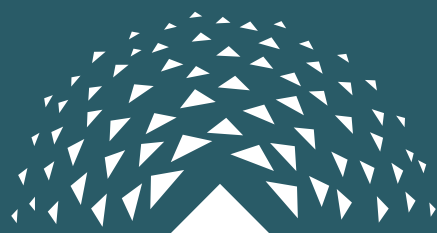


**Hungary's Eastern Opening:
Political and Economic Impacts**

Magyarország keleti nyitása:
Politikai és gazdasági hatások

LISA IRIMESCU



KKI Policy Brief

Series of the Institute for Foreign Affairs and Trade

Publisher:

Institute for Foreign Affairs and Trade

Reviewers:

Márton Ugródsy

Péter Goreczky

Typesetting:

Andrea Tevelyné Kulcsár

Editorial office:

H-1016 Budapest, Bérc utca 13-15.

Tel.: + 36 1 279-5700

Fax: + 36 1 279-5701

E-mail: info@ifat.hu

<http://kki.hu>

© Lisa Irimescu, 2019

© Institute for Foreign Affairs and Trade, 2019

ISSN 2416-0148

Abstract: This brief seeks to understand the political and economic impacts of Hungary's "Eastern Opening" policy. Despite nearly ten years of this turn to the East – specifically China – this brief finds that the outcomes of the policy are negligible. In response, this brief recommends that the government focus on helping Hungarian firms break into the Chinese market, build human capital, develop FDI game plans for Chinese investors, and rebrand the Budapest–Belgrade railway as infrastructure to export Hungarian goods to the Balkan nations. In essence, this brief argues that the government must focus on using its partnership with China to empower Hungarians, rather than Chinese firms.

Összefoglalás: Az elemzés célja a magyar „keleti nyitás” politikai és gazdasági hatásainak az ismertetése. Annak ellenére, hogy közel tíz éve kezdődött ez a kelet – különösen Kína – felé fordulás, az elemzés értékelése szerint e politika hatása elhanyagolható, ezért azt javasolja a kormánynak, hogy elsősorban a magyar cégek kínai piacra jutásának az elősegítésére, a humán tőke fejlesztésére, a kínai befektetők FDI-jének elősegítésére fókuszáljon, és ismét prioritás legyen számára a Budapest–Belgrád-vasút infrastruktúrájának kiépítése, hogy könnyebbé tegye a magyar áruknak a balkáni országokba exportálását. Az elemzés lényegében a mellett érvel, hogy a kormánynak arra kell összpontosítania, hogy a Kínával fenntartott partnerség révén sokkal inkább a magyar cégeket erősítse, mint a kínaiakat.

INTRODUCTION

The twenty-first century has been referred to as the “Asian century” in an effort to emphasize the growing and impressive economic power of Asian countries, notably Japan, the “tigers,” and China. Nations with small- and medium-sized economies often focus on increasing their interaction with China, in order to boost their own economic growth. Such is the case with Hungary's “Eastern Opening” policy. That said, as this policy nears the [ten-year mark](#) (in 2020) it offers an opportunity to pause and reflect on the value of this partnership with China (heretofore: partnership). This brief will evaluate the partnership by examining its political and economic impacts on Hungary. In doing so, officials will be equipped with the knowledge they need to alter the terms of the partnership or address existing issues to maximize its benefits for Hungary.

From a political standpoint, this brief will discuss China's motivations for pursuing the 16+1 partnership and how Hungary fulfills (or fails to fulfill) these interests. It will also touch on how Hungary's position or – perceived – behavior has changed in the international sphere as a result of this partnership. From an economic standpoint this brief will focus on the trade balance, Chinese foreign direct investment (FDI) in Hungary, and the Belt and Road Initiative's (BRI) Budapest to Belgrade railway. This brief concludes that the positive political and economic impacts of the partnership



are minimal. Consequently, it recommends that the Hungarian government make extra efforts in policy and negotiation in order to secure greater benefits for Hungarian citizens and businesses.

