SUBNATIONAL REGIONALISM IN A SUPRANATIONAL CONTEXT: THE CASE OF HUNGARY

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Abstract[1]. *European economic integration drives a political economy of regionalism that—far more than traditional divisions between labor and capital—defines the principal axis of political-economic division in the New Europe. The New Economy drives a radical shift in EU policy from cohesion or redistribution toward innovation promotion, affecting distributional struggles and policy approaches at the EU, national and subnational levels. Shifting strategies pose significant challenges at the national and subnational levels with important implications for future EU, national and subnational economic and regional development policy goals. At the national level, and in particular less developed economies, the New Economy creates incentives for the increasing centralization of decision-making. EU-level reforms, such as the Lisbon Agenda and an increasing emphasis on cohesion as opposed to structural funding, do much to strengthen these trends. Subnational regions, at least in the near term, may be the principal losers. But such trends are likely to strengthen future demands for greater subnational political decentralization.*

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JEL classification: F15 Economic Integration

Increasing economic integration in the European context places national governments and subnational regional entities at odds with each other—in particular in the less developed economies of Europe. Market integration drives greater concentration of economic activity in the more advanced regions of Europe and as well as in the more advanced areas of the New Member states. Increased differentiation on the basis of economic geography drives the rise of national and subnational economic and political regionalism. The consequences of economic geography are multiple, pitting more and less advanced national governments against each other—in particular though not exclusively in the struggle over EU Structural and Cohesion Funds (SCF's, the subject of a companion paper)[2]—and pitting national governments against subnational regional entities (the subject of this paper).

This paper asks what factors create the foundation for the implementation of greater

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[2] This struggle emerges on many levels, but is perhaps most visible at the level of debates over the EU's SCF's (Ellison, 2007). However, this struggle has also triggered EU-wide debates over national and EU-level corporate taxation and competition policies (Ellison, *forthcoming*).

political decentralization and/or regional autonomy. Previous authors have argued that demands for greater subnational regional autonomy are driven by such factors as democratization and potentially ethnic identity, the carrot of EU benefits (structural and cohesion funds), the power and influence of the European Commission (in particular as a tool to weaken states), and broader phenomena such as globalization. Ohmae (1993) argued that economically successful regions are emboldened by failed governance at the national level and the potential rewards of political autonomy at the regional level. More recently, Alesina and Spolaore (1997) have argued that integration into supranational institutional frameworks—in particular those strengthening trade relations—reduces dependence on the state and emboldens demands for greater regional autonomy.

I argue that national governments—in particular in the less developed EU economies—are placed at odds with subnational regional entities due to the challenges of the emerging economic geography. States at lower levels of economic development are subject to cohesion and convergence demands at both the national and regional levels and are thus likely torn between competing demands. National governments are likely to respond by promoting the degree of political and economic centralization—in particular where economic planning and the distribution of resources are concerned. The rise of the exogenous economy characterized by strong vertical integration with the West European marketplace now places CEE governments before the challenge of strengthening ties between foreign and domestic firms, strengthening R&D networks and building domestic potential for innovation promotion.

Subnational regional entities—in particular where subnational regional resources are threatened by centralized interests and projects—are likely to push for greater political decentralization and decision-making autonomy. Such subnational regionalism may take on different forms in different regions depending on the level of economic development and the degree of dependence upon centralized state level authorities. Where national and regional level interests coincide, i.e. where interests in the development of innovation promotion and the building of ties between foreign and domestic firms are compatible with regional interests, demands for greater political decentralization and regional decision-making autonomy will be muted. But these interests are likely to be less compatible in the less developed regions of Hungary. In this case, the carrot of EU SCF resources may potentially drive a wedge between national governments and regional entities—in particular where such resources create prospects for greater regional independence and autonomy.

The development of subnational regionalism however is also impacted by the domestic political context. Two factors stand out. One is the role of regional identity—or the lack thereof—and its potential for creating divisions between central and regional governance. Demands for greater regional autonomy and political decentralization may gain strength with time. But without a strong sense of identity based on ethnicity or language differences, complete secession will not likely be pursued. The second is the role of existing political institutions. In the Hungarian case, the emerging two-party system fuels the degree of political polarization between central elites and regional actors. Moreover, polarization impedes the role of local politicians, since the degree of party discipline common to parliamentary systems creates barriers for local actors with future political ambitions.

This paper proceeds as follows. The first section discusses the role of economic geography in explaining the structure of national and subnational regional interests. The second analyzes the impact of Hungary's economic integration in the European marketplace. The third provides an overview of the development of regional structure in Hungary. The fourth discusses the structure of interests at the local, county, regional and national levels in Hungary. The final section concludes.

Paradigm Shift? Cohesion, Redistribution and Innovation Promotion

In the broader theoretical literature, explanations for why governments choose to decentralize power vary from democratization, the carrot of EU benefits (structural and cohesion funds), the power and influence of the European Commission (in particular as a tool to weaken states), to even broader phenomena such as globalization. There is however a considerable degree of variation in the relative degree of decentralization and also in the importance of the regions among the old EU member states as well. Very few EU Member states have strong regions. Belgium, Germany, Spain and the UK (Wales and Scotland) appear to be the exceptions. For the most part regions are generally weakly developed in the Member States (Le Galès and Lequesne, 1998). Despite attempts by the European Commission to strengthen regional government as a form of institutional leverage over the power of EU Member states, the formation of powerful regions lags expectations. Thus the more relevant research question may be when and why central governments are likely to relinquish more control over the ambitions of regions.

A broad scale rewriting of industrial and regional development goals has been afoot in the European Union for some time. The *Sapir Report* dealt a considerable blow to previous regional policy initiatives. Since that time, DGRegio appears pinned between the competing agendas of regional development and the onslaught of *growth and competitiveness* and *Lisbon Agenda* policy orientations.[3] This intellectual and political economic debate is evidence that *New Economy* models cast new light on the geography and driving forces of economic growth and development. Observations from this literature have repercussions both for theorizing about the shape and substance of EU, national and subnational-level regional policy tools and goals,[4] as well as the institutional framework within which they are formulated. One of the principal contributions of the New Economy Models with respect to regional policy and national (or supranational) development goals is to question the nature of the linkage between regional, subnational development policy and the nature and structure of economic growth and development. In particular, the literature on the *equity vs. efficiency tradeoffs* of economic intervention, industrial policy and regional development strategies highlights both the challenge and problems of formulating compatible regional and national level economic policy goals.

[3] A book-length Danish Technological Institute (2005) study commissioned by DGRegio was dedicated to exploring the compatibility between regional development and *Lisbon* goals. Most recently, Regional Policy Commissioner Danuta Hübner has spent considerable time giving speeches on the significance of Lisbon goals for regional development. See for example the series of speeches listed on DGRegio's website given in early March 2006.

[4] See in particular Bachtler and Wishlade (2005), Martin (2003), and Baldwin and Martin (2004).

New Economy models designate the mix of *endogenous growth* and *economic geography* models popularized in particular by Romer (1994), Krugman (1991) and Lucas (1990). *External increasing returns*[5] derive from the geographic clustering of firms. Economic geography models in particular highlight the *territorial* nature of localized factors generating technological progress. Territorial effects arise both from local *spillovers* generated by the geographic concentration of economic activity, as well as from factors limiting the potential geographic range over which knowledge or technological progress is spread (see Leamer and Storper, 2001; Scott, 2000; Martin, 1999; Storper, 1992). Theoretical controversy remains over what specific factors ultimately drive external increasing returns, ranging from the *Marshallian* effects related variation in the size of the available labor pool (Krugman, 1991), to informal informational exchanges (Leamer and Storper, 2001; Scott, 2000; Storper, 1992;) to variation in the level and share of human capital (Lucas, 1990; Romer, 1994). Empirical evidence suggests the most significant impact of globalization and economic integration is regional variation in levels of economic development, in particular at the subnational level (Sala-I-Martin, 2002; Martin, 1999; and Quah, 1996), a phenomenon that is perhaps best explained by New Economy type models of economic development.

