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The global crisis and possible paths of Hungary's economic development[1]

The global economic crisis, which became prominently visible in 2008 is of a global nature in several senses of the word; it has various dimensions. The US mortgage crisis is, on the one hand, a part of it and, on the other hand, a factor that revealed it. Yet there is a correlation that lies much deeper, namely, a tension that results from an excessive divergence or split between the real economy and speculative financial flows. That tension was coupled with indebtedness that had become universal and affected countries, companies, local governments and individuals alike. This, on the one hand, further increased the gap between the cash flowing in the world and the actual production or the level of material goods; on the other hand, it made the four groups dependent on banks and, at the same time, made their creditors depend on them, and, finally, made banks depend on each other within the framework of the financial world.

The crisis is global in terms of geographical dimensions, as well. In the first years of the 21st century it cannot happen otherwise. In a globalised world, where borders have ceased to exist, economic processes can spread without borders: the crisis, which had started in the US, spread all around the world.

In the global crisis, Hungary needs to find a new path of development: not only a pace of development that is increasing, but, at the same time, those internal economic and social structures that prove to be more favourable than the previous ones. It is not that the crisis spread to Hungary. After the democratic transition, the Hungarian internal market became international; almost half of our gross production and more than two thirds of our foreign trade is produced by transnational companies that had established themselves in Hungary.

Undoubtedly, the global crisis opened a new chapter in the process of defining Hungary's path of development. The crisis, on the one hand, made changes inevitable, and, on the other hand, accelerated their pace. Yet the crisis in itself may conceal the erroneous paths and inefficiencies of Hungary's internal development temporarily, or may serve as a warning sign that gives information on the weak points of our post-transition development of almost two decades.

INTERNATIONAL TRADE INCREASES FASTER THAT PRODUCTION

The global nature and the spread of the crisis are due to the fact that the openness of world trade has become more prominent than ever before. The process of the opening of foreign trade started one and a half centuries ago and accelerated after World War II. As for the beginning of the process, that is, the first phase on the path to globalisation, in 1870 the ratio of the world's exports of goods to global GDP was below 5%. By the turn of the 20th and 21st centuries, this ratio had roughly tripled: it was above 17%. It is also worth noting the changes within the general figure of the global average. The ratio of Western Europe, originally under 10%, had increased above 35% by 2000, while countries with enormous internal markets (e.g. the USA or China) had transformed into open economies whose level of foreign trade, if compared to production, gradually increased. *(See Table 1)*

From the perspective of individual countries and the world alike, the major reason for this is, that in the phase of economic history referred to above, world trade displayed a development that was 1.5–2 times faster that that of production. In the 50 years after World War II, global production increased sixfold, while the level of world trade grew to 18 times its former size. On the one hand, the process of foreign trade growing faster than production affected production, more specifically, accelerated its rate of expansion; on the other hand, the wide divergence between the two processes – albeit it did not constitute the root cause – did make the separation of production and financial flows possible.

THE DEVELOPMENT OF GLOBAL ECONOMIC OPENNESS

The limitless spread of the global economic crisis of 2008 is due to the fact that since the 1970s, parallel to a continuous growth of foreign trade, the flow of working capital has started and its role in international trade has gained an ever-increasing significance. This process marked the beginning of a new era of openness. Within the framework of international foreign trade, there was a movement of products (development was limited to a certain degree by geographical distances); in the era of the flow of working capital gaining ground, big companies establish affiliates everywhere around the world – and the production of these affiliates form a part of the economy, GDP and

Table 1

THE RATIO OF EXPORT OF GOODS AND GDP BETWEEN 1870 AND 1998

(prices of 1990; percentage)

Country, region	1870	1913	1929	1950	1973	1998
Western Europe	*8.8*	*14.1*		*8.7*	*18.7*	*35.8*
France	4.9	7.8	8.6	7.6	15.2	28.7
Germany	9.5	16.1	12.8	6.2	23.8	38.9
Netherlands	17.4	17.3	17.2	12.2	40.7	61.2
Great Britain	12.2	17.5	13.3	11.3	14.0	25.0
Eastern Europe and the former Soviet Union	*1.6*	*2.5*		*2.1*	*6.2*	*13.2*
United States	2.5	3.7	3.6	3.0	4.9	10.1
China	0.7	1.7	1.8	2.6	1.5	4.9
India	2.6	4.6	3.7	2.9	2.0	2.4
Japan	0.2	2.4	3.5	2.2	7.7	13.4
World	*4.6*	*7.9*	*9.0*	*5.5*	*10.5*	*17.2*

