Weekly Briefing

Hungary political briefing:
A review of the Eastern Opening policy - Hungary’s economic relations with the East
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A review of the Eastern Opening policy - Hungary’s economic relations with the East

The Eastern Opening policy was launched twelve years ago, in 2012. Back then, the geopolitical conditions were different, and the policy seemed hasty in the eyes of some observers. In the meantime, the change in the world order is more tangible than ever and the economic opening is much easier to justify. Twelve years ago, one of the counter-arguments was that only the influx of cheap imported goods from the East was to be expected and that no further results were to be expected. Despite negative comments and gloomy expectations, today we can observe the steady inflow of foreign direct investment from Asia, making the region more important than ever in terms of foreign direct investment. Another frequently voiced counter-argument was that the Hungarian economy is too deeply embedded in European supply chains and that this fact will not change. We believe that this argument contains two errors. Firstly, we recognize that supply chains can change over time, both the point at which economies join the chain and the amount of value added that certain regions and countries contribute to the chain. The other problem is that excessive dependence on one relationship – in Hungary's case, excessive dependence on the West is a proven fact - can expose the economy to external shocks – in Hungary's case, the great financial crisis (2008-2009) revealed the depth of the problems. For this reason, it is worth avoiding this situation or reducing exposure in one direction. This briefing looks at the development of the Eastern Opening policy, it also examines its historical roots.

Introduction

Why did the Hungarian government introduce the Eastern Opening Policy? Several analysts pointed out that the ruling party wanted to maintain and strengthen political relations with the non-democratic systems of Asia and that this policy framework would be a vehicle for the implementation of such a policy. There are several problems with this argument.

1. Firstly, the Eastern Opening policy never meant turning away from the West, its basic political and economic model.
2. Secondly, Hungary adheres to the Westminster model of democracy. At the same time, co-operation with countries that apply other models is in line with the principle of non-interference in the internal affairs of other countries.

The Eastern Opening policy is more about the diversification of Hungarian trade and investment relations. In order to understand the need for a reorganisation of Hungarian relations, we will briefly look at the country’s economic model.

The model, often referred to as the "dependent model"," was successful in many economic indicators after 1990. Following the rapid transformation of the economy in the early 1990s, inflation and unemployment rates slowly declined after the initial shocks. Foreign direct investment from the West flowed into Hungary and fundamentally changed the country's economic structure. Before 1990, Hungary, like other CEE countries, was characterised to varying degrees by heavy industry, which was replaced by manufacturing industry; the automotive industry in particular became a flagship in the Central European region.

The automotive industry accounted for 13 per cent of GDP in Slovakia, 10 per cent in the Czech Republic and 4-6 per cent in Hungary in 2019!

Foreign investment and the resulting exports restored balance in the economy; newly created jobs in these industries triggered spillover effects; higher wages boosted domestic demand and affected the demand for domestically produced goods and services. So we can say that the "dependent model" was successful up to a point in the development of these countries, including Hungary.

However, the Global Financial Crisis revealed the weaknesses of the model, which is not only dependent on external financing, but also on a region whose economic strength is relatively weaker. The EU accounted for 15 percent of global GDP (PPS) in 2017 (excluding the U.K.), and that share will fall to 9 percent by 2050. The US. faces the same decline, with its GDP

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1 https://www.reuters.com/article/us-easteurope-economy-automotive-analysis-idUKKCN24V0QT
2 PPP: purchasing power standards
expected to shrink from 16 percent in 2016 to 12 percent in 2050. Meanwhile, China's share will rise to 20 percent, but not only is China expected to increase its share of global GDP, but the so-called E7 countries have also developed significantly. The total GDP of the E7 countries was half that of the G7 countries in 1995 and reached about the same size as the GDP of the G7 group in 2007. According to PwC, the GDP of the E7 could be twice that of the G7 by 2040.⁵ (PwC, 2017: 4).

