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Hungarian Economic Development Prospects – in the Light of the One Belt and One Road Initiative

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Abstract

This paper attempts to delineate the most important aspects of the historical Hungarian economic development path, while shedding light on long-term Chinese investment and trade opportunities in Hungary. In order to make the One Belt and One Road Initiative a success, China needs proper knowledge of the Central European countries' long-term development needs and goals. This analysis delivers a first assessment of the basic long-term questions of Hungarian economic development. The paper reviews milestones of economic progress after 1990 until the present, and shortly looks into the effects of the economic transformation of the 90s, and the main repercussions of the Global Financial Crisis (2008-2009). At the end of the paper a short glimpse is given on how the Hungarian economy could develop, and what are the possible development models to be utilized by Hungarian decision-makers. At the same time, it will be clear where Hungarian and Chinese need can intersect each other.

Keywords: *China, Hungary, trade, investment, economic development model*

1. Introduction

Improving economic, cultural and higher educational relations between geographically distant countries is never easy. The difficulties are easy to see thanks to the well-known gravity model of world trade. The law of gravity states that the gravitational attraction between any two objects is proportional to the product of their masses and diminishes with distance. As a result, the trade between any two countries is, other things equal, proportional to the product of their GDPs and diminishes with distance (Krugman, 2012: 12). But this general rule does not exclude anomalies, which means that long distances do not necessarily prevent improving relations leading to relatively strong trade, capital relations and developing contacts in fields like cultural and higher education cooperation and exchange. But for this to happen, several prerequisites must be met.

The first in the line of such prerequisites is the responsibility of diplomacy. High-level support of bilateral relations always facilitates the expansion of all forms of international relations. Frequent high-level meetings inspire active relationship-building endeavors on a lower level as well e.g. cooperation of chambers of commerce or between universities. Political contacts may also help set up financial funds to facilitate grassroot business development with publicly funded projects.

The second important prerequisite relates to shared interests. In several decades of bilateral relations between Hungary (Central Europe) and China, we have never witnessed such a constellation of common interests as we see today. And this interest is related to efforts of opening towards third countries in an era of global economic and power restructuring, when the competition between corporations and countries is steadily increasing. The growing pressure for improving competitiveness has developed along with growing opportunities: rapid economic development, improving transport and communication systems facilitate more and better business and cultural contacts.

But the third prerequisite is the most problematic one. If we want to capitalize on the opportunities, a lot of work and effort will be required. This work must include the desire to want to get to know each other better, understand the attitude of the people and cross-cultural differences, explore prospective fields of trade, capital and other business relations, and finally, we must facilitate the flow of information between the two countries. Too often, businessmen assume that their partners have the same business values as themselves – but that is not correct. Different countries have different people, different people have different values and different behavior patterns. One of the biggest challenges of doing business in a foreign country is learning how to operate in a diverse cultural setting. If these objectives are achieved, relations can reach a higher level. Without putting in this arduous day-to-day work, the currently existing window of opportunity cannot be used, and the opportunity may be squandered.

And finally, one additional aspect should be raised. Building relations between countries often require personalities who are willing to travel a lot and communicate with all stakeholders on a regular basis. These personalities could be instrumental and essential in the process.

2. Interests, Interactions and Strategies

In recent decades, relations between Eastern Europe and China have been shaped by domestic political difficulties, geopolitical changes and deep economic transformation. From the perspective of economic history, the two regions share important characteristics. Being made up of peripheral country groups of world economy prior to the great transformation of the 1990s, both regions had faced "peripheral structural crisis"[1] since the seventies, although Central and Eastern Europe (CEE) was hit hard, while China was able to mitigate the negative impacts and could enter a rapid, sustainable economic growth period (Berend, 2004). Their development paths and global economic positions were uprooted during this period. Entry into the European Union by ten Central European countries had opened up new regions to the CEE which it had either only few or politically hampered links with. China along with several rapidly developing countries in Asia have enjoyed a period of rapid growth over the last more than thirty years; their international economic position changed, several countries have been able to ease their dependence on international economic institutions. The region has become one of the fastest emerging parts in global economy today.