For the purposes of this article, *New Economy* models cast new light both on the forces driving economic growth and development and on their territorial impact. Observations from this literature have repercussions both for theorizing about the shape and substance of EU, national and subnational-level regional policy tools and goals,[6] as well as the institutional framework within which they are formulated. A principal contribution of the New Economy Models is to question the linkage between regional development policy and the nature and structure of the factors promoting economic growth and development (Martin, 1999). Theories of economic geography and endogenous growth promote increasing attention to regional clustering and the promotion of regional, geographically-localized spillovers. In doing so, they have two potentially detrimental implications for conventional regional development policies. First, they focus attention on pre-existing geographic concentrations of economic activity—in particular regions that are more economically advanced. And second, by promoting innovation-promotion oriented policies, they draw attention away from redistributive-type policies.

The nature and structure of European, macro-level and regional development goals has undergone considerable revision in the past two decades. European economic policy goals have exhibited a gradual shift away from their previous *sectoral* structure and direct redistribution (e.g. subsidies to firms and the support of declining industries, income support and the like). Emphasis is now placed on more *horizontal* forms of assistance with broad application, in particular on the role of physical and human capital (or infrastructure, R&D, training and education).[7] Reform of EU regional development goals follows in the footsteps of these economic policy reforms.

[5] Krugman's (1991) distinguishes in particular between increasing returns resulting from firm-level economies of scale and *external* increasing returns generated by the geographic concentration of economic activity. The implications of the latter are the focus of this analysis.

[6] See in particular Bachtler and Wishlade (2005), Martin (2003), and Baldwin and Martin (2004).

[7] Early discussion of the shift toward horizontal measures can be found in "Industrial Policy in an Open and Competitive Environment: Guidelines for a Community Approach" (COM(90) 556) and "An Industrial Competitiveness Policy for the EU" (COM(94) 319 final).

Intentionally or not, the *Sapir Report* dealt a considerable blow to previous regional policy initiatives. Since that time, DGRegio appears pinned between the competing agendas of regional development and the onslaught of *growth and competitiveness* and *Lisbon Agenda* policy orientations.

Though the radical shift in development strategies and goals is perhaps only moderately perceptible, what is being questioned is the long tradition of EU and national level policy orientations focusing resources on agriculture, declining industries and lagging regions.[8] As many argue, if Europe is to become more competitive, it must shift more resources to more competitive economic activities. Following Streeck (1999), this is part of a more generalizable phenomenon occurring at the level of the state as well. Streeck emphasizes the current national government practice of promoting *productive assets* (physical and human capital, education, R&D, infrastructure, etc.) at the expense of *redistributional spending* (transfer payments, unemployment insurance and other forms of income maintenance). Competitiveness concerns drive a broad re-orientation of economic management strategies. Moreover, this phenomenon is occurring at both the supranational EU, national and subnational level of policy-making.

The specifically *regional* character of shifting policy orientations is less obvious. Yet New Economy models prompt a comparatively radical rethinking in particular of the compatibility of national and sub-national regional policy goals. These models have focused attention both on the importance of agglomeration economies and their clustering of economic activity, as well as on the importance of regions insofar as such clustering tends to exhibit a particularly regional character. One should not however confuse (as some of the literature appears to do) the focus on the regional clusters of economic activity with the previous focus on regional policy and regional development in the less advanced regions of Europe. The New Economy model is focused on promoting dynamic regional growth—in particular in regions exhibiting a positive propensity to support such growth—while the other is more clearly focused on an attempt to reverse patterns of economic decline. The outcome is likely to be an increasing degree of competition between *growth promoting* and *cohesion inducing* public policy goals or, as phrased at the outset of this article, between *innovation-oriented* and *redistributive* policy goals. Moreover, this competition exhibits a decidedly *territorial* character.

The prospects of Europe's less developed regions are further frustrated by significant regional variation in long-term levels of economic development. Repeated failures to turn some regions around (e.g. the Italian *Mezzogiorno* and East Germany), propel many to ask why EU or national level resources should be allocated to policies that do not always bear fruit.[9] A number of authors thus point to *equity vs. efficiency* trade-offs with respect to national and regional economic policy goals (Brakman et al, 2005; Bachtler et al, 2003; Martin, 1999). In their view, if agglomeration is crucial to the nature and character of economic development, then transferring resources to less developed regions is likely to slow the rate of economic development in advanced regions and accordingly may—by diverting valuable resources—fail to achieve their desired effect in less advanced regions.

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[8] This point is clear from the Sapir report (European Commission, 2003: 79, 126).

[9] For recent overviews of the literature on the relative success of regional policy, see Jouen (2005: Annex) and Funck and Pizzati (2003).

Revising policy approaches directed toward less developed regions or reducing government intervention in regions on the decline are likely outcomes of such observations. In fact, promoting growth in the more developed regions is often seen as the key to promoting growth in the less advanced regions (see Brakman et al, 2005; Scott, 2000). As Scott argues, "*geo-economic space*" is made up of a "*central nucleus*" and a "*hinterland*" of variable size (2000: 48). Implicit is the notion that the welfare of more remote regions—though excruciatingly unclear where such regions begin and end[10]—is dependent upon and pulled along by the welfare of the core regions. In this regard, *New Economy* models disadvantage redistributive policy and favor more targeted and potentially more *supply-side* oriented policies focused on the development of human and physical capital (education, R&D and infrastructure), potentially diminishing the *regional cohesion* and *redistributive* content of development policies.

Efficiency motives provide strong incentives for both national governments and regions to exercise greater control over economic development strategies. For national governments, both EU-based and national-level regional development strategies—in particular those focused on cohesion and redistribution—potentially drain resources away from more advanced states and regions. While all states are broadly similar in this regard, the level of economic development across states generates variation in policy interests. For *more advanced states*, such observations drive an interest in promoting Lisbon-type objectives over more traditional forms of regional development. Lisbon-type objectives, however, embody implicit challenges, both to the interests of less developed states and regions and to the future of regional policy more generally.

For *less advanced states*, regional development goals are preferable to Lisbon-type strategies where this portends a greater concentration of funding on less developed states. At the same time however, in the domestic arena the specifically regional focus of regional development strategies may potentially draw resources away from emerging economic clusters and potentially upset the fine balance between regional and national level economic restructuring and overall economic development. If the dispersion of resources designed to promote overall development leads to an overall decline in rates of economic growth, national governments will then presumably favor agglomeration promoting policies over regional redistribution. Less advanced states in particular are thus faced with significant equity vs. efficiency tradeoffs and are torn between the objectives of *cohesion/ redistribution* and *innovation promotion*.

Due to efficiency concerns, states in particular are likely to be torn between *innovation promotion* and *cohesion/ redistribution* and are also likely to favor greater centralization in the institutional structure that oversees the making of economic management policies at the national level. Increasing demands for decentralization (whether their origin is the Commission or the regions themselves), in particular over EU funds, are likely to be paralleled by increasing national government attempts to maintain control—at least as long as politically feasible. Less advanced states in particular have strong incentives to side with growth-club constituencies in the more advanced regions,

[10] One way of thinking about this problem is to ask how it fits the European case which Scott does not directly address. For example, should one think of central nuclei and a hinterland at the national, subnational or European level? The relevant unit of analysis here is terribly important in terms of its policy implications.

since these are presumably more likely to attract important resources for the state—in particular government revenues and improved employment.

The role of the EU and the subnational regional level in attempting to foster greater decentralization at the regional level may well be rendered somewhat ambiguous in this general context.[11] The current trend—even in the framework of EU funding and the institutional management of these funds—seems to run in the opposite direction. For one, the EU has begun shifting more of the redistributional funding away from the *structural* and toward the *cohesion* elements of the SCF. This has the impact of increasing the role and importance of the state over the regions. Moreover, while DGRegio has tended to emphasize the importance of regions, current efforts likewise place considerable emphasis on the coordination of regional and state-level economic strategies,[12] once again pushing the emphasis toward the state level. For another, EU co-financing requirements ultimately favor national level institutions, since approval of such funds tends to depend on national or ministry-level support for individual projects.[13] Finally, despite an initial interest in greater decentralization, during the period 2004-2006 the coordination and management of EU SCF funding was primarily left up to CEE states. Left to their own devices—in particular with the advantage of increased political centralization—states and national governments can more easily decide how best to allocate resources across regions. Thus the EU's indecisiveness and ambiguous approach to the politics of regional development allocates much of the political struggle over economic policy strategies to the national arena.