As we understand it, the turning point came in the wake of the global financial crisis, when these countries recognised the subsequent economic problems and put the catch-up process on hold:

1. **Asymmetrical dependence of EU members of the region.** Moreover, the economic dependence on the West did not disappear, as the asymmetry became even greater in the years following 1990. Thomas Piketty, the Nobel prize winner economist pointed out in 2018 that the profits and revenues from real estate leaving the countries of the Central and Eastern European region represent a much higher number than the EU funds, so the argument that these countries were the clear winners of the EU regional funds is completely wrong.

2. **The gap between productivity and wage developments.** Several researchers emphasize the gap between productivity and wage development were seen as evidence of asymmetric dependence. Usually, the rise in productivity leads to increasing living standards, translated to people through higher wages. But wages lagged behind productivity growth in Hungary,

3. **The problem of foreign ownership.** As productivity gains increasingly went to (foreign) capital owners rather than workers, this also led to large capital outflows.

4. **Core-periphery relationship between Western and Central-Eastern Europe.** In the spirit of dependency theories, it can be argued that Central-Eastern European economies are in asymmetric relationships despite the considerable EU funds. The low use of EU funds for domestic research and development suggests that this situation will continue.

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3 E7: seven emerging countries: China, India, Indonesia, Brazil, Russia, Mexico and Türkiye.
4 G7: the group of Seven: Canada, France, Germany, Italy, Japan, the United Kingdom and the United States
The above factors explain why Hungary needed to diversify its economic relations. To these long-term and economic arguments we can add a new and hopefully more short-term aspect resulting from the geopolitical changes. Due to the negative impact of technological warfare and economic sanctions on trade, the rise of economic and trade blocs is predicted and the likelihood of Hungary ending up as part of a bloc has unfortunately increased. This would be the worst-case scenario for a small economy with little or no natural and energy resources.

**Recent trade data on Eastern Opening**

We first look at the trade data between the target countries of the policy and Hungary. In this context, it should be remembered that the detailed trade data only goes back to 2014 and we are analysing the trends in this period. (2014-2023). In terms of target countries, we exclude Russia from this analysis as Hungary has joined the EU economic sanctions against Russia since 2022 and this data would therefore distort the trends. In this chapter, we focus on China, Japan, South Korea, Turkey, Malaysia, Singapore and India. Singapore and India.

In 2014, the above-mentioned Asian economies accounted for 11.5 per cent of Hungary’s total imports, and in 2024 they will account for 18.3 per cent of Hungary's total imports. The export share of the seven Asian economies fell slightly from 5.2 per cent (2014) to 4.8 per cent (2024). If we look at the total trade share of the seven Asian economies, we see that the ratio increased from 8.2 per cent to 11.4 per cent between 2014 and 2023. If we look at the economies, we can see that imports have increased more than sevenfold in the case of South Korea and threefold in the case of Hong Kong and Malaysia. In the case of China, imports increased two and a half times. (It should be noted that the Hungarian Central Bureau of Statistics publishes the data for Hong Kong and mainland China separately) Japan and Singapore fared poorly in contrast to the other countries.
Table 1. Export and import growth in percentage between 2014 and 2023 (%)

<table>
<thead>
<tr>
<th>Country</th>
<th>Import</th>
<th>Export</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>306.1</td>
<td>253.8</td>
</tr>
<tr>
<td>India</td>
<td>251.7</td>
<td>252.1</td>
</tr>
<tr>
<td>Japan</td>
<td>186.2</td>
<td>189.2</td>
</tr>
<tr>
<td>China</td>
<td>249.7</td>
<td>113.7</td>
</tr>
<tr>
<td>South Korea</td>
<td>718.7</td>
<td>230.1</td>
</tr>
<tr>
<td>Malaysia</td>
<td>307.3</td>
<td>212.6</td>
</tr>
<tr>
<td>Singapore</td>
<td>171.8</td>
<td>177.9</td>
</tr>
</tbody>
</table>

Source: own calculations based on Hungarian Statistical Central Office data

If we look at the economy country in trade from this group, China is dominant in both exports and imports. If we take the seven economies as a region, we can say, that China accounted for 42.3 percent of imports from the seven Asian economies and 38.2 percent of exports from this region in 2023. If we add Hong Kong to the Chinese figures, the total ratio of China is slightly below 50 percent. (See table 2!)