CHINESE MOTIVATIONS

China's motivation for pursuing this partnership with Hungary, among other Central and Eastern European (CEE) nations is largely driven by economic interests. Indeed, [China suffers from](#) (1) an overcapacity in several industries (including infrastructure, steel, glass, cement, real estate, etc), (2) rising unemployment, (3) a need to create demand for Chinese goods abroad, and (4) a significant slow-down in economic growth. The partnership – and more generally, the 16+1 group – is designed to permit China to address the aforementioned issues.

For example, Tiejiju Engineering & Construction and China Railway Electrification Engineering Group [were awarded 50% of the contract](#) to construct the Budapest–Belgrade railway, meaning that China is able to export its overcapacity in the infrastructure sector by ensuring that Chinese firms secure BRI projects. These firms then employ Chinese citizens, rather than locals in order to lower the unemployment rate in China. Admittedly, Hungary's low [unemployment rate \(3.3%\) doubles](#) as an incentive to import Chinese workers. Since the railway's purpose is to introduce and [transport Chinese goods](#) from the Greek port of Piraeus to European markets, it is also expected to help China increase demand for its products abroad, while sustainably raising the nation's economic growth as a result of exports to Europe. As Junchi Ma said to the author of this policy brief on July 19, 2019, [CEE nations' markets are small](#) – except for Poland – and are unlikely to have enough purchasing power to address China's four economic motivations, alone. Therefore, China's interest in the CEE region primarily revolves around the BRI infrastructure projects because they yield the greatest benefits for the Chinese economy.

On the other hand, Chinese officials are keen to ensure this partnership fulfills a strategic interest as well. In particular, China is eager to establish a [Chinese-oriented economic world order](#). Today, China does not need a hub in CEE to access European markets, as Chinese companies own critical ports in Western Europe and have [established their own headquarters](#) in the UK, Germany, and France. However, China seeks allies that will either (1) encourage Western European countries to open up to Chinese power, investment, and goods, or (2) defend China's reputation and interests within the European Union (EU). For this reason, Poland, Hungary, and the Czech Republic make for excellent partners because Chinese officials know that [these nations have voting power in the EU](#) and are themselves already open to Chinese influence.

As Viktor Eszterhai told me on June 25, 2019, in an interview, a positive image in the eyes of the EU is important to China because the Chinese government's

primary goal in Western Europe is to buy a significant share of the renowned German manufacturing sector. This sector is rich in innovative technology – due to Germany's R&D model – and offers China direct access to European markets. If China manages to meet this mandate, the nation will secure its position as a leader in R&D, while gaining possession of competitive firms with large shares, in a market where demand for these products already exists. But, China cannot achieve this goal without the German government's permission, which requires a positive perception of Chinese firms and their intentions.

In sum, Hungary is an ideal partner for China. This is especially the case since Poland and the Czech Republic recently turned a cold shoulder to the Asian nation. As some Western European nations – [such as Italy](#) – express increasing interest in Chinese goods, the BRI, and a willingness to promote China in the EU, Hungary may no longer be of strategic importance to China. This means that the Hungarian government must develop a strategy that attracts Chinese firms solely for the country's economic potential. This will be elaborated upon in the "recommendations" section of this brief.

THE GLOBAL STAGE: POLITICAL IMPACTS ON HUNGARY

The 16+1 group attracted significant attention from the Western European nations since its inception in 2012. The group faced criticism for "dividing Europe" on China because the members [endorse Chinese interests](#) in the EU without concern for the negative impact on Western European nations' industries. At the same time, the 16+1 is perceived to be a group of unsuspecting CEE countries, which are manipulated by Chinese officials to [open EU doors to Chinese firms](#) and influence. Indeed, Greece and Hungary have been singled out as nations that have given into China's influence. For instance, the former blocked the United Nations (UN) from releasing a statement criticizing China for its human rights abuses, while the latter [refused to sign an EU letter](#) condemning China for detaining and torturing lawyers.