The economic crisis in 2008 hit the rapidly emerging Asian region and most importantly China much less severely than it hit advanced countries, but as a result of the shifting international economic and political centers of the world and the social and economic implications of global challenges, certain changes regarding domestic and external economic policies had started to unfold. Although some of the CEE economies faced above-average output decline in 2009, most of them were soon able to regain their momentum owing to their modernized, competitive economic structures. The region would be able to deliver much better economic performance than the "core" of the European Union – particularly the large and most developed countries therein – but the development prospects of the countries in the CEE are now mixed. The economic crisis in the USA and Europe brought about the need to diversify economic, political and cultural relations in the CEE and it also questioned some of the earlier assumptions on the sustainable and linear convergence of these peripheral countries.

From the part of Hungary, the intention for cooperation with China has a long history. But from time to time periodically the intensity of interests has changed due to economic or political reasons. In the early nineties, immediately after the political and economic systemic changes, the demand in Hungary's most important export markets (the Former Soviet Union and other Central and Eastern European countries) collapsed due to the unfolding transformational recession.[2] The need for the rapid reorientation of trade was now a pivotal objective and the logical choice was the geographically close markets of the Western European countries. In order to facilitate external trade with this region and to get additional development incentive, the unquestionable priority of the country was to join the European Union, a large single market, as soon as possible. Other regions in the external strategy became less important for a while. Along with this objective, attractive investment opportunities had surfaced for large firms to take over the domestic markets (in every Central and Eastern European – CEE – countries) from insolvent local firms through privatization from the early 90s. In addition, export-oriented greenfield investments (Foreign Direct Investments – FDI), attracted by cheap labor and cost-related incentives, also started to increase. FDI was promoted by economic policies in the region, especially in Hungary, due to the scarcity of domestic investment financing. The sudden rush of Western business into the region had resulted in several positive structural changes (and many negative consequences),[3] and created the basis for an export-led development pattern. This was the case in each of the CEE countries, leading to fierce competition for FDI, not least because of the expectation of associated economic benefits in terms of export performance, economic structural change, employment, growth and competitiveness. As a result, for almost two decades, Central Europe's pre-crisis economic model, including Hungary's strategy, was based on export orientation led by large inflows of foreign direct investment with the leading role being played by the European Union in both trade and FDI.

3. The Role of Export Orientation as a Means of Diversifying External Relations

Development model questions, the issue of export orientation, import substitution or other trade-related aspects are always in the forefront of the economic and political thinking of countries where convergence towards more advanced regions is amongst the most important economic issues. In the case of emerging markets, export-oriented (or export-dependent) economic development is, in most cases, vital for achieving a certain degree of catching up, although in the long run export constraints may be significantly different from country to country. A large domestic market (or more precisely, significant and rapidly increasing domestic purchasing power) can partly substitute the role of export in GDP growth. Countries with small domestic markets, however, are much more likely to be forced to maintain export orientation in the long run at any price. Some of the heavily exporting countries (measured either in terms of export volume or export/GDP) rely (or relied) on cheap labor (China until recently for example), the availability of crucial natural resources (Russia, oil-exporting countries, etc.) or the economies of scale. The impact of export, when based on economies of scale, can be crucial for smaller countries, where even a very limited number of large, export-oriented firms can significantly impact on GDP growth (and jobs). (Of course, the factors on which strong export performance is based may be mixed.) The prospects of these country groups differ with respect to export potential and FDI relations in the coming decade.