Efficiency motives are also likely to give rise to intense national level conflicts over resource distribution. The New Economy view of what drives economic growth raises explicit challenges for regions. Economically *more advanced regions*, on the one hand, are likely to lobby national governments in favor of regional development strategies that favor agglomeration and the development of greater innovation potential. Such regions may be at the forefront of national-level autonomy drives, but are less likely to be strong supporters either of national or supranational EU-level redistribution toward less developed regions. On the other hand, insofar as EU membership provides such regions with greater political autonomy and the ability to trade freely with the other regions of Europe, they are likely to be strong supporters of European integration.[14] Economically *less advanced*

[11] For many reasons, DGRegio is likely to find itself in a considerable state of turmoil. For one, such a paradigm shift ultimately entails shifts in the policy constituencies and *entrenched interests* built up over time for the purposes of institutional survival. At the same time, both the phenomenon of paradigm shift and the EU's changing membership basis distinctly threaten older constituencies. In this regard, DGRegio is likely to be torn between competing interests. Moreover, some of this process is likely to be mirrored at the level of the state. The Hungarian case presents an interesting example. Power was first shifted to the National Development Office and only later shifted back to the Ministry of Local Government and Regional Development.

[12] The recommendation of the Danish Technological Institute's (2005) report, for example, strongly recommended that in order to pool the synergies of regional and state-level economic development strategies—and in particular in order to make Lisbon type strategies more compatible with regional development goals—it was important to coordinate and align them.

[13] Co-financing tools—for example the EU's 50% co-financing requirement for structural funds is typically seen as a mechanism for forcing correspondence between regional and national level interests in economic development (e.g. Bachtler et al, 2003: 16).

[14] This is the beauty of Alesina and Spolaore's (1997) argument that as nations become more economically integrated—or as free trade deepens and becomes more widespread—there are increasing incentives for regions to seek greater political autonomy from nation states.

regions, on the other hand,—in particular in the less advanced states—are likely to become strong supporters both of more traditional forms of national-level and EU support and in particular of the EU redistributional framework. In addition, they may potentially become strong advocates of political decentralization. Advocating political autonomy, however, is less likely in a context where such regions are dependent upon the approval and resources of national governments—in particular for co-financing of EU-funded projects. But in the context of national government support for more advanced regional economic clusters—less advanced regions—notwithstanding the ambiguities noted above with respect to EU-level loyalties[15]—may eventually see the EU as a haven for the defense of regional interests and as a vehicle through which they can gain greater political control over resources.

There are important caveats to the *New Economy* approach. For one, faster economic growth in Europe's peripheries appears as a potential contradiction to New Economy models and provides some support for neoclassical approaches. Slow growth in Europe's core has been one of the driving forces behind the interest in re-orienting European policy approaches toward the Lisbon agenda. While it is beyond the parameters of this paper to respond adequately to this debate, even some of the more avid and astute proponents of New Economy approaches provide occasionally contradictory data with surprisingly little commentary. Martin, for example, builds an argument around the New Economy approach but then provides data to suggest that the peripheries grew more rapidly over the period 1995-1999 (2003: 22).[16]

Others have likewise noted that although less advanced regions are frequently assumed to benefit less from economic integration and EU membership, the evidence to support this claim is at best mixed. Thus Hooghe and Keating, voice a degree of skepticism about the *core-periphery* model (1994: 369). Such findings generate further uncertainty in the calculation of which regions are likely to win and lose from the process of economic integration and EU membership. Moreover, some countries and regions have met with considerably more success than others, suggesting that other factors also play a role—in particular, the specific institutional features of individual countries and regions. Variation in the economic success of Irish, Spanish, Portuguese and Greek regions, for example, is difficult to explain only on the basis of EU-funding.

Hungary and the Rise of the Exogenous Economy

The countries of Central and Eastern Europe are faced both with the challenge of promoting a stable, functioning macro-economic framework and with the dilemma of promoting successful regional economic development. Early discussion of the consequences of European integration focused almost exclusively on national level benefits to economic integration and little attention was devoted to the potential impact of economic integration at the local or regional

[15] To the extent that the European Commission continues to lean in the direction of national-level control of EU-funding, this may greatly limit the ability and interest of less advanced regions in promoting their ties to the European Union.

[16] Martin does argue that while there is economic convergence across states, there is economic divergence across Europe's regions. However he essentially neglects the larger question of what explains convergence across the states of Europe.

level in individual countries.[17] However, with the rapid increase in regional disparities, regional development strategies have become increasingly important. Many regions in Central and Eastern Europe have been devastated by the economic transition and the rapid economic restructuring of some regions, leading to high levels of unemployment and cross-regional wage disparities. At the same time, both democratization and the EU accession—in particular through the creation of NUTS II level regional administrative entities and the distribution of EU structural funds—have encouraged the formation and development of regional entities that grow increasingly interested in developing their own capacity to promote regional development and administrate EU funding.

The Central and East European countries are caught at an awkward juncture. On the one hand, they have—in particular the more advanced among them—achieved considerable progress in promoting foreign direct investment (FDI) and economic growth. Most or all of the Central and East European economies are now well integrated into the European marketplace, have dramatically boosted their overall levels of trade with the West and have received substantial FDI. On the other hand, as a number of authors have illustrated (Ellison, *forthcoming*; Pavlínek, 2004), there is a growing gap between those firms that are now well integrated into European networks and those firms that remain on the fringe. This gap is to some extent commensurate with a distinction between foreign affiliates and domestic firms or what some refer to as the *dual economy*. However, some domestic firms in CEE clearly benefit from their growing links to the West or from economic and/or market transition more generally.

EU membership and economic integration in the European marketplace reinforces and exacerbates the existing national-level economic geography. A frequent complaint in Hungary is that FDI and the presence of foreign MNC's has contributed generally to economic growth (a rise in productivity), to rising wages and to rising shares of Western oriented exports. But the share of R&D related activity and thus, many contend, Hungary's innovation potential is on the decline. For one, Hungary previously had far more substantial shares of R&D expenditure (in 1988 these amounted to 2.3% of GDP but by 1996 they had fallen to 0.7% of GDP) (Havas, 2001: 11). For another, incoming MNC's occasionally scaled back existing Hungarian R&D activities or transferred some R&D activities to home bases (Sass, 2004; Pavlínek, 2004).[18]

While the complete picture here is more nuanced, many fear that high reliance on foreign-owned MNC's is likely to reduce the share of Hungarian innovative potential, leading to a degree of path dependence. The worst case scenario is that hopes for greater convergence in the standard of living are likely to be frustrated in the longer term. In this sense, the countries of Central and Eastern Europe are torn between national and

[17] Bachtler et al, for example, note that 'market economy based' regional measures did not develop rapidly. More emphasis was placed instead on macro-level national economic variables (2003: 16). While this may overemphasize the degree to which the regional level was in fact neglected—many of the incentives schemes adopted in the mid to late 90's in countries like Hungary in fact offered quite generous rewards to investment in less developed regions (see Ellison, *forthcoming*)—there does appear to have been a far greater emphasis on national level economic development and a much weaker interest in regional economic development.

[18] Not all of the evidence is so negative and there are a few significant examples of firms importing important shares of their R&D activity. See e.g. Berend (2000) on the example of General Electric in Hungary. For a broader overview of this general problem, see Ellison (*forthcoming*).

regional-level economic strategies and interests. Moreover, the requirements of EU membership ultimately forces these countries to think more regionally or locally than was previously the case—in particular with respect to the use and administration of the EU's structural and cohesion funds.

