Hungary in the European Union

‘Catching Up’, Forever

JÓZSEF BÖRÖCZ

In 1989, Hungary was seen as the most market-ready economy in eastern Europe. In terms of its per capita GDP, however, Hungary is yet to catch up to state socialist levels even after two decades, despite incorporation into the European Union and sharply increased global and European trade flows. The privatisation of the erstwhile socialist state’s property and the dominance of western Europe-based capital in assembly plant manufacturing has meant high import content for exports and weak wage and subcontracting effects for the local economy.

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József Böröcz *(jborocz@rci.rutgers.edu)* is with Rutgers, the State University of New Jersey and the PhD Programme in International Studies at the Pázmány Péter Catholic University in Hungary.

The collapse of state socialism in eastern Europe and northern Eurasia occasioned the outbreak of a pandemic of modernisation optimism. The first symptom was a sudden loss of awareness of the complexities of the political, economic and geopolitical histories of eastern Europe. Three hyperbolic expectations followed.

First, it came to be widely supposed that formal representative democracy would congeal the disparate wills and interests of various segments of the region’s societies into coherent and legitimate, democratic political authorities. Second was the anticipation that “Euro-Atlantic integration” – membership in both North Atlantic Treaty Organisation (NATO) and the European Union (EU) – would provide sufficient external stability to the region to assure a predictable and prosperous “European” future. Finally, third, there arose the belief that the removal of the institutional and organisational features of the state socialist system – portrayed only as restraints – would give so strong a boost to the region’s economies that they would “catch up” with western Europe. This last hope explains the remarkably peaceful character of the transformations.

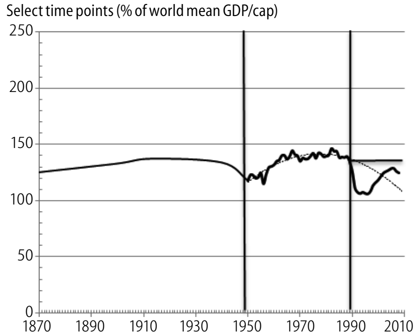
There is much to be said about the multiple theoretical oversights, empirical imprecisions, and logical flaws comprised in those expectations. That, however, is not my purpose here. In this paper, I focus on how those anticipations withstood the empirical test of history, by taking a closer look at Hungary, the society that was widely regarded, in 1989, as the most “market-ready” and “EU-compatible” in eastern Europe.

An Empirical Test

As Figure 1 indicates, simply put, Hungary’s post-state socialist history shows no sign of catching up in terms of its per capita GDP.[1] As a matter of fact, no other era but the first half of the state socialist period shows anything resembling a dynamic upswing, reaching a peak around the mid-1970s to early 1980s. The post-state socialist period was marked by an initial collapse so that, in the first three years after 1989, the country’s per capita GDP dropped from 135% to 107% of the world average (i e, approximately 10% below its position in 1950), an average loss of 9% per annum. The recovery, which began in 1995, has yet to bring the country back to its position in the last year of state socialism [2] – a position that was, itself, the result of a decline in the preceding decade.[3] To place this ambition of catching up in context, according to Maddison, western Europe had an average per capita GDP of approximately 285% of the world mean in 2008 – a figure somewhere between the estimates for France and Spain – i e, more than two and a half times higher than Hungary’s level. Hungary has definitely not been catching up with western Europe.

Figure 1: Hungary’s Per Capita GDP (as Percentage of World Mean) Before, During and After State Socialism

Select time points (% of world mean GDP/cap)



Source: Maddison (nd).

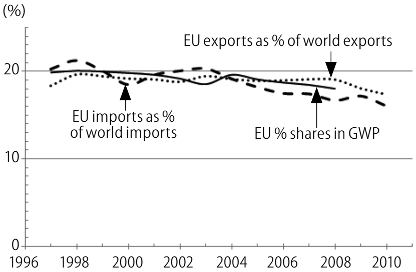
Catching up was supposed to be ensured by a number of geopolitical and economic mechanisms. Inclusion in pan-EU trade was supposed to be key among them. For the hegemonic intellectual framework at the time – neoclassical economics – international trade is, ultimately, a “win-win situation” for all parties involved. That foreign trade is “a driver of prosperity” was the position not only of the neo-liberal Cato Institute and various United States (US) governments,[4] but also, remarkably, of the Commission of the EU.[5]

With NATO membership sealed in 1999 and full EU membership accomplished in 2004, Hungary was ready to catch up through free trade with the west.