1. Cheap-labor countries can face increasing difficulties in the coming decades. Although cost factors are still important, at the same time, the speeding up of technological development renders labor force skills even more important as the wage level starts to increase parallel with the growing per capita GDP. This change is clearly reflected in the intensification of reshoring of industries from developing countries to developed nations for example.[4] This applies mostly to the relatively large emerging countries that need to change their underlying development model and promote a smooth transition to a much more domestic demand-based strategy.
2. The position of exporters of natural resources seems to be strong, especially when we consider that even after the commodity price increase witnessed during the last decade, future price developments for most of these commodities remain rather favorable. (Obviously, these countries also try to diversify their economies, which is quite clear, for example, in the case of several oil-exporting countries in the Middle East.)
3. The third group consists of export-oriented small countries that do not possess easily exportable natural resources, and have very high export openness (export/GDP) reaching 80-95%. This is the case in several Central European countries, including Hungary. Their economic development mostly depends on export performance. If firms in these countries are to increase sales and create more jobs, there is simply no other alternative to internationalization. And as the exports of these countries are mostly based on the performance of FDI-related manufacturing and services firms, whose domestic purchasing power is limited, they should elaborate strategies that preserve and strengthen this export orientation. (This does not mean the negligence of domestic demand factors, such as consumption and investment, but

rather indicates that their role is to balance the growth pattern, rather than replace export orientation).

As Hungary cannot compete with low wage countries (though wages are still low in international – European – comparisons), long-term sustainable strategies cannot avoid upgrading technological capabilities to maintain or increase current export levels. The other possibility is to find new markets and promote the internationalization of more and more small and medium-sized domestic firms. The application of these two strategies at the same time may be a starting point for the external strategy of Hungary in the future.

4. The Trend of Geographical and Sectoral Diversification

Today's global political and economic environment cannot be described with the simple terms of the bipolar world's traditional center-periphery relations when political support of large powers – to gain more international influence – helped the economic development of less developed states. The picture is further complicated by the transnationalization of business activities as a result of increasing global competition and by the surge of regional integration initiatives that sometimes overlap each other in terms of scope or geographic location. Peripheral or semi-peripheral countries in this sense no longer serve as the background territories for only one economic or political center, but are influenced by several at the same time (although the level of political and economic influence varies from one center to the other, not least because of geographical distances or ideological reasons). This is the very position of Hungary now. It is clear that each country will always have a major international trade and capital partner (which in the Hungarian case is certainly the European Union), but countries consider other relations important too, which has been increasingly true in the past few years when the more advanced countries, notably the Eurozone, have been facing massive financial instabilities and growth problems.

For Hungary, an export-oriented strategy will – without a doubt – remain one of the most important elements for balanced development in the coming decade. Domestic demand without significant export performance is insufficient to deliver sustained economic growth. Export openness, however, in most cases carries substantial risks. At the beginning of the economic crisis in 2008, export-oriented countries, such as Hungary, had been hit most severely. But the implications of this external demand shock were different from the earlier ones because international trade today is different from the pattern prevailing prior to the turn of the millennium. According to WTO estimates, close to 55 percent of the world's non-fuel trade is conducted in intermediate products. And it is mostly a result of the growing importance of the Global Value Chains in which large multinational firms have dozens of subsidiaries in various countries and these subsidiaries trade with each other. Ultimately, demand for exported intermediate products in the Hungarian case is not necessarily defined by the demand in the importing country (Germany is by far the most important destination of Hungarian products, close to 30 percent of Hungary's export end up in Germany and about one fourth of FDI stock in Hungary has been sourced from this country. Despite vigorous efforts to open up to third countries in trade and investment, the concentration ratio is predicted to further grow – unless a major economic shock takes place).