This new perception of Hungary among Western Europe has a [negative impact on Chinese officials' opinion](#) of Hungary's ability to convince the EU to open its doors to China. There is concern that Hungary's promotion of the nation as an *alternative* to EU funds portrays China as a competitor, rather than a potential business partner for the EU. Though the partnership diversifies Hungary's economic partners and allies, it also risks damaging Hungary's traditional relationship with key regional allies, and as a result reduces its influence within the EU.



ROOM FOR IMPROVEMENT: ECONOMIC IMPACTS ON HUNGARY

If the purpose is to better Hungary's economic situation, the partnership with China has fallen short of achieving the desired effects. To arrive at this conclusion, this brief considered Hungary's trade balance, Chinese FDI in the nation, and the Budapest–Belgrade railway project. This brief advocates that regardless of the current reality, it is possible to use the three aforementioned pillars of the partnership to secure better outcomes for Hungary.

THE SITUATION ON TRADE

Ultimately, [Hungary's trade with China](#) accounts for only 2.9% of Hungarian exports and 5.9% of Hungarian imports. This indicates that regardless of the policy's initial intentions, Hungary has not significantly reduced its dependency on its EU trading partners. This is unlikely to happen because both the Hungarian and regional European economies are heavily integrated with one another. As is evident, Hungary's trade relationship with China is not critical to the wellbeing of the Hungarian economy, but it is still worth considering the dynamics of the relationship.

Hungary has experienced a [positive overall trade balance](#) since 2009 and continues to do so to date, but the CEE nation is currently suffering from a trade deficit with China worth approximately \$ 2.6 billion USD. This trade deficit with China is not problematic in itself, but it merits an investigation into the success of Hungarian firms in Chinese markets. The deficit suggests that Hungarian firms are not able to benefit from this new partnership with China. The reason for this is twofold.

Firstly, [the Chinese government implements policies](#) that limit foreign firms' access to the domestic market, while providing immense support for its own firms, both within China and abroad. In other words, despite the fact that Chinese firms already possess knowledge of the laws, culture, and markets in China, they also invest much less than foreign (ex. Hungarian) firms would have to in order to secure a competitive position in the domestic market. This imbalance in the barriers to entry makes it difficult for foreign firms to match the competitiveness of their Chinese counterparts. Secondly – as Viktor Eszterhai stated – Hungarian firms, primarily small and medium enterprises (SMEs) are unable to access the resources and knowledge they need to succeed in Chinese markets. Therefore, Hungarian firms that may be competitive in Chinese niche markets are unlikely to be aware of this opportunity or lack the capital they need to take advantage of it. Consequently, Hungary's trade relationship with China is not enough to provide Hungarian firms with tangible opportunities and therefore requires some policy changes before the benefits of this relationship can be realized.