Source: Gács, János: A gazdasági globalizáció számokban. A nyitottság alakulása az EU-országokban ["The Economic Globalisation in Charts. The Development of Openness in EU Member States"], Közgazdasági Szemle, October 2007, pp. 876–902 performance of the host country. In 2000, approximately 60,000 transnational company centres were operating in the world. The number of subsidiaries located and functioning in other countries, is over 700,000 – more than ten times higher than the number of parent companies. *(See Table 2)*

Nowadays the role of *the flow of working capital,* capital leasing and the establishment of companies abroad *far surpasses the economic importance of traditional foreign trade between countries.* The working capital base, which was around UDS 600 billion at the beginning of the 1980s, had exceeded USD 10,000 billion by 2005, while the sales of foreign affiliates had risen above USD 22,000 billion, which amount is approximately twice as much as the global export of goods. *(See Table 3)*

In a new, open and globalised world, *transnational companies were given a role that is independent of countries* in many respects. This fact is manifest in gross absolute figures and performances. *(See Chart 1)*

The annual performance (level of added value) of major transnational companies, such as Exxon Mobil, General Motors or Ford equals the annual GDP of a medium-sized country (e.g. the Czech Republic or Hungary). Yet the essence of the economic functioning of a globalised world does not lie simply in gross values. In the periods of global economic booms as well as crises, interlinked assets and complex

Table 2

THE NUMBER OF AFFILIATES OF TRANSNATIONAL COMPANIES IN VARIOUS REGIONS AT THE TURN OF THE CENTURY

Region	Number of parent companies	Number of affiliates
Developed countries	48,791	94,269
Developing countries	12,518	355,324
Eastern and Central Europe	2,150	239,927
Global (total)	63,459	689,520