The growth of the supply chain has increased the exposure of Hungary to final demand outside Europe, to an extent that is no longer captured by bilateral trade statistics. Spillovers from aggregate demand and policy actions in the rest of the world are now much greater than ever before. Conversely, German domestic demand spillovers to Hungary remain relatively small. A significant share of bilateral trade between Germany and Hungary is performed in intermediate goods: final demand in Germany is not the main determinant of exports to Germany. As a result of this pattern, export orientation has made the country part of a large international network, which can mitigate external shocks.[5] Yet export performance rebounded very quickly after the 2008 crisis since it was not the ailing demand of the European Union, or of the Eurozone in particular that defined demand for Hungarian products. Exposure to international economic developments and demand may still make a country vulnerable to external shocks. However, when countries which import Hungarian intermediate products re-export finished goods containing the intermediate product that had originally come from Hungary, the ensuing positive impacts of such re-export translate to improved Hungarian export figures. Hence any increased demand for, let's say, German export products, will also improve Hungarian output. This indirect export due to the activity of multinational firms, mainly in the manufacturing sectors, has changed the nature of dependence on international trade and transformed it into stronger dependence on the strategy of multinational companies. Interestingly enough, the expansion of multinational firms and their global optimization strategies have also led to increased presence of several Far Eastern emerging countries in international trade mainly through growing exports in intermediate products. (Of the six largest exporters of intermediate goods, four are from the Far East: China, Japan, the Republic of Korea, and Hong Kong followed by other rapidly developing countries from the region).

All these have led to the significant concentration of the export sector and by today about 30-32 percent of Hungarian exports come from the automotive industry and according to estimates, about 10 percent of the output directly depends on the performance of this sector. The geographical pattern closely mimicked the foreign direct investment pattern, and this has led to the European Union, and Germany in particular, absorbing the lion's share of Hungarian exports.

This heavy reliance on a single region and one or two sectors has made the country vulnerable to the developments in the EU, mostly in the Eurozone and the car industry. It is this very pattern that calls for the diversification in terms of geography and product structure. But diversification is extremely difficult in a period when most trade is conducted by multinational firms and in intermediate products. The objective of diversification and creating improved relations with geographically distant countries and regions is to forge social, economic and cultural relations with these countries. More specifically, the diversification strategy envisages a three-pronged approach towards the countries of Southeast Asia. The first objective is to renew political contacts and understanding. The second is to achieve enhanced economic interaction in investment and trade, science and technology, and in tourism. And thirdly, we aim to promote cultural, educational exchange and the flow of information.

5. Future Prospects

Along the road to membership, Hungary – like other Central European countries – was aiming to comply with the *acquis* as soon as possible. After the early years of the 1990s, the driving force behind democratization and economic transformation was associated with the continuous integration of the region into the Euro-Atlantic structures, including both NATO and the European Union. During this period, the transformation seemed unstoppable, and the only question was when the process of catching up would result in a substantial rise of household incomes. In the pre-accession years, the most important drive behind economic and political transformation and foreign policy orientation was the EU. The accession objective was achieved in 2004, and the previously unanimously supportive environment for the EU changed, the motivating and disciplinary force of the membership perspective vanished. This change was coupled with three unfavorable trends.

First, Hungarian domestic politics became very complicated; objectives became obscure and difficult to follow. A second problem was apparently related to the lack of strategic vision on how EU membership could be part of a long-term development strategy for the country. Short-term objectives and lack of consent among political parties on long-term development goals made the elaboration of a viable strategy impossible. The third challenge was related to developments in the EU, namely, the strategic problems regarding its future. At the turn of the millennium ambitious plans and strategies were formulated including enlargement or the Lisbon strategy, not to mention the introduction of the euro, but by 2004–2005 no further plans were on the table.

When the dynamic phase of eastern enlargement ended, there were clear signs of destabilization in parts of the CEE as a result of unfulfilled expectations concerning mostly living standards. Voices questioning the success and rationale of more than twenty years of transformation and EU accession started to become stronger and questioned the competence and efficiency of the EU. Hungarian convergence was either slow compared to Poland or Slovakia or the absolute level of development lagged substantially in comparison to the Czech Republic.