These countries now face the requirement of consolidating the past decade of privatization, economic restructuring and foreign investment into more firmly embedded systems of economic production and technological development. Essentially these countries would like to improve national networks for innovation promotion—to counter the encroachment of exogenous economic development with the creation of more endogenous economic networks. At the same time, powerful forces are at work in the European Union to limit the degree of economic competition between East and West, potentially reducing the inflow of resources and restricting the nature and shape of the economic development tools these countries have at their disposal. EU membership, for example, meant the disbanding or reduction of many investment promotion strategies previously used by national governments in Central and Eastern Europe (Ellison, *forthcoming*).

Widening regional disparities in income and employment increasingly weigh on national level politics and encourage regional actors to become more and more politically active, in particular with respect to the national and regional level decision-making framework. Moreover, the EU's imposition of decentralization in the formulation and administration of regional policy goals and funding (in particular where regional policy is governed by structural fund projects), reinforces the political strength of regional actors.

Central governments in Central and Eastern Europe have so far been resistant to the decentralization of regional policy. There are of course multiple factors that might explain this. For one, CEE central governments enjoyed highly centralized political power throughout the Communist era and may not be willing to relinquish such power easily. For another, decentralization has for the most part been imposed from above and thus does not always map well onto local and national-level interest formations (Dimitrova, 2002). This fact alone raises important questions about the degree to which the created regions are what one might call "*organic*" structures of interest representation. Dieringer and Lindstrom (2002) argue that the degree of compatibility between EU and national policies is above all a function of the degree of *fit* or *misfit* between existing and adopted EU regional institutional structure. More "*organic*" definitions of regions that preserve the character of locally embedded knowledge-creation and interest networks may be more likely to promote the economic development and long-term competitiveness of regions.[19] To the extent that regions and regional governments—in particular those in decline—are not well-suited to the development of locally embedded knowledge-creation, efforts at decentralization and regionalization are likely to be resisted.[20]

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[19] McDermott (2004) makes the argument that Polish regions represent embedded regional interest networks and thus exhibit a high degree of "fit" in the language of Dieringer and Lindblom. In Hungary, NUTS II regions were superimposed on the existing structure and network of counties with approximately 3 counties for every region (except for Central Hungary, which represents Budapest and the surrounding area). The resulting regions often exhibit little attention to more *organic*, locally based structures of interest and identity.

[20] In Hungary, for example, local governments around the Balaton area have resisted their division and incorporation into 3 separate regions. As the Balaton region has long survived on the foundation of tourism,

The most compelling reason however for resistance to decentralization is simply that highly centralized policy making facilitates the formulation and implementation of cohesive national economic policy goals, while the strengthening of regional bodies may have the impact of fragmenting and dissipating their focus. The vertical rigidity introduced by Hungary's integration into more EU-based market networks propels national level policy initiatives intended to promote the creation of internal innovation promotion networks. This is presumably easiest to do by promoting the strengthening of ties between domestic and foreign firms and investors in the more developed regions and by attempting to strengthen R&D capacity in Hungary.

Thus, the interests of actors in the more developed regions of Hungary are more likely to fit easily with current interests in counter-acting the rise of the exogenous economy. Both foreign affiliates and domestic firms in regions with larger FDI shares are likely to lobby for the extension or continuation of national level economic policy goals. Thus, in the long run these actors are likely to be the allies of central governments since they are likely to favor the continuation of the status quo—in particular to the extent that such policies emphasize investment promotion and other attempts to build linkages between foreign and domestic industry (at least to the extent that these policies do not run counter to the EU competition policy).[21]

In the less developed regions of Hungary, on the other hand, regional development and investment needs are at least potentially very different. While this point is clearly recognized by some analysts (see e.g. Sass, Czakó and Bakács, 2006; Pál, 2005), its implementation and realization remains problematic. Thus both domestic firms and regional government entities in lagging regions are likely to lobby strongly for more pronounced regional policy efforts and ultimately for greater levels of political decentralization. Foreign affiliates—in particular because they are less dependent on local sources for capital and investment support—may potentially go either way. They may remain indifferent to regional policy goals, or they may favor national level policy goals (e.g. Lisbon-type strategies), or more regional policy goals depending on their immediate production and infrastructure needs.

The Development of Regional Structure: Hungary's Insistent Centrism

In Hungary, centralized, national-level political development has a long history, equaled and eclipsed only by the long historical development of county governments (vármegye). A third level of governance was initiated at the beginning of the democratic transition with the 1990 law on local government and a fourth possible level of governance was introduced with the 1996 and 1999 laws on regions introduced in compliance with European Union (EU) demands for the establishment of Nuts II level administrative units. In important respects, Hungary's growing tug of war between its

some have mobilized for the creation of an independent Balaton region. The division and incorporation of the Balaton region into 3 separate regions comprising the rapid development of manufacturing has meant that regional efforts confront competing demands. In such cases, the presence of significant resources (i.e. EU structural and cohesion funds) may drive strong demands for more local and newly defined regional decision-making autonomy (see Oláh, 2005).

[21] Prior to EU membership, this was in fact the case. EU accession has witnessed the increasing grip of EU–level competition policies and thus the elimination of some national-level investment promotion strategies in Central and Eastern Europe (Ellison, *forthcoming*; Antalóczy and Sass, 2003; Szanyi, 2003)

insistent centralization and regional, county and local demands for economic development and greater political decentralization have only just begun. But given both the rapidly increasing regional differences in the level of economic development, regional disparities and the uneven flow of foreign investment from the European Union, regional politics will become more and more heavily politicized in the years to come.

In the early 1990's, there was stronger government support for political decentralization in Hungary. The 1990 Act on Local Self-Government greatly strengthened the lowest level of governance by allowing local councils to voluntarily form some 3200 local governments with direct elections. At the same time, this Act greatly weakened the previous dominance of Hungarian counties by assigning the right to levy taxes and all basic competencies to the local governments (Vigvári, 2005: 230; Pálné Kovacs, 2005: 206). Thus, local governments were granted far greater political power and autonomy than they had enjoyed under the previous Communist regime. Most argue this was a response to the overly centralized power of the state under Communism and thus an example of democratization (Fowler, 2001).

In contrast however, Hungary began to recentralize political power with the introduction of NUTS II regional administrative units. NUTS II regions were created in Hungary as administrative units for the management of pre-accession and structural and cohesion funds, largely at the behest of the European Union—pointing to the importance of the EU. However, several authors have suggested that the creation of NUTS II administrative regions in Hungary was taken as an opportunity to reassert the powers of the central government and thus the state over the formulation of regional policy and EU funding. Moreover, both of the major political parties in Hungary appear to have been equally interested in maintaining greater centralized control (Fowler, 2001).

Hungary began to introduce NUTS II regional administrative units with the 1996 law on the regions. One of the strongest indicators of the lack of central government will to introduce strong regional governments was the fact that NUTS II regions in Hungary were initially voluntary. Counties wishing to band together to form regional administrative units were encouraged to do so, but there was no legally binding requirement for this to happen. Consequently, the regions established after 1996 were loosely organized administrative structures and were not formed either consistently or uniformly across Hungary.

With the 1999 law on the regions, Hungary introduced legally defined administrative regions and guaranteed funding for them. However, even these regions and the respective "regional development councils" (RDC's) have remained more strongly controlled by the central government and the respective ministerial bodies (Pogátsa, 2005a; Fowler, 2001). Half the RDC votes are distributed among local governments and micro-regions, counties and city-counties and the other half are distributed among government officials representing the various ministries. The more numerous local governments and micro-regions in particular remain heavily under-represented due to their very small seat shares (Pogátsa, 2005a: 21-2). The consequence is that unless regional entities can coordinate voting, they are easily outweighed by central government representatives.

Since, as noted above, the municipal level currently enjoys a far greater degree of democratic accountability and legitimacy, the voting structure in the RDC's results in a potential mismatch between democratically legitimated authority and authority at the county and regional level. Pálné Kovacs further argues that power within the RDC's is frequently dominated by individuals able to cumulate mandates across county public office (in particular county general assembly chairs automatically become chairs of the County Development Councils), county and regional development councils, and higher offices (e.g. the National Development Council and/or National Parliament) (2005: 14-15).

