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Hungary in the changing world*

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After the political transition, a new chapter has started in the history of Hungary. The economy and the society of the country have undergone an enormous transition and in the meantime the world surrounding Hungary has also been transformed. This book discusses the peculiarities of the past 25 years through conversations with the three authors. The book presents the authors' own experiences and opinions on the events of the given period. The authors are Dr Mihály Patai, President of the Hungarian Banking Association, and Chairman and CEO of UniCredit Bank Hungary Zrt., Dr László Parragh, President of the Hungarian Chamber of Commerce and Industry, and Dr Csaba Lentner, Professor and Head of the Department of Public Finances at the National University of Public Service.

The first part of the book, published by Éghajlat Könyvkiadó and comprising of eight chapters, analyses the major economic and social problems of the past twenty-five years that affected Hungary, while the second structural unit contains the interviews with the authors.

One of the areas in the focus of the authors is the period after the political transition of Hungary, analysing how the external and internal socio-economic changes impacted the situation of Hungary and its perception abroad. They also touch on the global economic crisis that followed the shock caused by accession to the European Union and the political transition, as well as the problems arising from foreign currency lending. They analyse the economic impact that may have been generated by the lack of accession to the euro area. They discuss at the probable future directions, and survey the changes that would be necessary for economic growth in Hungary, in particular by reforming the higher education and consolidating the Hungarian corporate sector.

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Chapter one presents the key economic and political events of the political transition, as well as the socio-economic situation of Hungary in the early 1990s. At the time of the political transition, Hungary struggled with large government debt and the national capital stock available for investments was extremely low. The engineering and technical level of the plants and enterprises significantly lagged behind that of the developed (western) states. After the political transition, Hungary opened up to foreign capital and significant investments were implemented within a short time. At that time Hungary was the champion in the Central and Eastern European region in attracting foreign capital. In 1997, the capital inflow to Hungary was as high as USD 1.5-2 billion (*Diczházi 1997*), while foreign investment until 2003 amounted to almost USD 43 billion, 50 per cent of which focused on industry. Direct investments and transnational enterprises were instrumental in the economic renaissance of the Central and Eastern European countries and their integration in the global economy. FDI also participated in privatisation. Foreign investors often purchased market only, as a result of which the modernisation and improvement of the majority of the sold plants did not materialise and they were shortly closed down. One of the privatisation objectives of the government, namely to develop the national enterprises, failed to materialise. The impacts of this can be still felt; these include declining output in certain economic areas, or even the full termination of production, primarily in heavy industry, textile industry, mining and quarrying and the sugar industry; however, it should be noted that these areas were on the wane since the 1970s in the developed countries as well.

As also reflected by HCSO figures, sugar manufacturing was not liquidated, but only one – in Kaposvár – was left out of the previous twelve factories. Sugar manufacturing was downsized by 2007, while bus manufacturing stopped in 2009, albeit later on it restarted periodically. On the other hand, there was a huge decline in cotton fabric manufacturing and coal mining. Nevertheless, these industries did not disappear completely. On the contrary, according to the latest data, although in 2011 and 2012 the output of the cotton fabric industry was only 2 million m^2 – most probably due to the crisis – this figure in 2013 was as high as 12 million m^2.

The authors mutually agree that foreign direct investment was essential for the Hungarian economy at the time of the political transition. With the multinational enterprises, the Hungarian economy realised profits never seen before and that would have not been possible without them. Until the political transition the enterprises in Hungary were owned by the Hungarian state. As a result of the privatisation and the settlement of the multinational enterprises, the ownership structure of the enterprises had undergone a considerable transformation by 1997. In 1990 there were 5,462 enterprises in Hungary with joint Hungarian and foreign ownership, or fully foreign ownership interest, while in 1997 this number reached 25,706 (HCSO). 12,729 of the enterprises in foreign ownership operated in the commercial, road vehicle and consumer goods repair sectors, 4,276 in

manufacturing and 4,107 in the real estate and letting business, and support services for economic activity.

The experts also point out that the political transition and the privatisation was a turning point not only for the enterprises and the economy, but also for Hungarian society. After 1989, as a result of factory shutdowns and the liquidation of the cooperative societies, unemployment suddenly appeared, which was a completely new phenomenon compared to the former full employment. In the early 1990s, suddenly many thousands of employees were fired. In order to avoid unemployment, people retired in large numbers or opted for some kind of pension-type benefit, while young people prolonged their studies in the hope of better chances for employment. All of this was a huge burden on the Hungarian economy. While the unemployment rate in 1992 was merely 9.9 per cent, by 1995 it had risen to 10.3 per cent. The employment rate fell from 52.5 per cent to 46.7 per cent, while the labour force participation rate decreased from 58.3 per cent to 52 per cent. However, these figures conceal regional differences both in the area of unemployment and economic activity. Huge inequalities started to develop between the various regions of the country. The unemployment rate in Pest county in 1997 was 6.6 per cent, whereas it was 15.3 per cent in Borsod-Abaúj-Zemplén county. The majority of the companies in foreign ownership interest settled in the Central Hungary and the North Transdanubia region, thereby adding to the regional inequalities. These regional difference still persist today (*Kiss 2007*) According to the official statistical figures in 1997 Pest county had 1,626, while Nógrád county had merely 147 companies in foreign ownership interest. As a result of unemployment, the decline in economic activity and the shutdown of companies and cooperative societies, Hungary's GDP decreased between 1989 and 1994, followed by a slow upward drift.