Looking at this history in 2012, we are now in a position to examine the verity of this expectation.

The EU as a whole shows remarkable consistency in this regard. During the 1997-2010 period, the EU's shares in global exports and imports (marked by the dashed and dotted lines in Figure 2, respectively) have declined from their peak of approximately 21% and 19% in 1998 to 2010 lows of 17.3% and 16%. The EU's share in gross world product (GWP) (indicated by a continuous line in Figure 2) has followed export and import figures closely, declining slowly from around 20% to about 18% by 2008.[6] Most important for my argument, for the EU as a whole, there is a clear link between its shares in global exports and imports on the one hand, and its share in GWP on the other: the three variables are roughly of equal magnitude, and the global economic weight moves, by and large, together with share in global trade.[7]

Figure 2: EU's Shares in World Trade and GWP

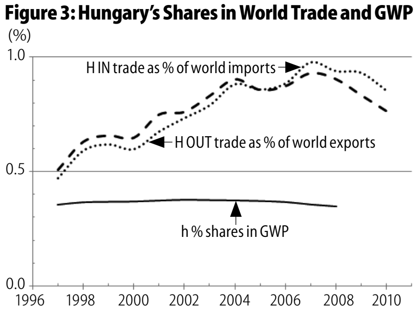


Source: Computed from Maddison (nd) and Eurostat (2009, 2011).

Based on neo-liberal theory, the EU Commission's official expectations and empirical data about the EU as a whole, we would anticipate a sharp increase in Hungary's foreign trade – particularly with full inclusion in the EU in 2004 – and, along with it, a steep increase in its global economic weight.

The first half of that empirical expectation – a sharp increase in Hungary's foreign trade – did happen, although with quite a unique and unanticipated temporal pattern. As Figure 3 indicates,[8] Hungary's participation in world trade had taken off already in 1997, the year when formal negotiations for EU membership began, seven years before membership was inaugurated. It reached a local maximum (at 0.9% of world imports and 0.88% of world exports) in 2004, the year of full EU membership. The ensuing crisis of the world economy reduced Hungary's trade figures somewhat. But much more striking is the fact that, during the period of the upswing in Hungary's participation in world trade (marked by an increase from 0.59% to 0.97% in exports and 0.51% to 0.93% in imports between 1997 and 2007), the country's share in GWP remained practically flat. (The curve shows an imperceptible increase from 0.35% to 0.38% and then a drop to 0.35% during the 14 years included in the graphs.) In other words, while exports and imports nearly doubled, the country's shares in GWP remained virtually constant, and at much lower levels than the country's shares in world trade.

Figure 3: Hungary's Shares in World Trade and GWP



Source: Computed from Maddison (nd) and Eurostat (2009, 2011).

Here we have a phenomenon fully unanticipated in terms of neo-liberal theory, official EU expectations, and on the basis of the overall EU patterns. In the history of Hungary's accession to the EU, steep export and import growth failed to generate a growth in GDP relative to GWP.

Foreign Trade and Income Growth?

It has been known for at least two generations that the growth of foreign trade can fail to generate income growth. As Raúl Prebisch and Hans Singer pointed out in the 1940s, deteriorating terms of trade can destroy the beneficial effects of economic growth under conditions of high levels of external trade dependence. A few years later, Jagdish Bhagwati (1958: 201) echoed the Prebisch-Singer thesis suggesting that:

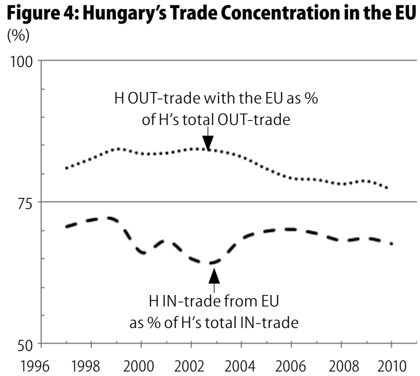
> "immiserising growth" obtains under conditions where "deterioration in the terms of trade [...] offset[s] the beneficial effect of expansion and reduce[s] the real income of the growing country".

Developed for what at the time were called the economies of the "third world", the original thesis focused on terms of trade between agrarian and industrial sectors. Additional work established that disadvantageous terms of trade between raw materials and energy on the one hand and high-manufacturing industries on the other have a similar detrimental effect.