Source: UNCTAD

Table 3

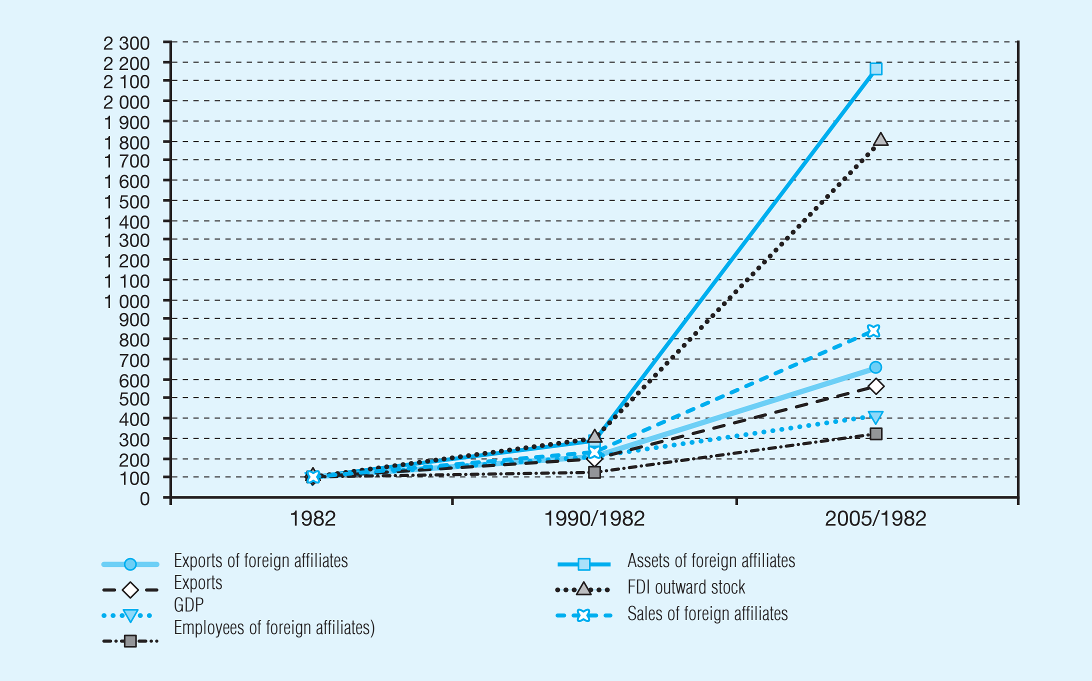
TRANSNATIONAL COMPANIES GAINING GROUND BETWEEN 1982 AND 2005

Term	Value at current prices (Billions of USD)			Growth rate (percent, 1982=100)		
	1982	1990	2005	1982	1990/1982	2005/1982
FDI outward stock	600	1,791	10,672	100.0	298.5	1,778.7
Sales of foreign affiliates	2,620	6,045	22,171	100.0	230.7	846.2
Assets of foreign affiliates	2,108	5,956	45,564	100.0	282.5	2 161.5
Exports of foreign affiliates	647	1,366	4,214	100.0	211.1	651.3
Employment of foreign affiliates (thousands)	19,537	24,551	62,095	100.0	125.7	317.8
GDP (global, in current prices)	10,899	21,898	44,674	100.0	200.9	409.9
Exports of goods and services (global)	2,247	4,261	12,641	100.0	189.6	562.6

Source: table constructed on the basis of the 2006 data of the World Investment Report (www.unctad.org)

Chart 1

DIVERGING TRENDS OF GLOBAL PRODUCTION, WORLD TRADE, FLOW OF WORKING CAPITAL AND THE PERFORMANCE OF THE FOREIGN AFFILIATES OF TNCS (1982=100)



Source: figure constructed on the basis of the 2006 data of the World Investment Report (www.unctad.org)

proprietary structures evolve. This, on the one hand, makes the interconnection of various processes global and, on the other hand, accelerates decision-making – and then the processes as a whole – to such an extent that they cease to be controllable or manageable.

Another decisive factor and, at the same time, the cause of the large-scale spread of the global crisis of 2008 is the fact that by the end of the 20th century the value of products and services produced in reality and the amount of capital, including the amount of speculative capital, had displayed a considerable divergence. It is almost impossible to give statistically exact data on the degree of divergence or the magniture of these two figures, yet there are estimations according to which *the magnitude of the financial space that has become largely speculative is 5–10 times as big as the annual GDP of the world.*

As for the evolution – and, more significantly, the intensification – of the global economic crisis of 2008, analyses (and facts) show that stock exchanges and stock exchange processes play a role of paramount importance. Again, the point is that recently (especially in the last decade) processes that differed from previous ones have begun: the production of companies listed by stock markets, the changes in their profits and total actual value on the one hand, and the value of quoted shares on the other hand, diverged increasingly. Particularly in the past five years, market indices have soared to an unprecedented degree; they doubled and grew continuously, thus giving the impression of stable value increase that seemed to go on for ever. In the 21st century, in a global world of a new structure that can be seen but partially and cannot be defined by the means of traditional statistics and concepts, any kind of partial "breakdown" that hit a certain level was sufficient to make a seemingly local problem spread over the whole fabric of the global economy with unparalleled speed and thus turn into a "global crisis."

It follows from what has been said on the essence of a global crisis that the "reconstruction period" of the global economy, which has become indispensable by now, is not merely a seeking and a re-establishment of economic balance, but a reconsideration and redefinition of the old structures that involve much tension. It is impossible to foresee the content that will actually evolve and come real; yet it is certain that the balance will require a framework wider than before. This wider framework includes not only the United States and Europe, but China and a large number of emerging economies, as well; it also includes – albeit at a different scale of magnitude – Hungary, which has the opportunity to define and formulate its renewed path of economic policy within the global framework outlined above.

HUNGARY'S GLOBALISING ECONOMY

Even in September 2008, when the crisis was accelerating, major figures of economic policy and leading economic workshops often raised the question if the crisis would spread to Hungary. Obviously, when a global crisis is unfolding, no country can stay intact with the implementation of some kind of isolation or autarchy (which, let us add, are both non-existent in the present age). Yet at the same time – and this is the point of the present essay and, in general, of economic policy – the fight against the global crisis and the success of such a fight, are determined by the strength of the given country's internal economy and the level of its gross economic performance, development, competitiveness, inner cohesion and employment standard. Returning to the issue of "spread", it is to be stated that in the perspective of the nature of global economy, it seems basically unjustified to raise the question. Almost two decades after the democratic transition, Hungary has become a part of the global economy; furthermore, *Hungary's internal market has become international, that is, a location where transnational companies and international banks are operating.* Hungary has also traversed the path described above (and traversed by the global economy as a whole): the democratic transition at first brought about an immediate opening in the field of foreign trade, while, almost concurrently, a rapid and large-scale flow of working capital began, and the stock exchange evolved – the paths of the financial space and the real economy that do not necessarily move parallel or are connected sufficiently.