FROM CHINA TO HUNGARY: FDI

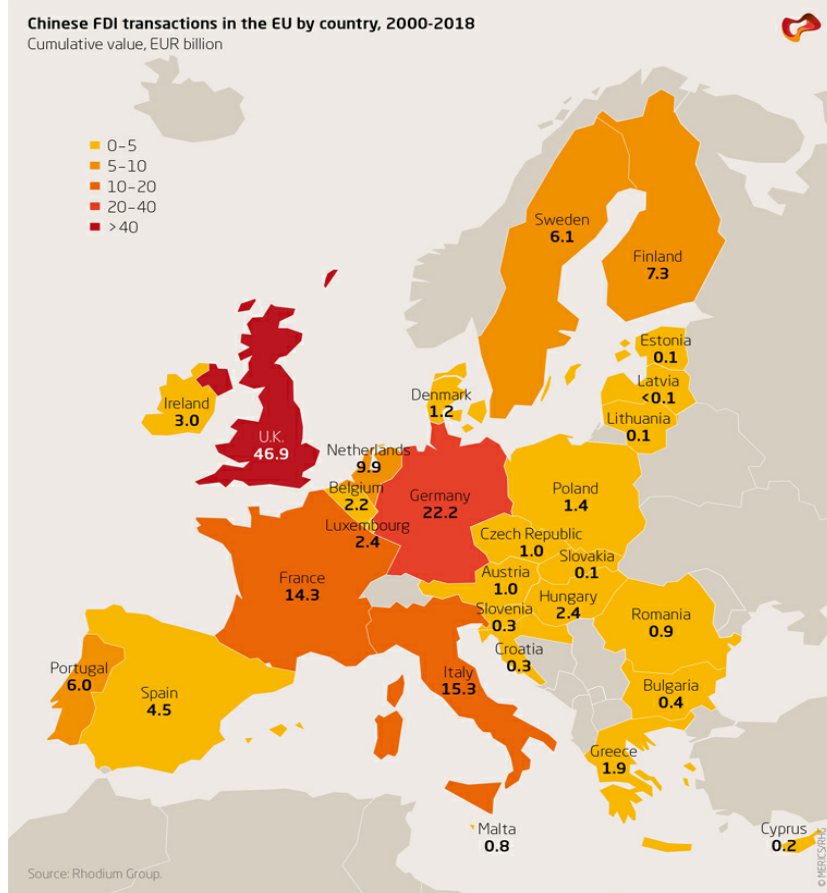
Chinese FDI flow into Hungary is on the lower end, compared to [Chinese investment in Western European nations](#). In fact, from 2000 to 2018 the top recipients of Chinese FDI have been the U.K. (\$46.9 billion EUR) and Germany (\$22.2 billion EUR). One of the main reasons for this is because Chinese FDI often targets nations with strong research and development (R&D) sectors, or where there is potential for competitive R&D following an investment flow. China's goal is to control technologies that make shifts up the global value chain possible, but since it currently lacks such high-end technology, it uses mergers and acquisitions [to gain the rights to this type of technology](#). Chinese FDI is often more sinister in nature than first appears.

Of the CEE countries, [Hungary has received the most FDI from China](#) so far (\$2.4 billion EUR). China's most notable investment in Hungary took place in 2011, when the Hungarian specialty chemical producer BorsodChem was bought by the Chinese company, Wanhua Chemical Group. This form of FDI was only beneficial for Hungary because it saved about 3000 jobs since [BorsodChem was at risk of closing down](#). In other words, FDI in the form of mergers and acquisitions – the most common form of Chinese FDI in Hungary and Europe – does not usually offer many longer-term and value-added benefits to the host economy, especially when compared with greenfield investments. Indeed, mergers often consist of one lump-sum investment in order for the investor to acquire the company, after which the profits of the company are no longer reinvested in the host nation's economy, but [redirected to the investor's home country](#). In certain circumstances such FDI can result in additional investments if the investor wishes to expand operations or improve existing ones (ex. R&D). By contrast, greenfield FDI means that the investor establishes a firm in the host country which creates new jobs, provides education, and infrastructure, while taxes and profits are reinvested in the host economy. Of course, this is not to say that greenfield investments are without downsides, merely that they offer unique benefits and for this reason should be pursued to balance out the drawbacks of mergers and acquisitions. Unfortunately, a majority of Chinese investments have not contributed to the Hungarian economy or society. To truly achieve a win-win situation, the government must incentivize Chinese investors to conduct more greenfield investments in Hungary.



Map 1

Chinese FDI Transactions in the EU by Country (2000–2018)



THE BELT AND ROAD INITIATIVE: BUDAPEST–BELGRADE RAILWAY

The Budapest–Belgrade railway which runs 374 km in length will be updated with the intention of operating [cargo trains at speeds of up to 160 km/hour](#). It is expected to eventually link Budapest to the popular Chinese-owned Greek port of Piraeus and will cost the Hungarian government 2.3 billion EUR. Under these circumstances, 85% of [the railway will be financed by a loan from the Chinese state](#) with an annual interest rate of 2.5% for 18 to 20 years.