Late 20th and early 21st century post-state socialist Hungary, however, has an economy that is neither predominantly agrarian, nor dominated by exports in raw materials or energy. On the contrary, a vast majority (in 2009, over 85%) of Hungary's post-state socialist exports consisted of machines.[9] Here, we have a semi-peripheral, export-oriented economy that suffers from the lack of domestic growth in spite of the dominance of high manufacturing content industrial products in its exports. The explanation for Hungary's inability to convert foreign trade involvement with economic growth must lie elsewhere.

A remarkable feature of Hungary's post-state socialist mode of entry in global trade is the high concentration of its exports and imports with the EU. As Figure 4 indicates, throughout the period under study,

Figure 4: Hungary's Trade Concentration in the EU



Source: Computed from Eurostat (2009, 2011).

the share of the EU in Hungary's exports has never sunk below 75%. Between 1997 and 2005, in fact, it remained above 80%. In imports, the EU's share has hovered between 64.5% and 71.7%. (Imports from the EU are slightly lower primarily because of Hungary's reliance on former Soviet, that is, non-EU, sources for energy, especially natural gas and oil.)

To put those figures into perspective, the geopolitical concentration of Hungary's foreign trade with the EU was 4.2 to 4.46 times greater for exports, and 3.18 to 4.23 times greater for imports than the EU's share in world trade. As a result, EU-Hungarian trade was 17.8 to 42 times more significant an economic factor for Hungary than for the EU. Also noteworthy is the fact that neither curve shows any decipherable break or change of tendency after 2004, suggesting that Hungary was already fully integrated into the geopolitical-economic orbit of the EU well before full EU membership.

Highly concentrated foreign trade partnerships are another well-known problem for (semi-)peripheral economies (see, for example, Meilak 2008). The United Nations Development Programme (UNDP) (2011: 21) recommends the following courses of action for countries that suffer from high export concentration: "boosting domestic demand, promoting export diversification, strengthening regional trade cooperation; and [creating an] enabling international trade environment".

Until 2010, Hungary's post-state socialist governments, irrespective of their overall political orientation, took an extremely strong pro-EU, pro-business and, specifically, pro-EU-business stance. Industrial policy was virtually non-existent, and subordination of all other issues to EU integration was an unquestionable dogma. Because of that dogma, and because of the entire Hungarian political elite's firm ideological commitment to the inherent superiority of a "free"-market version of western capitalism over any geopolitical-economic alternative, the privatisation of the erstwhile socialist state's property – including almost all productive assets in the economy as of 1989 – involved transfers, at discounted, in some cases extremely discounted, prices, to foreign investors. "Greenfield" investment was also strongly encouraged, with very significant infrastructural commitments on part of the government, not to mention the usual tax breaks.

SEZ Country

As a result, a large part of Hungary's GDP today accrues to foreign, primarily EU-based, multinational companies. Such a high proportion of exports comes from manufacturing because of production by EU-based multinationals for re-export under conditions resembling tax- and tariff-free arrangements known in other parts of the world as special economic zones (SEZs). Because of Hungary's early acceptance of the EU's legal system, the entire country can be regarded as an SEZ for EU-based capital.

Hungary's post-state socialist economic transformation took a form, vaguely reminiscent of the boom of the maquiladora industries – electronic and machine equipment assembly operations on the southern side of the US-Mexico border. One particularly consequential feature of foreign-owned, assembly plant-style industrial growth is the relatively high import content of such industries. Since the two main points of attraction that drive multinational capital to such arrangements are low labour costs and easy logistical arrangements – for example, geographical proximity to component producers and export markets, or a pre-existing rail, road and/or water-based transportation system (all amply present in Hungary, especially from the perspective of EU-based capital) – local production of main components becomes relatively low priority. Obviously, the value of such imports added to the production of such components augments those economies where they are produced, not where they are installed into the final product.

Due to the predominantly foreign ownership of these machine assembly industries, local income-generating effects can be expected in two areas: wages of the workers and the local management, and revenues of the local subcontracting firms. Since low labour costs are a key dimension on which governments compete for foreign direct investment, and because the highly mechanised, high productivity character of this production generates relatively small demand for labour, the developmental effects through wages are minimal. Subcontracting arrangements put local businesses in an economically, legally and technologically subordinate position vis-à-vis foreign multinational capital. Multinationals can, and do, shop for subcontractors globally, whereas local subcontractors have serious spatial and temporal constraints. The developmental effects of such subcontracting arrangements are also relatively small. Given that the national industry inherited from the state socialist period was dismantled through the privatisation process only to be recast as predominantly foreign-owned and assembly plant type, and given the endemic unavailability of indigenous capital for domestic industry, the highest value added operations in industrial production in the Hungarian economy are controlled by foreign capital.