Immediately after the democratic transition, due to the collapse of COMECON and the cessation of former economic contact points, and in parallel with a favourable structural change, the gross level of several basic performance indicators of Hungary's economy fell. The GDP decreased by 15%, the export fell to below USD 10 billion, the internal market weakened to an even greater extent, the employment rate decreased from 5 million to 3.8 million. Out of the four selected basic indicators that characterise international contacts (foreign trade), the condition of the internal market, the condition of the labour force, the level of total production, and exports, it was the latter that was the fastest to regain its former dynamics and turned from decline to growth.

It is worth examining when the value of the highlighted indicators reached the 1989 level. A decade later, the GDP (taking the 1989 level as 100%) was 99%, and reached and exceeded the "transition level" in 2000. Retail turnover, which is illustrative of the strength of internal market and the population's purchasing power, displayed a major recession; it hit rock bottom (65%) in 1997, to reach the 1989 level as late as in 2003. Twenty years after the transition, employment – one of the most complex factors of economic and social processes – is still around 75% although employment level is perhaps the most important indicator of Hungary's actual modernisation in terms of its economy as well as in other fields. It was export that was the fastest to recover; it took six years to reach the 1989 level (101% in 1995). However, one of the most important questions concerning economic policy and possible paths of development is whether exports can still be considered a development indicator with the same significance.

The question is answered – and, at the same time, a description of the entrance into another path of openness is given – by the history of the flow of foreign working capital to Hungary. At the time of the democratic transition, there were some 250 companies with foreign ownership in Hungary, with USD 250 million of working capital base. A decade later there were 25,000 companies with partial or total foreign ownership in Hungary and approximately USD 25 billion of working capital base.

Hungary's economy changed not only in terms of gross indicators of economic performance, but its inner structure was fundamentally transformed, too, including ownership structures, distribution conditions, the roles of large, small and medium sized companies, regional differences or the level of the divergence between the earnings or the incomes of various social groups or of individuals. Beside several other aspects, in terms of the present investigation it is a fact of deep significance that, *as far as GDP generation is concerned, the ratio of foreign and Hungarian companies is 50–50%.* Equally important are the facts that the number of companies is over 400,000, large enterprises produce 52% of the net turnover and *the share of international companies in Hungarian exports is around 75%. (See Chart 2)*

At first, the openness of Hungary's economy (on the basis of which Hungary faces the global crisis or plays a role in it) was the result of the above-mentioned fast expansion of foreign trade. In the year of the democratic transition, Hungary's export of goods (in USD, at current prices) was 9.5 billion; in 1995, 12.9 billion; in 2000 it exceeded 28 billion, and in 2003, 43 billion. In the recent years, the growth rate of foreign trade has continued to accelerate: in 2004, 2006 and 2007, it exceeded the rate of the previous year by 18-18 and 16% respectively. In 2007 the value of exports was EUR 68.6 billion.

The main consequence for economic policy is the realisation that *the role of exports in Hungary's economy has undergone a change:* the trends and volumes of internal production and foreign trade turnover have displayed a divergence. Although export growth is still a major factor of the expansion of Hungary's economy, if compared to its scale, it exercises but a limited effect: the direct relation of export growth and GDP increase is less intense. This is due to the above-mentioned second wave of the process of opening: transnational companies gaining ground in Hungary's economy. In the Hungarian economy, with its low level of capitalisation, there were but a limited number of other ways; however, the possibility for a more harmonious formation of inner structures did exist in certain contexts. Yet by 2008 it was an undeniable fact that *the condition and development of Hungary's economy* – given the country's weak internal market and feeble SME sector – *had become greatly dependent on the functioning and results of transnational companies.*