To see the change in the importance of these economies, we can look at the export share of the seven Asian economies in Hungary’s total exports which increased from 9.1 percent in 2014 to 15.9 in 2023, while the import share of these countries remained unchanged around 3 percent.

Table 2. Export and import shares of the seven Asian economies in the group of the seven economies (2023, %)

<table>
<thead>
<tr>
<th>Country</th>
<th>Export Share</th>
<th>Import Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>6.3</td>
<td>10.9</td>
</tr>
<tr>
<td>India</td>
<td>3.2</td>
<td>8.3</td>
</tr>
<tr>
<td>Japan</td>
<td>7.7</td>
<td>20.8</td>
</tr>
<tr>
<td>China</td>
<td>42.9</td>
<td>38.2</td>
</tr>
<tr>
<td>Korea</td>
<td>34.3</td>
<td>12.2</td>
</tr>
<tr>
<td>Malaysia</td>
<td>2.6</td>
<td>3.9</td>
</tr>
<tr>
<td>Singapore</td>
<td>2.9</td>
<td>5.8</td>
</tr>
</tbody>
</table>

Source: own calculations based on Hungarian Statistical Central Office data
How are these figures to be interpreted? One might be tempted to conclude that growing trade with these countries leads to a higher trade deficit with these countries, that these figures only show Hungary's lack of competitiveness and that it is not good policy to promote these trade relations. This reasoning is flawed for several reasons:

1. In today’s trade, intra-industrial trade is the predominant form of trade, i.e. intermediate products are mainly traded from one country to another, while inter-industrial trade is less typical in today's circumstances, as trade in final products is no longer so typical. (It was more typical before 1945)
2. If inter-industry trade were still dominant in world trade, Hungary's trade figures mentioned above would indeed not show positive trends. But in our globalized world, most of the goods imported from the seven Asian economies are not final products. In many cases, the imported products are used in Hungarian factories as part of the final products and then exported to other countries.
3. In other words, as long as Hungary’s overall trade is more or less balanced, it is not a problem that we have an imbalance in one relationship, as this imbalance actually helps to create a surplus in the other trade relationship.
4. The current influx of foreign direct investment is one reason for the growing imbalance in trade with the Asian economies, as the new factories being built or to be built also require significant amounts of imports from the investor in order to start production. Once the factories are producing, this balance worsening effect will disappear as domestic value added increases.

**Foreign direct investments and Eastern Opening policy**

The Hungarian government's motivation to incentivise investment from the East becomes understandable if we take a look at the global picture. Whereas a few decades ago 70 to 80 per cent of global investment was financed by the West and the rest by the East, the situation has now reversed and the majority of global investment comes from the East. The Eastern Opening Policy is an adaptation to this new situation. Hungarian policy is being challenged by political forces, particularly in the West, which are reacting to this new reality by attempting to divide the global economy into several spheres of political and economic influence. This is often referred to as decoupling or de-risking. The Hungarian Foreign Minister has described this
battle of forces: “This approach [de-coupling] struggles with the reality and goes against the reality. But there is a realistic approach too, which has its feet on the ground and relies on the reality and says that we need a closer Eastern-Western economic cooperation than ever.”

In this context, we can also understand why the inflow of direct investment is often criticised in the Hungarian media. While the same observers welcomed foreign direct investment 15-20 years ago, today they often criticize the alleged weaknesses of foreign direct investment. It is also a telling sign that criticism is not voiced when foreign direct investment comes from the West, but when it comes from the East.

We continue to believe that the figures reveal the truth and tell a success story rather than problems. In 2022, the total value of foreign direct investment in Hungary amounted to €6.5bn and in 2023 to €13bn, with most of the investment coming from the East. As previous briefings have often dealt with direct investment from China, Korea and Japan, with a focus on the automotive industry, we report on a current mega investment in the property sector.

The investment deal was signed this month between Hungary and the United Arab Emirates. The total value of the property real estate development amounts to around 5 billion euros. The aim is to build a new district of Budapest covering the area of the so-called Rákosrendező railway station and its neighbourhood. The Hungarian Foreign Minister said of the investment that “This giga city development project will give a new impetus not only the cooperation of the two countries, but the development of Budapest too since not only a new city district will be built here but a city development project will take place providing the city with complex touristic, economic and sport functions.”