Due to the changes that took place in the early 1990s, the downsizing of part of the economy, the spread of unemployment, the rise in regional differences, impoverishment and deteriorating living conditions, the society lost faith in the Western path. According to the authors, the economic crisis of 2008 recalled or perhaps even increased this disappointment. Thus, the society is in a kind of "permanent" crisis.

The authors are of the opinion that the economic crisis in 2008 was attributable to the overflow of the markets and the banks; by the 2000s the companies were unable to sell more products, while banks could not lend more; accordingly, the growth rate of the profit declined. First in North America, and then in an increasing number of countries, loans were granted also to non-creditworthy borrowers. Later, these loans defaulted in large numbers. Banks concealed these losses for a while by securitisation and the outsourcing of defaulted credit claims to workout companies, but by 2008 the situation has become unsustainable. Several large

banks went bankrupt, loans became expensive and credit channels dried up, and the crisis of the banking system evolved into an economic crisis. Hungary was hit hard by the crisis, because the foreign-owned banks transferred the repaid loans to their home countries to cover the costs and losses of their parent banks rather than reinvesting it Hungary; however, as the authors point out, no stones should be cast at the foreign banks for this. It should be clear for all that both the households and the enterprises need loans; the problem was not the fact of the lending, but the degree and the proportions.

An additional problem that rose during the crisis was that the regulatory and control authorities failed to monitor and audit these processes efficiently enough. The authors believe that the greatest mistake committed by the Hungarian society was that it had no savings. The common attitude inherited from the previous regime, namely that the "state will solve all problems", still persists in the society.

The authors of the book are of the opinion that the crisis was preceded by several events which exacerbated the consequences. The crisis hit Hungary amidst poor economic circumstances; for example the degree of government debt was very high. According to the figures provided by GKI Gazdaságkutató Zrt. government debt in 1989 was 73 per cent of the GDP, which rose to 80 per cent in the period of 2008-2010, which is a huge burden.

The resolution of the first massive crisis after the political transition was a huge challenge for the government then in office. It applied a variety of measures and instruments to address the unfavourable situation as smoothly as possible. One of the government's crisis management measure was to make people work. It introduced the fostered workers programme to assist the unemployed. The authors believe that in this area the next important step would be to achieve that the Ministry of the Interior should cease to be the largest employer, as is now the case with the fostered worker programmes; the objective is to direct fostered workers back into the private sector.

In addition, the reform of higher education, healthcare and research and development (R&D) is essential for achieving sustainable growth. Reforms in higher education are needed, because the capacity of the Hungarian universities today is 550,000 students, but only 320,000 – indeed, in 2014 only 307,000 – students studied in higher education. To make things worse, a further decrease may be expected due to the population decline and the increasing number of those enrolling to foreign institutions. The realistic objective should be to adjust the capacity to the real demands and ensure full utilisation of the higher education capacities. One of the problems of the reform of higher education is that if a town is left without a higher education institution, the town will start to plummet, thereby taking an unfavourable direction in socio-economic terms, as part of the youth and the intellectuals will leave. It is important to ensure that only such fields and

professions are taught that are needed by the market. László Parragh points out that the economy, education, R&D and the use of additional funding must work together for Hungary to achieve a considerable economic growth in the future.

The experts deem it indispensable for Hungary to have a broad corporate sector built on domestic capital. Sustainable growth requires a strong middle-class, which should be fostered by the state by appropriate measures. Another step to achieve economic growth is the expansion of the market in the east, meanwhile preserving the existing western markets. It is also important to sustain a balanced central budget. Although the deficit is below 3 per cent at present as well, efforts should be made to reduce it further in the future.

Csaba Lentner emphasised that it is essential to support the income growth of the Hungarian families, which requires the decrease of taxes and an increase in social benefits. Personal income tax should be reduced to below 10 per cent, while it is justified to decrease the VAT rate of 27 per cent to the European average. He also deemed it important to reorganise the fostered worker programme in the future.

Taken together, the reader gets a view of Hungary's position in the changing world in the interpretation of three experts coming from different fields, but essentially taking similar positions. All of this is available in an easy-to-understand, readable form, with plenty of summarising and analytical information. The discussions help us see and understand Hungary's development in the last 25 years and its economic situation from a complex, unbiased approach.

I recommend this book to all readers interested in finding out what three acknowledged experts think about the economic, social and political changes of the past 25 years, the experiences they gained, their opinion on how to make the Hungarian economy prosper and the important changes needed in the future to achieve sustainable economic growth.

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