The socialist MSZP government elected in 2002 introduced a plan in late 2002 that foresaw directly elected regional governments and an increase in their share of own resources[22]—presumably with the intention of increasing the degree of democratic legitimation of regional policy. However, the MSZP government failed to introduce its proposals into law and quickly dropped discussions of them. Part of the problem faced by the socialist (and other Hungarian) government(s) is the requirement of a 2/3rds majority for constitutional amendments (Pálné Kovacs, 2005: 9).[23] Moreover, this requirement is likely to present more and more difficulties in the future, as Hungary gradually becomes more of a 2-party system—potentially rendering it impossible for Hungary to make further constitutional changes. Given Hungary's current two party dominant composition (both the SZDSZ and the MDF are quite small), it is more than difficult for either the MSZP or FIDESZ to call upon a sufficient share of votes to be able to pass such changes on their own.[24] Further, given the degree of ideological distance and conflict between the two major parties, it is difficult for them to pass such constitutional amendments in concert with each other.

The *National Regional Development Concept* (NRDC) published in June 2005 called for regional reform. However, regional elections are put off until approximately 2014, a time-framework that would preserve centralized control even over the general outlines of the EU's 2014-2020 Financial Framework Perspective. Moreover, further discussion on appropriate models for the creation of self-governing regions was put off until 2008-2010. At the same time however, the NRDC provided the foundational framework for the development of regional operative programs (ROP's) for the second National Development Program covering the period 2007-2013. This represents a significant change from the more centralized strategy pursued over the 2004-2006 period. During this period, the first *National Development Plan* (NDP) only provided for one centrally managed ROP for all seven Hungarian regions at once (Lakatos and Túry, 2005). All-in-all, only very limited attention was granted to regions in the first NDP.

While the election of a FIDESZ government in 2006 might possibly have modified some of these plans, big changes in policy were not likely.[25] For one, if previous experience is any guide, the central

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[22] See for example the Hungarian Ministry of the Interior's "Public Administration Reform Plans in Hungary (2003-2006)" (2003: 4).

[23] The 1999 reform was made easier for the FIDESZ government to pass by classifying it as focusing on "regional development" and not "public administrative" reform, thus requiring only a simple parliamentary majority (Fowler, 2001: 26).

[24] Since 1989, only one Hungarian government enjoyed a strong enough majority to be able to successfully pass constitutional legislation: the 1994-1998 MSZP-SZDSZ government. This fact represents a significant and under-researched dilemma in the current Hungarian constitutional framework.

[25] During the 2006 electoral campaign, Fidesz criticisms of the MSZP's national development program amounted to little more than objections that the party's platform drew too heavily on the MSZP government's plan. Fidesz proposed few concrete alternatives.

government (whoever is in power) is likely to hold onto central decision-making authority for as long as possible. To date, both of the major parties have tended to favor more centralized control over decisions related to regional development and have failed to make significant institutional reforms to further strengthen regional decision-making autonomy. While frequent promises are made with respect to further decentralization, in general there has been only very limited progress.

The replacement of the head of the National Development Agency (NDA) with the 2nd Gyurcsany Ferenc government in July 2006 ultimately witnessed a further significant centralization of national government control over EU SCF's. Rather than continue to disperse money through different programs and ministries, Bajnai Gordon announced the intention to "centralize spending (and thus decision-making) in the hands of a single office", except where such funds are to be distributed through regional authorities. Where previously several teams from different ministries were involved in the management of EU funds, the funds were then "merged into one single organization".[26] Moreover, despite increased emphasis on regional operative programs, the NDA announced—as outlined in the New Hungary National Development Plan, 2007-2013—it will spend some 75-80% of its 2007-2013 Framework Perspective funding on sectoral programs, while 20-25% will be used for human capital development.

The growing centralization of political control has resulted in strong criticisms from the major opposition party, in particular due to the lack of parliamentary control over NDA decisions. While the broad parameters of the most recent New Hungary National Development Plan have been approved by the national government, on October 25th, 2006, parliamentary control over the broad framework of the program is lacking. Despite discussion of the possibility of elevating the office to the level of a ministerial position—requiring parliamentary approval of NDA decisions—this step was not taken until July 1st, 2007, well after the major decisions concerning the distribution of EU funding had already been made.[27]

Trends from the European Commission tend to reinforce greater centralization at the level of the state. The previous structure of the EU's SCF provided an impetus for stronger regional involvement in decision-making. The reverse was true however for the 2004-2006 Framework Perspective and is likely to remain true for the 2007-2013 Framework Perspective. For one, the 2007-2013 Framework Perspective approved by the European Council in December 2005 represents a significant shift toward the cohesion model. The result is a significant shift toward the state level and away from regional involvement in decision-making (Pogátsa, 2005b: 267).

Features of SCF planning proscribed by the European Commission likewise reinforce the decision-making capacity of the state. For one, EU co-financing requirements ultimately favor national level institutions, since approval of such funds depends on national or ministry-level support for individual projects.[28]

[26] *Budapest Business Journal*: "Bajnai takes over development office ahead of revamp" (July 16th, 2006).

[27] The modified version of Government Decree 130/2006 went into effect on July 1st, 2007. In this modified version, the NDA is responsible to the Ministry of Local Government and Regional Development. Prior to this modification, the NDA was responsible only to the Prime Minister's Office (see Complex Jogtar, 2007).

[28] Co-financing tools—for example the EU's 50% co-financing requirement for structural funds is seen as a mechanism for forcing correspondence between regional and national level interests in economic development (Bachtler et al, 2003: 16).

Moreover, the regions in Hungary are resource-poor and thus not able to finance programs on their own. Finally, a recent DGRegio commissioned study—assigned the task of identifying linkages between the Lisbon Agenda and regional policy goals—came to the conclusion that regional policy should be more firmly integrated into national-level policy goals.[29] Finally, the growing emphasis on the Lisbon Agenda and more horizontal measures further strengthens the hands of the central government.

Thus the role played by the European Union has been ambiguous. Though some view the European Union—in particular the European Commission—as one of the main proponents of decentralization and the rise of regionalism, the Commission's role has been more ambiguous in Central and Eastern Europe. The Commission has seemingly encouraged greater decentralization of regional administration while at the same time requiring—at least for the early years of structural and cohesion fund administration—that the central governments maintain strong control over the formulation of Regional Operative Programs (ROP's), and the administration and use of EU funds for the 2004-2006 period. Thus, while the EU required the introduction of NUTS II regional administrative units for the purposes of distributing EU resources, it failed to require that regions be granted decision-making autonomy.[30]

This does not mean that the effect of the EU has been entirely negative on the formation and strengthening of regional entities. The distribution of both pre-accession and structural funding has encouraged greater organizational efforts at the local, city and county levels for some time (Lakatos and Tury, 2005). But in most respects, the real consequence of creating NUTS II regions and RDC's in Hungary has been a tremendous strengthening of the powers of the central government over local, city and county level interests. The degree of centralized power extends from the control of votes in the RDC's all the way down to the funding of applications for EU structural fund projects, which some argue predetermines the content of final projects.[31]

Few seem to disagree that further reform of the Hungarian regional development model and its institutional underpinnings is clearly needed. Most appear to agree that the regional institutional structure needs to be strengthened. Further, most seem to agree that there are too many local governments and that some more efficient (and moderately more centralized) system of local governance needs to be established. Beyond that, there appears to be little consensus on what form a new version of regional government should take. The establishment of regional governments based on the current NUTS II level of organization would presumably go a long way to legitimizing regional development policies and goals. Moreover, due to the legitimation factor, democratically elected regional governments would presumably make it politically difficult for the central government to dominate decisions over

[29] See in particular the conclusion of the report completed for the EU's Regional Policy Directorate General by the Danish Technological Institute (2005).

[30] See for example Keating (2003), Hughes, Sasse and Gordon (2003). On the Hungarian case, see Pogátsa (2005a). Considerable disagreement is evident in the literature over who was responsible for centralized government control of EU funding during the 2004-2006 period. While Keating (2003) argues that the European Commission promoted centralization, my own interviews suggest that—at least in the Hungarian case—the impetus arose from Hungarian government insistence on retaining centralized control during the first National Development Plan. This view is further supported by Inotai and Szemlér (2005).