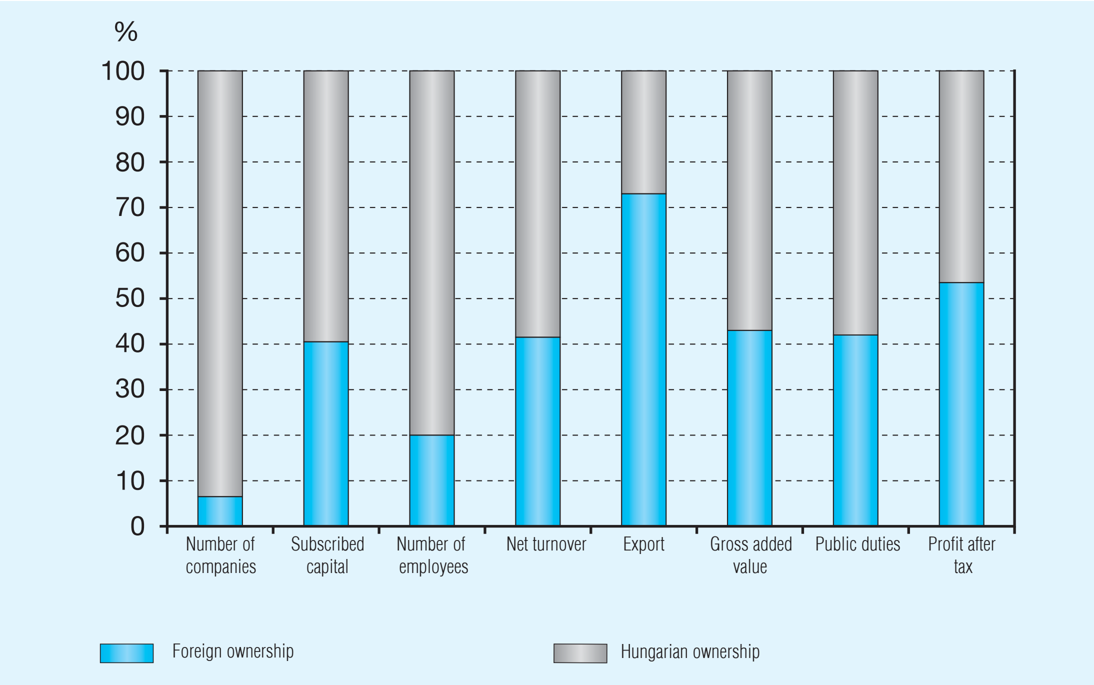
EXTERNAL BALANCE, INNER HARMONISATION AND GROWTH

Now, in the period of the global crisis – and most probably in the forthcoming period, too,

Chart 2

DISTRIBUTION OF COMPANIES OF TOTAL AND PARTIAL FOREIGN AND HUNGARIAN OWNERSHIP ON THE BASIS OF THEIR VARIOUS PERFORMANCES IN 2005

(percentage)



Source: Chart constructed on the basis of Zoltán Pitti's calculations)

Hungary's economy is and will be characterised by the presence of two seemingly opposite factors. Without an adequate level of foreign direct investment, the Hungarian economy as a whole cannot come up with proper economic results; yet if foreign capital fails to integrate into Hungary's economy to a greater degree, then the internal market will stay weak, the employment situation will remain problematic and Hungarian enterprises will not gain strength. The growth of exports, and its specific form that brings about internal strengthening, follow from these relations. *Today, a significant part of Hungarian exports is made up of the re-exporting of the imported goods of transnational companies, with a low level of value added in Hungary.* However, making foreign working capital an organic part of Hungary's economy can solve the contradictions between export growth and internal development.