As a result, skepticism developed regarding the success of economic transformation; negative perceptions of the EU's role in convergence strengthened, which made the emergence of very divergent strategies regarding relations with the EU possible. Parallel to the "not so promising" economic developments in the EU, the crisis resistance observed in some emerging countries was now being seen as a more successful model. In Hungary, politicians and economic experts started voicing opinions about the need to develop economic and political relations independent from the influence of the West (EU) and to make new and stronger ties with fast-growing emerging regions.

Given this framework, a new narrative emerged in Hungary. Its most important elements were the following. The whole transformation project was based on Western ideologies and principles that did not seem to be in the interest of the Central European countries (e.g., the basic principles of the Washington Consensus, supported by renowned Western, mostly US advisers); international corporations investing in Hungary only extract their “extra” profits and disregard the true interests of the country. The EU uses double standards when applying economic and political rules and regulations requiring “new” and weak members to exhibit better performance than older and large members.

These problems within the European Union, which led to the active search for new strategies in Hungary, were then coupled with the growing interest of China towards the CEE region. Given this background the well-known strategies initiated in recent years by China are logically attractive for Central European countries and Hungary too. But it is only the framework and here comes the biggest challenge for the future. Even if people or policymakers are aware that traditions, culture and doing business practices are very different, it is still very difficult to establish closer cooperation between them. We should keep in mind that not all people from a given culture act the same way, but in order to describe cultural traits, generalizations are inevitable. When it comes to intercultural interactions, every situation should be approached with an understanding of the basic tenets of a given culture and yet one should remain alert to the specific cultural signals one receives in each situation and adjust one’s behavior and expectations accordingly. Raising awareness of intercultural differences might be a first and necessary step in order to establish smooth cooperation and working relations between our cultures. Given this background, we must mention the importance of higher education and direct people-to-people contacts. In order to facilitate this process, it is highly desirable to encourage the application of a triple-helix type model in which the Academia, Business and Public Administration work together in order to create the necessary framework and knowledge base to understand intercultural differences that is the precondition of doing business together successfully.

Notes

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1. Peripheral structural crisis means the preservation of the traditional economic structures and low-technology production levels after the introduction of certain reforms from time to time. As a result, innovations remained weak; the financing of technology upgrading continued to be difficult. In principle this means the inability of a region or a country to abandon its non-competitive economic structures and replace it with a more competitive one, which would be desirable to adjust to ever increasing international competition. These experiences had long-lasting consequences in countries at the global peripheries. Using the Schumpeterian analogue, the developments in CEE seemed to have been aimed to demolish earlier economic structures without creating something

new, competitive structures. Instead of creative destruction, the destruction without creation became an important feature of development in both regions.

2. This term was introduced into the economic literature by János Kornai describing the phenomenon developing in all the post-socialist countries in Central and Eastern Europe. He believed that there were similar causes and a common pattern behind this unfavourable development which was different from the usual cases described in the economic cycle theories. Later this term was widely used for economic crisis emerging due to the transition from the socialist to the capitalist system.
3. See more on the positive and negative impacts for example: "From plan to market: The transition process after 10 years" (contributors: I. Berend , J. Svejnar, E. Berglöf, P. Welfens, S. Gomulka, G. Kopits, S. Malle, J. Menzinger, L. Grigoriev, M. Landesman, P. Hare, A. Nagy, M. Elman), *Economic Survey of Europe*, No. 2/3 (1996). The assessment of the transition based on the Washington Consensus and the impacts of the chosen transformation method in individual countries remains controversial.
4. Paul R. Krugman stresses "[...] one of the reasons some high-technology manufacturing has lately been moving back to the United States is that these days the most valuable piece of a computer, the motherboard, is basically made by robots, so cheap Asian labor is no longer a reason to produce them abroad." (Krugman, 2012) Or see BCG reports on the significant impacts of reshoring projects from 2015 onward.
5. The success of export-led growth strategy depends on several factors and there are a number of risks and challenges inherent in such a strategy.

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