[31] I thank discussions with Ilona Pálné Kovács for this observation.

regional policy and the use of EU structural funds. However, given the lack of "organic", embedded interest structures paralleling the NUTS II level in Hungary, there is necessarily considerable competition and concern over the eventual outcome of regional reform.

The Structure of Local, County, Regional and National Interests

Support for globalization, EU membership and European economic integration is presumably hardest to win in the less developed regions of Hungary (and other CEEC's). Rapidly rising consumer, land and housing prices meet here with rapidly declining levels of employment, falling GDP per capita and dramatically low FDI. Thus nowhere are the differences between winners and losers in the Central and East European transition more evident than in their cross-regional variation. The pronounced geographic and regional distribution of the benefits and disadvantages of integrating markets suggest that while there may be aggregate welfare benefits to globalization and European economic integration, these are not evenly distributed. Empirical evidence suggests the real losers of globalization and European integration are low-skilled workers with little education, especially those in declining regions. Not only do individuals in these regions exhibit the lowest and declining labor force participation rates, per capita GDP adjusted for the cost of living (PPP's) has likewise declined in the less developed regions of Hungary (Pál, 2005; Szemlér, 2004; Ehrlich and Szigetvári, 2003; Déak and Lengyel, 2003).

Variation in regional rates of economic growth and development is of course not news in the wider European Union. Despite evidence of increasing economic convergence across states, increasing regional disparities are a global phenomenon (Sala-I-Martin, 2002) and are likewise well recognized in the European context (Quah, 1996). Their appearance however in Central and Eastern Europe (CEE) represents one of the greatest challenges to the creation of a successful Union. This is above all the case because the less developed regions of CEE have experienced some of the worst features of the economic transition. The fall in both regional real wages and per capita GDP—together with dramatic increases in the CEE price index and declining regional activity rates—place significant burdens on the welfare and future outlook of the less developed regions.

Despite their increasing relevance as socio-economic units of construction, regions may only have a high propensity to become strong political actors within the European framework under certain circumstances. National level expenditure on regional development tends to be more significant than EU level structural and cohesion fund spending. By way of example, approximately 24% of government expenditure in Hungary is delegated to the local governments (Vigvári, 2005: 231). While EU spending in Central and Eastern Europe will not be negligible, it has generally been capped at no more than 4% of the GDP of any individual country.[32] Further, EU structural and cohesion fund spending imposes a co-financing requirement generally paid by central governments and thus—as noted above—likely to favor national over local governments. Although there is some expectation that local governments will participate financially in structural fund projects, local governments in Hungary and other Central and East European countries

[32] Part of the 1999 Berlin Agreement, the 4% of GDP cap has not been modified, despite objections it imposes an artificial ceiling with little relevance to the actual "absorption capacities" of states.

are typically resource-poor and thus highly dependent upon national governments. Finally, as noted above, the gradual shift toward cohesion and away from structural funding further will further emphasize and strengthen the role of national governments over local governments.

At the EU level, regional actors do not as yet play a significant role in the political decision-making process. Despite the relative degree of support such actors may receive from the Commission, they are not able to outweigh the political power of states or individual EP representatives and do not have explicit voting power (in contrast to both state level representatives in the Council of Ministers and country level representatives in the EP). Moreover, on the key distributional questions decided by the EU (the CAP and SCF), voting continues to be made by unanimity. Thus the power of individual states to block agreements remains greater than the power of any other single actor in the political decision-making process. The only caveat here is that the EP appears increasingly willing to exercise its budgetary powers over the multi-annual framework perspectives, in particular the current 2007-2013 Framework Perspective. However, even here, one might expect individual MEP's to vote state interests on such high profile distributional issues.

At the national level, the potential mismatch between national interests in economic growth and regional interests in reversing within border increases in economic inequality is ultimately likely to lead to competing interests at the level of local and national level policy-making processes. Assuming regional variation in economic performance across all states—this may be an erroneous assumption, since smaller states are potentially less likely to be confronted with the demands of regional variation in economic development[33]—one can expect there to be at least two kinds of regional groupings that might form some kind of collective action group. Which collective action formation is likely to be stronger at the national and/or regional level, and which of these two possible groupings is likely to promote specifically regional over national interests is more complicated. For one, both types of regional grouping are potentially equally interested in state support, the one because it will potentially bring higher profits and an increase in the standard of living, the other because it is likely to bring relief from economic decline and citizen discontent.

Evidence that spatial and regional considerations structure interests is provided by suggestions that when questions of territorial significance arise, partisan differences fade at both the national and regional levels in favor of the representation of either national or local government interests. As discussed above, Fowler (2001) demonstrates that the two major parties favor strong centralization of political power in the management of the regions. On the other end, political parties—in particular in the less developed regions—others have observed a willingness to forget party labels and lobby governments independently of the party label. Kulcsar and Domokos (2005), for example, observe that actors engage in cross-party territorially-based coalitions of interest. Such a-partisan behavior is facilitated and reinforced by the application for and potential receipt of EU and other types of funding.

[33] Streeck (1999) argues that smaller states will have an easier time dealing with the problems of regional variation in economic performance and demands for stronger regional governance since small states are more likely to synonymous with regional economic structure. Hungary however, with a population of approximately 10 million, exhibits pronounced variation in regional economic development.

Nonetheless, the regional vs. central dimension is clearly open for political exploitation and polarization along regional-central lines. This in fact happened following the May 2006 re-election of the MSZP government. In September 2006, revelations that the MSZP knowingly shielded a rapidly growing budget deficit from the public eye in order to win the May elections led to widespread public discontent and national protests. Elections to local and county governments in October 2006 resulted in landslide wins for Fidesz led regional governments in all counties except for one. Budapest SZDSZ mayor (Demszky Gabor) also managed to remain in office by a wide margin.

Thus the county level elections are likely to further contribute to the polarization of the regional-central political debate in Hungary. The major part of this regional-central debate is currently focused on the Hungarian government's *New Balance* austerity policy and reforms of the educational and health sectors. However, elements of these reforms likewise generate strong conflicts across the regional-central dimension—in particular where they involve decisions on the survival of regional healthcare facilities and schools. And there are strong indications that the regional-center political debates—in particular in the context of its party polarization—are likely to affect the ability of the central government to promote strong regional development goals and policies.[34]

Perhaps the most interesting question to emerge out of the current political formation is whether the politically polarized regional-central configuration will persist on into the future. The gradual convergence in Hungary toward a two-party system along with the potential staggering of national and local government elections suggests that such polarization could characterize future governments.

Divergent interests dominate the political centralization/decentralization debate. "*Decentralizers*" favor handing over greater decision-making autonomy to regional and lower level administrative bodies. The basic defense of this position is frequently based on arguments supporting decentralization as a means of achieving higher levels democratization.[35] Further, some argue that state-control is likely to reinforce a more "sectoral" approach to regional development—influenced in particular by state ministries and/or the new National Development Agency. Finally, some argue that regional sub-units exhibit little economic uniformity and thus require greater attention to regional specificity and local knowledge resources. Though decidedly difficult to characterize supporters of decentralization, interests in decentralization appear to have a strong regional flavor. Supporters of decentralization are frequently from the regions themselves, while those closer to the center are frequently supporters of more centralized control.

Those favoring stronger centralized control argue that decentralization threatens to fragment or de-concentrate the potential impact of regional economic development spending. In this literature, the consequences

[34] According to news reports, Orban Viktor instructed fellow party members not to negotiate with the central government. This may have disrupted not only government attempts to reform the educational and healthcare sectors, but more importantly for this paper, could hamper regional development initiatives—in particular Regional Operative Programs—funded by the EU's SCF's and requiring co-financing from the central government. See e.g. www.168ora.hu: "Something is Happening" (Feb. 2nd, 2007).