The railway project is the heart of the partnership because it permits both nations to address their main motivations. As has been mentioned, China uses BRI infrastructure projects to relieve overcapacity in several industries (ex. infrastructure), boost Chinese employment, create demand for Chinese goods abroad, and secure a steady economic growth rate. At the same time, it is valuable for Hungary for two reasons. Firstly, CEE lacks updated North–South infrastructure which can impede regional economic development. The railway is a step in the right direction from a regional economic perspective. Secondly, [it is believed that Chinese companies will use Budapest as a hub for goods](#), before exporting them to Western Europe.

As a result, Budapest would experience investment and economic growth, while becoming indispensable for Chinese exports to Europe.

[Map 2](#)

The Budapest–Belgrade Railway
Including Existing and Proposed Railway Infrastructure



Despite the aforementioned, this brief cautions that there are four facts which prevent Hungary from benefiting from the railway as expected. In particular, this brief suggests that the intention to use the railway as a step towards transforming Budapest into a hub for Chinese firms exporting goods to Western Europe is unlikely to succeed. These facts are as follows:

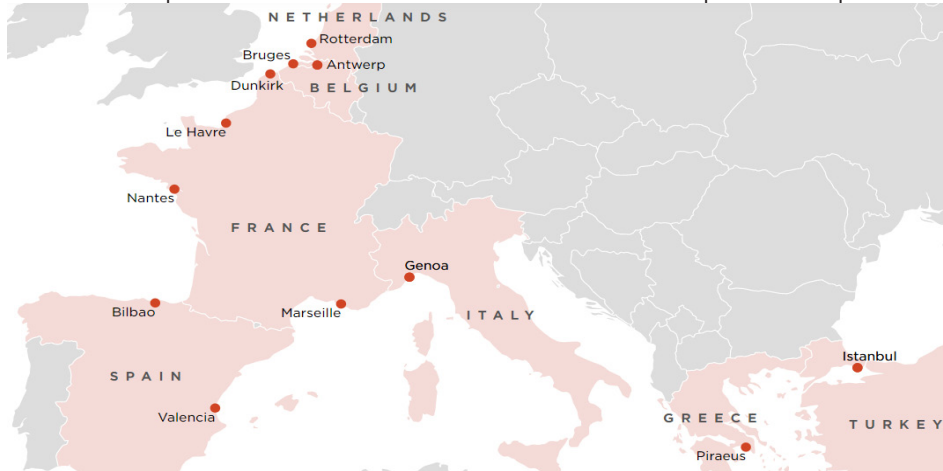
- It is important to note that, though the loan is not crippling for Hungary, the ease with which it can be paid off is compromised due to [Hungary's existing loans](#) from other external actors (ex. Russia). Failure to pay off the loan can lead to further economic or even political complications with China.
- Even if the Budapest–Belgrade railway updates are completed, the infrastructure connecting the port of Piraeus to Belgrade is not built for high-speed trains. This means that the railway will not be functional – in terms of moving imported Chinese goods from Piraeus to Budapest – once it is completed. Unless construction of the remaining infrastructure occurs simultaneously – which is unlikely, given the planning, bureaucracy, and time required to do so – the finished railway will take years before Hungary will experience a return on its investment.
- Chinese firms own significant shares of different ports in Western Europe. Thus, the Chinese already have several hubs for their goods before they enter Western European markets. Ultimately, [it will be cheaper for Chinese firms](#)



to transport their goods to Western European ports rather than using Budapest as a hub for their goods before moving them West by rail transport. Therefore, the incentive to use the railway is minimal.

Map 3

Ports Across Europe in Which Chinese State-Owned Enterprises Acquired States in



- An interview with a representative from the Chinese firm, Chinese Ocean Shipping Company (COSCO) which now owns Piraeus, indicated that the company does not expect to see a change in its logistics calculations once the Budapest–Belgrade railway is established. Indeed, the firms that already use the “outdated” existing rail infrastructure noted that [the updates would only speed-up their logistics](#) by a negligible four hours. Evidently, though the aforementioned firms will continue to use the rail infrastructure, an increase in rail traffic due to the updates is improbable. In that respect, the Budapest–Belgrade railway will not transform Budapest into a hub for Chinese firms.