Conclusion

In some important ways, the collective frustration of the Hungarian failure to catch up is the obverse of the Greek debacle. In the Greek case, the shared currency allowed the less wealthy EU member state to adjust its budget and, specifically, its social policy provisions, to mimic those of wealthier states. Greece thus created the paradox of a tremendous over-borrowing crisis on part of the government, in spite of commendable economic growth. (Greece's GDP rose at a rate higher than the GWP throughout the one and half decades preceding the current crisis.) The funds generated by private capital in the booming tourism and shipping sectors of the Greek economy did not get re-routed to finance the social safety net, infrastructural expenditures, and various other social provisions that society expected the state to provide. Domestic capital consistently refused to finance the Greek state, and within EU, non-Greek capital also refused to finance it.

The Hungarian economy has been as dependent on trade with the EU as Greece, with one crucial difference: the absence of a shared currency. For that reason, the structural problems of the Hungarian economy show up not on government balance sheets but in its inability to increase its GDP. The "independent" Hungarian currency is hence extremely vulnerable to exchange rate fluctuations, essentially depressing the value of domestic labour as well as capital. Since the value of the Hungarian currency is determined almost entirely outside Hungary, the government has extremely little room for manoeuvre to influence processes of accumulation within "its" borders. The EU as a supra-state polity "sharing and pooling...the sovereignty of its member states" has, on the one hand, quite successfully wrestled away a large part of the ability of the national states to influence economic processes in "their" territory. On the other hand, by virtue of it not being a state (see, for example, Böröcz and Sarkar 2005) – and hence not carrying the same moral responsibility and accountability vis-à-vis its member states as a state does vis-à-vis its regions – it does not, and cannot be expected to, perform functions of the developmental state. Instead, it merely promises automatic prosperity once the driver of trade is set off.

NOTES

1 The GDP and per capita GDP figures used in this article have been computed from data provided in the magisterial compilation of historical population, GDP and per capita GDP estimates by economic historian Angus Maddison (nd). For more on the method of computation, see Böröcz (2009).

2 For easier comparison, a horizontal line marks the level of the last year of state socialism in 1989 in Figure 1.

3 The sudden drop followed by a sluggish recovery that is yet to reach the initial levels repeats itself in 24 of the 26 additional cases of post-state socialist transformations (Böröcz 2012). The two exceptions, where the recovery has already brought the economy slightly above the last state socialist position – Poland and Slovenia – do deserve close scrutiny. Yet, even in those relatively less disastrous cases, it is not possible to talk about a "catching-up" with western Europe anytime soon.

4 For example, "there is a strong case for moving towards free trade and competition among countries, and for building world institutions to apply uniform regulation, taxation, and the like in a fair manner and to block arbitrage based on uneconomic difference" (Kindleberger 1983: 637).

5 A European Commission working document, states, for instance, in completely unambiguous terms that "[t]he triple benefits from trade opening are: [e]conomic growth [...], consumer benefits [..., and] employment" (European Commission 2010).

6 2008 is the latest year in Maddison's dataset, the source for the GDP and per capita GDP estimates.

7 Global economic weight is an indicator of the relative influence of an entity on the world economy, measured by the per cent share of its GDP in GWP. For more on the rationale for such an indicator and the various issues in measuring it, see Böröcz (2009).

8 Figures 3 and 4 refer to "IN trade" and "OUT trade" because the language used in the EU for within-EU economic transfers avoids the conventional terminology of "exports" and "imports". So, in EU statistics, any EU-member state has two kinds of trade involving movements of goods beyond its borders. Exports and imports refer to transactions with actors outside the 27 EU member states; "dispatches" and "arrivals" denote transactions with non-national actors within the EU 27. Hence, in Figures 3 and 4, "IN trade" is the sum of "imports" and "arrivals", "OUT trade" is the sum of "exports" and "dispatches".

9 According to the CIA World Factbook, in 2009, Hungary's two main exports were "machinery and equipment (55.3%)" and "other manufactures (30.6%)". As of 28 April 2012, https://www.cia.gov/library/publications/the-world-factbook/geos/hu.html

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