[35] On the case of Central and East European countries, including Hungary, see Bruszt (2005). On Poland, see McDermott (2004). This approach however extends to discussions of economic development in Western Europe. See for example Putnam et al (1993).

of decentralization are two-fold: 1) regional administrative units are ill-equipped—due to insufficient financial resources and weak organizational skills—to handle the co-financing and administrative requirements of EU regional development funding; and 2) the potential impact of regional development spending is likely to be weakened or defeated by the failure to maintain integration and cohesiveness with larger projects organized and approved by central governments.

Central Governments

Central Governments have a natural desire to preserve their decision-making autonomy and presumably favor decision-making processes that are less distorted by local level concerns. Moreover, some degree of decision-making autonomy may be a good thing—in particular where this protects governments from *capture*. Finally, democracy is likely to provide a more equal distribution of public resources than authoritarian government and central government policies that depend on democratic institutions are more likely to be broadly responsive to the interests of the electorate.[36] In this regard, where there is already some degree of centralized political control over economic policy, one might expect to find a status quo bias in favor of centralized political control. This is above all likely to be true due to the government's gatekeeper role with respect to the chosen level of centralization and decentralization.

Moreover, central governments in Central and Eastern Europe (and in other less advanced states) face somewhat unique circumstances in that they are strongly pressured to find ways to promote greater economic convergence with the more advanced regions of Europe. What the role of the state should be in this regard is far more controversial. At least part of this discussion needs to engage notions of the New Economy and their appropriateness for understanding economic processes. Neo-liberal models assume the state should be much less involved in the management of economic processes. New Economy models, on the other hand, tend to arrive at quite different assumptions about the possible role of the state.

The pressure of pursuing economic convergence and the presumed requirement of government involvement in that process may lead the central government to be more skeptical about the decentralization of economic decision-making. Simply devolving decision-making and resources to lower levels of the decision-making process could lead to the fragmentation of economic strategies or the misallocation of resources and thus to a diminution of the central government's ability to pursue aggregate growth and convergence. Moreover, significant differences in the level of economic expertise or the skills and manpower of regional and local development agencies are likely to lead to a strong status quo bias toward centralized control. Finally, uneven political power (e.g. local dominance of opposition parties) or inadequate reform of local political party structures may likewise lead to hesitation toward the decentralization of political decision-making.

In many ways, this fits the Hungarian case well. For one, the central government has contributed significant resources toward the restructuring and rebuilding of the Hungarian economy (Ellison, *forthcoming*). Many of these

[36] Hellman (1998) argues the countries of Central and Eastern Europe exhibiting greater degrees of democracy were compelled to distribute resources more evenly across the populations in Central and Eastern Europe. Failed democracy made it possible to distribute benefits to government cronies. More generally, Lake and Baum (2001) argue democratic political systems distribute benefits more evenly than authoritarian ones.

policies—in particular privatization and investment promotion strategies—have produced a remarkable degree of success. The Hungarian economy is now heavily privatized and foreign firms in particular contribute to a significant share of economic activity and the export market (see e.g. Hunya, 2004). Moreover, it is clear that government policy has for the most part tended to favor national level strategies and has been much less strongly focused on regional concerns—in particular in the early years of the transition process.

This does not mean however, that government policy has completely neglected the less developed regions of Hungary. Early on, investment promotion strategies in Hungary attempted to favor regions by lowering the minimum requirements for such regions and occasionally granting more significant tax advantages (see Ellison, *forthcoming*). Keune et al (2004) likewise point out that regional actors have been equally successful in attracting state resources. Both types of policies however have seen remarkably little success. While government expenditure has been devoted to less developed regions, as noted above, this has not been accompanied by a similar degree of economic success. The eastern regions remain under-developed, exhibit far higher levels of unemployment and have received very little to none of the large share of foreign direct investment flowing into Hungary. Whether this fact is directly attributable to the mismanagement of funds at the local level or to simple disadvantages of economic geography is less clear.

In the long run, however, the relative success of national level government policies in the western regions and Budapest in particular is likely generate some resistance to the complete decentralization of regional development strategies. In the eyes of some, decentralization will lead to further deterioration in the quality of national and regional economic development policy goals. Moreover, in Hungary, national level economic strategies have begun to take on a new flavor, more oriented in particular toward the promotion of R&D potential and building stronger links between foreign and domestic firms. Finally, there is the insufficiently theorized but ever-present threat that misallocated funds are wasted funds. Misallocated funds draw resources away from regionally centered growth engines that may ultimately have positive feedbacks on less advanced regions as well.

Local, City, County and/or Regional Governance

Regional entities in Hungary are tremendously fragmented and do not typically work well together. Even the various associations of village, local, city, large city and county government tend not to cooperate with each on attempting to improve the nature and quality of regional governance. The voluntary establishment of over 3000 local governments in Hungary has led to an inefficient public administration structure frequently unable to handle the multiple tasks of government. Thus even the small local government associations argue that local governments cannot continue to administrate all the features of government currently in their purview (healthcare, education, sanitation, infrastructure (local roads) and that some of these tasks need to be organized at more moderately more centralized levels. Further, NUTS II regions have no historical antecedents in Hungary, thus creating considerable mismatch between the regional level and the more “organic” institutional and organizational structures present at the county and local levels.

In many respects, the interest structures in Hungary are still relatively undefined.[37] While the availability of EU funds and the requirement of submitting well-defined and tailored project proposals provide incentives for the creation of stronger regional entities, several features likewise makes them relatively weak bodies. For one, as many authors point out, Hungary has a far larger number of local governments than most other Old Member states, suggesting that the level of governance is too strongly dispersed and unmanageable. For another, governments at the regional and local level lack sufficient funding with which to pursue more independent agendas. Most local, city and even many county governments are thus dependent upon the central government for financial assistance. Finally, local, city and county governments lack sufficient skilled staff with which to engage in the development and formulation of large independent plans for regional development. It is perhaps no surprise that the most successful regional plans have been put together in the more advanced regions of Hungary.

The interests of local and regional governments (or agencies) are likely to diverge depending on how individual regions have fared during the economic transition. As the New Economy literature would generally predict, economic development in Hungary has been quite uneven and regions that have traditionally lagged behind national levels of economic development have continued to do so throughout the process of economic transition. On the one hand, regions that have fared well are likely to be more favorably disposed toward the continued role of the central government in economic policy-making. While the failure of some firms—in particular many domestically owned small and medium-sized enterprises (SME's)—to gain greater linkages into European production networks may not make them favorably disposed toward European integration, the principal political resource for such dual economy firms is above all the central government.

Whether greater local autonomy would necessarily strengthen the political bargaining power of SME's in the more advanced regions is questionable. For one, they are in a minority at the local level and compete against much larger multinational firms (MNC's) for local and state resources. Local elites—to the extent that they wish to keep larger MNC's with sizeable employment effects in the region—are inclined to pay more attention to their interests than those of a much smaller subset of SME's employing far smaller shares of the local population and making smaller contributions to local public revenues.

At the national level, SME's comprise a more sizeable political force and the national government likewise tends to view the degree of "*local embeddedness*" of MNC's as a potential counterforce to the otherwise "*footloose*" nature of many firms in the global economy. Thus, through increasing the share of interactions and exchanges between the larger MNC's and the SME network in individual regions—or by otherwise building supplier-manufacturer networks between foreign and domestic firms—it is hoped to secure longer term economic, social and political stability in these regions. For the most part, national and local government strategies are thus focused on promoting local R&D networks and strongly favor investments in local skill and content. While less advantaged dual economy firms are likely to favor a stronger focus on the local content of investment promotion strategies, they are not necessarily likely to favor strong decentralization.

[37] See e.g. the article "Területfejlesztés" published by Rechnitzer in *Nepszava* (July 31, 2006).

Whether regions that have not fared well are likely to be favorably disposed to maintaining a strong role for the central government in regional policy, or whether they would prefer more regional autonomy is problematic. On the one hand, the less developed regions tend to feel left out of the economic catch-up game. Eastern Hungary, for example, has received very little FDI and even the rate of infrastructure development (e.g. rail and highways) and other government investments have been slower. While there has always been a regional component to the national industrial policy framework (e.g. the investment ceiling required for receiving 10-year tax holidays for large investments was far lower in the less developed regions), foreign investment strategies have tended to follow predictable paths, with the predominant share landing in historically more developed regions of Hungary: Budapest and the Western regions of Hungary.