The Arab investors already had similar projects in Vienna, where they had to develop and recultivate similar abandoned urban areas. The area to be developed in Hungary is about 130 hectares in size and comprises exclusively state-owned land. The area is surrounded by dynamic

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6 https://www.origo.hu/itthon/2024/02/szijjarto-peter-europanak-szuksege-van-a-keleti-beruhazasokra
regions and is accessible via the railway, the 3 motorway and the Hungaria ring road. According to the plans, the new district would include 15 thousand new flats, public facilities and a new park in the northern part of the district. The new neighborhood would help to reduce the cost of living in Budapest by providing reasonable rents for flats and increasing the overall supply. Part of the development is to offer these flats to healthcare workers, teachers and public transport employees.

Summary

There is another, rarely discussed aspect of the Eastern Opening Policy too. As we have already mentioned, the correlation between productivity growth and income growth is much weaker in Hungary and other Central European countries than in the West. The main reason for this phenomenon is that the weakened Hungarian state in the 1990s and early 2000s was not able to control the entering multinational companies, which not only entered the market but also often took advantage of their sometimes oligopolistic, sometimes monopolistic market situation. Although they brought new knowledge and new technologies to the country and created jobs, they also deepened the excessive dependence on the West. Asymmetric dependence is not a problem in itself, but it can become a problem in times of economic shocks and crises.

While Hungarian economic policy before 2010 mainly served the interests of foreign companies, a stronger state after 2010 protected Hungarian interests more vehemently and caused political backlash from the West. We must also understand that other political steps aimed at strengthening Hungarian capital owners, Hungarian companies, flanked the diversification policy of Eastern Opening Policy and served the same purpose, the purpose of a more sovereign economic policy. For this reason, we expect that this economic policy will continue to be attacked by Western countries since these government often protect and support their home-company.

Bad practices of Western multinational companies have been accepted by Central European countries for a very long time. An excellent example is that these companies often sold products under the same label, brand with very different quality (often called dual quality
products) in the West and the East. Even in 2021, the share of these products was 21 per cent in the EU. Another example is the recent dispute between the Hungarian government and SPAR retail chain. In this dispute, the government made it clear that it believes that extra burden of inflation and war can be taken by Hungarian families, and this is the reason why it takes away extra profit from these retail chains. In an optimal market, the government would not be forced to take these measures since market forces would alleviate these temporary frictions.

The link between these political steps and Eastern Opening Policy can be found in the attempts to weaken the over-dominant position of Western European multinational companies in Hungary. Both mentioned policy approaches take the long-term view. As we have seen in the case of Eastern Opening Policy, it took around ten years to reach a breakthrough in the volume of the foreign direct investment. It is obvious that oligopolistic and monopolistic situations are difficult to change, but it can be made as the case of utilities show in the case of Hungary. Ten, fifteen years ago, electricity, natural gas, water providers were all in the hands of Western companies, for now the situation had changed. Similar changes can be seen the banking sector and telecommunication. At the same time, we should add that the Hungarian economic policy clearly distinguishes between multinational companies creating new manufacturing capacities, bringing new technology and companies making advantage of their oligopolistic or monopolistic situation in trade or services.

<table>
<thead>
<tr>
<th>Table 4. Foreign firms in Hungary (%)</th>
<th>2010</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of firms</td>
<td>3.3</td>
<td>2.5</td>
</tr>
<tr>
<td>Share in total revenues</td>
<td>51.6</td>
<td>48.6</td>
</tr>
<tr>
<td>Share in total added value</td>
<td>49.3</td>
<td>47.8</td>
</tr>
<tr>
<td>Share in gross investment</td>
<td>49.0</td>
<td>40.1</td>
</tr>
<tr>
<td>Share in employment</td>
<td>24.7</td>
<td>26.3</td>
</tr>
</tbody>
</table>

Sources: Hungarian Central Statistical Office: Külföldi irányítású vállalkozások Magyarországon, 2018, p. 5

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