The profitability of the BRI project depends on who will use the track. Under these circumstances, if the Budapest–Belgrade railway updates will be carried out, the finished product must be used by Hungary, for Hungary. In other words, the railway should be used to meet Hungarian interests by encouraging Hungarian firms to use it, rather than Chinese firms. This will be elaborated upon in the subsequent section.

RECOMMENDATIONS

Based upon the previously mentioned economic impacts, this section will now provide three recommendations for securing better outcomes for Hungary. The following recommendations can be implemented simultaneously or gradually.

TRADE: EMPOWERING HUNGARIAN FIRMS

To help Hungarian firms break into the Chinese market the government must offer them the opportunity to gather more information on the Chinese market, culture, and customs. In some cases, firms may also require assistance with taking the first step to sell their product to the Chinese. Below are ways in which these prescriptions can be realized:

- Organize and sponsor conferences in Hungary where experts and professionals can discuss Chinese market intricacies, including barriers to entry, needs, niche market opportunities, success stories, etc.
- Conduct trade missions where members of the Hungarian business community travel to China with diplomats and participate in networking events, market sector presentations, business briefs, and business2business (B2B) meetings with Chinese importers.
- According to Junchi Ma and Péter Goreczky – who gave an interview to the author in July, 2019 –, encourage Hungarian firms to focus on small city-markets such as Wuhan and Nanjing, rather than the entire Chinese market. Hungarian SMEs will have a difficult time tackling the Chinese market, but local (second tier city-wide) markets are much more manageable in size and allow firms to gain valuable experience before expanding in the Chinese market.
- Allocate a fund for firms in order to buy plane tickets to exhibitions in China so that firms can showcase their products – once they know it is likely to succeed in the market, said Gergely Salát to the author on July 17, 2019.

FOREIGN DIRECT INVESTMENT:

ALIGNING CHINESE CAPITAL AND HUNGARIAN NEEDS

According to Gergely Salát, increased Chinese greenfield investment in Hungary is ideal, but it cannot happen if Chinese investors do not know which sectors offer both Hungary and China a win-win situation. Even so, greenfield investment will not happen if Hungary does not possess the human capital to make such an investment possible. Therefore, the government must focus on making the nation more attractive for greenfield investors, while dictating the terms of FDI to such investors. Below are ways in which these prescriptions can be realized:

- Establish a government committee which will conduct research on Hungary's industries, identify FDI opportunities in such industries, draft conditions for FDI to protect Hungarian interests, and present such offers to Chinese investors.
- Invest in human capital – as said by David Yi Wang in his speech “Opportunities, Challenges, and Reciprocity” on the Hungary–China Economic Forum in Budapest, Hungary, on June 18, 2019 – by increasing education



budgets, developing policies that promote pursuing an education in the “jobs of the future” (ex. R&D, medicine, and finance), encouraging immigration to boost human resources, and investing in health and poverty reduction programs to nurture existing human capital.

THE BUDAPEST–BELGRADE RAILWAY:

EXPORTING HUNGARY, IMPORTING THE BALKANS

According to Viktor Eszterhai, although the railway updates have been branded as infrastructure that will benefit Chinese firms, the reality is that it holds great potential for Hungarian firms looking to expand. The railway should be used by Hungarian firms to export their products to the Balkan markets and vice versa. The objective is to secure railway traffic to ensure a return on investment for the government. Below are the ways in which these prescriptions can be realized:

- Use the media to rebrand the BRI railway as a project built to help Hungarian exporters reach new and existing markets in the Balkans at a cheaper price than road transport offers, while securing faster shipping by avoiding highway traffic.
- Repeat the aforementioned trade recommendations for the Balkan markets to assist Hungarian firms in realizing their product(s)' potential abroad.
- Encourage Balkan firms to use the railway to export and introduce Balkan products to Hungarian consumers.