leading factor in creating the integrated nature of financial instruments.

The last section of the presentation offers some policy recommendations for better financial instruments serving more cohesion effects. In examining the proposals for a financial intermediation system for repayable development funds, the research proved that a higher level of integrated policymix should be established for the proper allocation of financial resources for strategic development purposes, including in particular social and financial sector and regional development policies. Coordinating these issues will enable development policy to reach its target groups more effectively. At the same time, it was a false assumption that the level of territorial development should be a leading factor in creating the integrated nature of financial instruments.

Another interesting result for the higher involvement of financial institutions in development policy is that there was a consensus among respondents in the financial sector that specialization in financial products of the financial intermediaries in the period 2007-2013 was clearly an advantage to deploy resources (for example, the specialization of business development foundations for microloans under HUF 10 million has been a successful step).

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