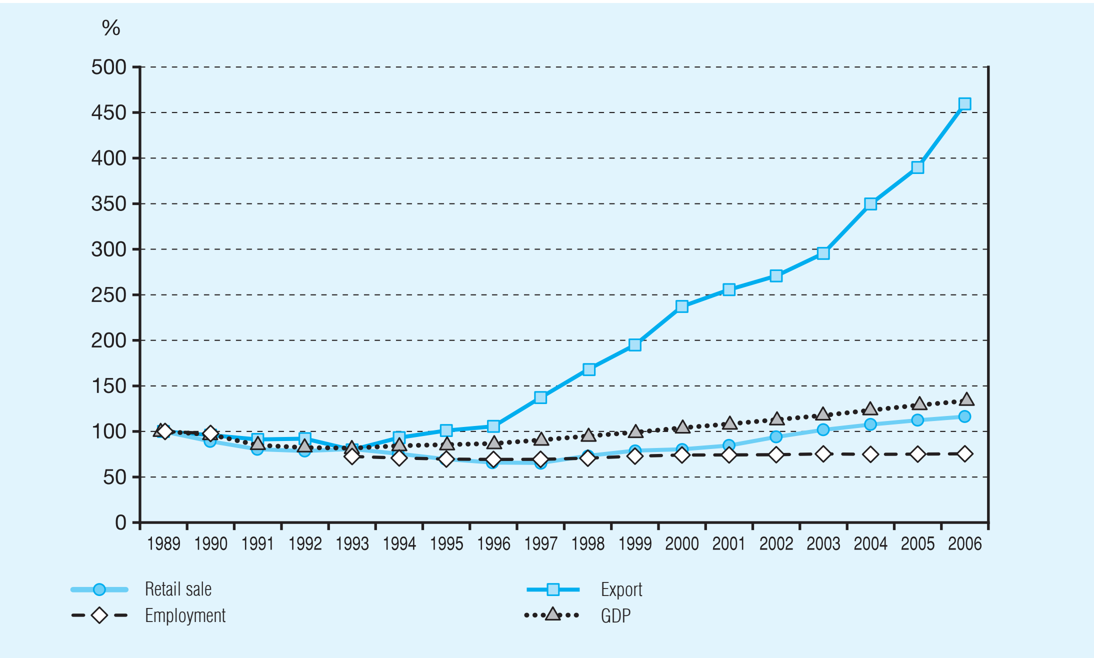
Similar to the global international economic environment – described in the first part of the present article –, Hungary also displays signs of an internal crisis similar to those of external crisis: the real economy on the one hand and financial and capital space on the other hand have diverged. It was mentioned that securities markets, provided that they function reasonably, can strengthen real flows and thus can exert a favourable influence on economic processes. In many respects, the changes of the Hungarian stock exchange reflect the processes of international stock exchanges. The Budapest Stock Exchange (where the ratio of foreign investors is around 75% – one of the highest ones, if compared to international stock exchanges), especially since 2005, has seen value changes that failed to follow the performance of the companies behind the stock exchange listings. In 2005, the BUX index was 23,000 points (more than twice as high as the level of 2003, when it was at 10,000 points); in the summer of 2007, it exceeded 30,000, whereas in the autumn of 2008 – as a result of the global crisis and as a sign of an internal crisis –, it fell below 12,000 points. The stock exchange capitalization of shares was HUF 2800 billion at the end of 2001; in September, 2007, it exceeded HUF 10,000 billion. At the end of September, 2008, the market value of shares was HUF 5,659 billion, which means that the total value decreased by more than HUF 4,000 billion. Hungary's economic policy has a double task to perform: to consolidate a securities market that has deviated from real processes, yet to do so, in any case, it has to consolidate the real economy.

Hungary's economy will have to face the global crisis and join in development processes of international scale within the globalised structure described above; furthermore, the country has to define and realise its own internal growth and development within this framework. This makes the re-establishment of balances inevitable. However, in the long run, a genuine catching up can commence only with the creation of a financial balance (the former is embedded in and directs the latter) and with the redefinition of internal structures. *(See Chart 3.)*

Returning to the four basic processes mentioned at the beginning of the analysis of Hungarian conditions, it is to be noted that it is an inevitable task for the economic policy to

Chart 3

THE BASIC FORMULA OF HUNGARY'S "DEVELOPMENT DISORDERS": DIVERGENT DEVELOPMENT PATHS OF GDP, EXPORT AND RETAIL SALE BETWEEN 1989 AND 2006



Source: figure constructed on the basis of (various volumes) of KSH Magyar Statisztikai Évkönyv ["Hungarian Central Statistical Office: Hungarian Statistical Yearbook"] re-order the diverging global growth path (GDP), foreign trade trends (including export), the development path of the internal market and the development paths of the employment situation. *To establish external and internal balance, re-align the conditions of the real economy and the financial space, secure steady growth and launch a sustainable development, essential issues, internal economic and social structures need to be harmonised.*

Note

[1] A related article is the author's sub-study "An Analysis of the Macro-economic Risks of the 2009 Budget", prepared on behalf of the ÁSZ FEMI (Research and Development Institute of the State Audit Office of Hungary), October 2008, pp. 92–97., and his recently published book titled Within and beyond global economy, Aula Publishing House, Budapest, 2008 (a review of the book was published in Issue 4/2008 of the Public Finance Quarterly – the editor).