On the other hand, due in part to the absence of large shares of foreign investors, local governments in the East of Hungary likewise have few independent revenue tracks upon which they can depend. While they do receive a share of national government revenues, this share has been on the decline. This typically means that local governments are highly dependent upon national governments for the funding of local and regional development goals. While this deficit ultimately represents a golden opportunity for the EU to strengthen regional demands for autonomy, essentially the opposite has happened. The EU has by and large favored greater levels of centralization or has failed to insist on adequate decentralization. It is telling that most of the different regional associations in Hungary see the problem of decentralization and greater regional decision-making autonomy as one that Hungary has to solve on its own.

Further, the compatibility of EU-type funding—in particular its suitability for coping with the problems of regional development in the less advanced regions—is a matter of contention (Ellison, *forthcoming*). One of the more successful tools for Hungary has been the use of investment promotion strategies. While the less developed regions have not benefited from this as much as the more advanced regions, it is still one of the more potentially beneficial strategies for these less developed regions. EU state aid policy however extends relatively strong limitations to the use of this type of policy. On the other hand, many of the newer Lisbon-type strategies promoted by the EU are more clearly suited to the needs of the more advanced regions in Hungary.

At least some regional associations—in particular MOOSZ (the Hungarian Association of County Governments) find the ROP emphasis on human capital and adult education somewhat problematic. Their preferences would have been for more emphasis on regular (elementary) schools, especially in the poorer regions and support for both agriculture and the local economy—in particular through SME's. In their view, while financing local government projects is good, too much funding will be spent on local infrastructure and education, but not enough on SME's and employment creation. Further, though most analysts suggest there are few important differences between East and West in Hungary with respect to political decentralization, MOOSZ proposed that Hungary be divided into only 3 regions (instead of the current 7): a Western, Eastern and a Central region. This 3-tiered breakdown maps almost perfectly onto existing regional economic contours and suggests that regional variation in levels of economic development is strongly related to regional variation in interests.

Discussion

One of the biggest obstacles to political decentralization and greater subnational regional autonomy is the lack of strong regional organization in Hungary. Regional associations themselves are not as actively engaged as they might be in pursuing political decentralization. Without greater unity and active engagement across the different regional associations, there is likely to be only limited movement in the direction of greater political decentralization and regional autonomy. While EU funding represents an important incentive to the greater organization of regional entities, the strong influence of central actors in the political decision-making process and the financial dependence of regional actors contribute greatly to the general increase in centralization.

However, in Hungary there are likewise serious constitutional impediments to the introduction of far-going reforms of regional institutional decision-making structures. For one, constitutional reforms require a 2/3rds majority in the Hungarian parliament. Now that Hungary has evolved into a more or less 2-party system, the ability to introduce constitutional changes is seriously hampered by the unlikely eventuality that any single party would control 2/3rds of the parliamentary seats. Barring this, it would be necessary that either the EU pass a directive requiring parallel changes in Hungary, or that the two major parties manage to iron out some kind of agreement. Though by no means impossible, such agreements are difficult to make. Thus, while the electoral fortunes of individual parties may potentially provide them with incentives to favor stronger decentralization, due to the constitutional hurdle and the presence of an emerging 2-party system, the requirement of cross-party cooperation may ultimately mean that little to no cooperation is likely to ensue.

Given the economic considerations noted above, further decentralization of real decision-making power in Hungary is unlikely in the near future. For both economic and political reasons, the two major political parties and other government actors have strong incentives to favor the existing status quo. At the same time however, to the extent that this continues to reinforce existing regional disparities, there is likely to be continued agitation in favor of greater regional autonomy. In this respect, there is at least the possibility that less advanced regions will feel emboldened by EU membership and will increase their demands for regional autonomy. But at the same time, this must be measured against the need for and dependence on national level resources.

This analysis draws particular attention to the problem of finding models—both economic and political/institutional—that can adequately promote both regional and national level growth at the same time. This requirement is all the more important for less advanced economies—in particular due to the problems outlined by the equity-efficiency trade-off, as well as by the increasing intellectual dominance of Lisbon-type strategies and thus ultimately more centrist focused strategies of economic development. As far as the conclusions of this analysis are concerned, it must remain unclear whether the political and economic dimensions of this debate pull in opposite or in compatible directions. Establishing complete regional decision-making autonomy—in particular with respect to economic development strategies—may lead to more appropriate and regionally-appropriate models of economic development. On the other hand, it may also produce the opposite.

Conclusion

The advent of EU membership and the governance of EU structural and cohesion funding in Hungary has dashed hopes for a more thorough democratization of local governance and the withdrawal of power from the central government. Where some anticipated the rise of more powerful subnational entities and progressive political decentralization, this has not occurred. Most agree the political center has been greatly strengthened by the confluence of creating EU NUTS II level regions, economic development strategies that tend to favor the interests of the more advanced regions of Hungary, the centralized control of EU and state funding and comparatively weak regional organization.

One of the principal obstacles to more successful regional planning and administration of economic development strategies is Hungary's insistent centralism. The failure to grant more political and administrative authority to the regions—however ill-fitted to respond to the needs of county, city and local governments—is itself the cause of local-level lack of expertise and planning capacity. Presumably the only mechanism available for reversing this process is the creation of regional governments—whether based either on the current NUTS II foundation or on some more aggregated foundation. Politically however this is difficult to achieve. The constitutional obstacle requiring a 2/3rds majority to change the regional electoral and administrative structure is almost unattainable—in particular given the current degree of political polarization between the two major political parties.

New Economy models play a powerful role in determining this outcome. Governments in less developed economies in particular face powerful incentives to maintain centralized control over the expenditure of EU and national-level funding in order to promote more cohesive economic development strategies. This may suggest that regional demands for greater decentralization may be more likely in the more advanced countries and regions of Europe. For one, the more advanced countries may be more likely to allow the market to decide how best to allocate resources. And for another, regional political units are more likely to be dependent upon the central government is less advanced states.

Consequently, national level strategies will not likely respond adequately to subnational regional needs and interests. Faced with a competing set of national goals, national actors are less likely to dedicate sufficient attention to regional development agendas—in particular in the less developed regions. In part, the above analysis suggests problems of *subsidiarity* or difficulties in determining the appropriate level of governance beleaguer national and regional level economic development strategies. Such problems are presumably exacerbated by difficulties in determining the appropriate *scale* from which to think about *problems of economic development* (e.g. supranational, national or subnational). The same basic problems are duplicated at the regional level. Regional actors are more likely to emphasize subnational regional concerns, potentially at the expense of national level considerations.

The central research question is to determine when and under what conditions national governments are likely to delegate greater decision-making powers to regions. With respect to the Hungarian case, the central government faces strong pressures to maintain relatively centralized control over the future shape and direction of regional development strategies. Thus in important ways, the potential for political decentralization is strongly influenced by the interests of the center. At the same time, however, Hungary lacks at least one element that has favored the development of strong interests in political decentralization in other parts of Europe: in particular, the less developed regions are based on distinct cultural or ethnic identities. Finally, the political-institutional structure in Hungary is not conducive to rapid political decentralization. Both the constitutional hurdle and the high degree of political polarization generated by the emerging two-party system represent important obstacles to more rapid political decentralization.

Finally, supranational pressures further encourage national governments to re-centralize political and economic control. With mixed signals coming from the EU, national governments in Hungary and other New Member states are clearly at liberty to organize the management of EU SCF funding as they see fit. Though regional operative programs are gradually gaining in importance, the central state-dominated level clearly plays the central role in Hungary and is likely to do so for some time to come. At the same time, one of the potential consequences of this degree of centralization is the continuing rise in regional economic disparities. This is likely to produce the groundwork for future initiatives toward greater political decentralization and regional autonomy. Thus while the *New Economy* and the incentives it creates toward greater centralization of political control over economic management pose the principal obstacle to greater subnational regionalism, this may provide the future motivation for its revival.

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