HUNGARY

AN ASSESSMENT OF CHINESE-HUNGARIAN ECONOMIC RELATIONS

1. CHINESE-HUNGARIAN TRADE RELATIONS

Over the past decade and a half, Hungary has committed itself to the development of relations with China. Budapest has become open to many types of cooperation with Beijing. Although the Hungarian political arena is rather divided, Sino-Hungarian relations enjoy a privileged position on all major parties' agendas. No matter how fierce the domestic political debates are, none of the parties question the importance of China for Hungary. Besides promoting economic relations with China, the Hungarian government has been rhetorically supporting China on many sensitive issues, such as lifting the arms embargo and granting market economy status to the country, in the context of WTO trade agreements. It has played an even more active role in the South China Sea issue and the One Belt, One Road initiative. In return, Hungary indeed occupies a disproportionately significant profile in China given its overall geopolitical importance.

The Hungarian government's desire has long been to serve as a gateway or hub for China from which to access the whole of Europe. It considers relations with China to be of great significance, where besides the development of bilateral investment and trade relations Hungary would also like to become a part of one of the main transit routes of Chinese goods targeting the European market.

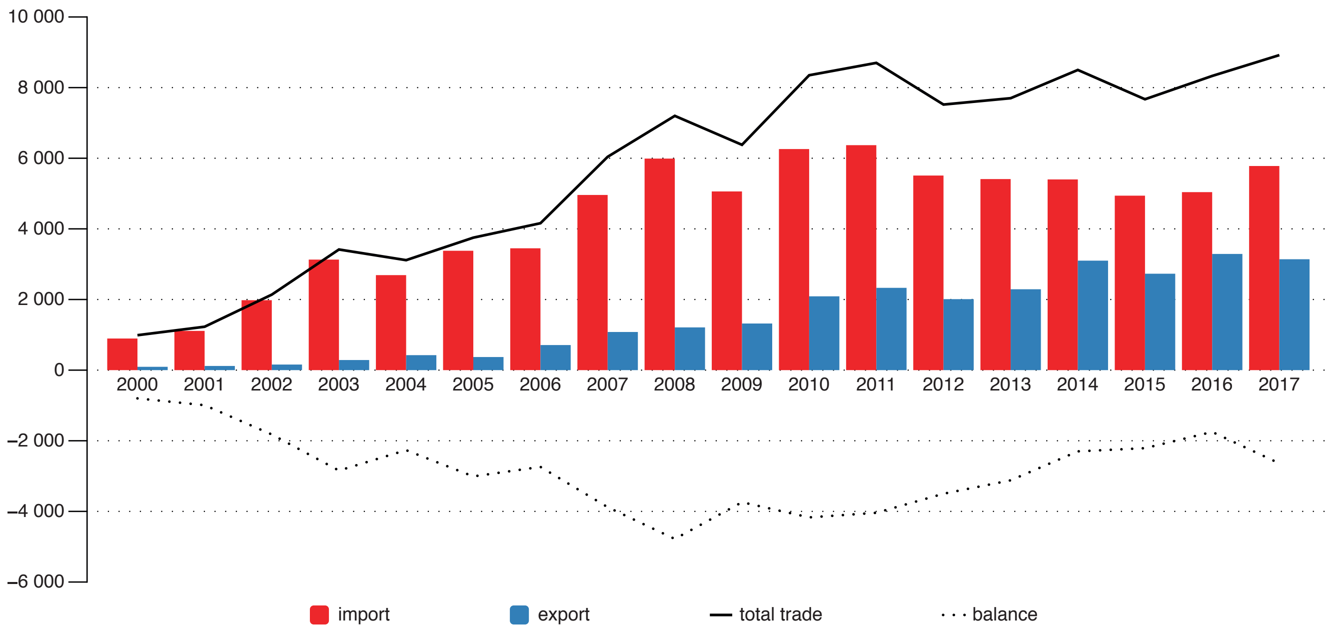
Although the Hungarian Government's Eastern Opening policy[1] has accelerated economic relations between China and Hungary, this opening process began well before the official announcement of the strategy in 2012. For example, in 2004, the Hungarian consulate in Shanghai was reopened, and in 2010 a new consulate was opened in Chongqing. Some organizations such as the Hungarian-Chinese Economic Chamber and the Chinese-Hungarian Business Committee have been established to intensify bilateral business relations, as well. In addition, for some years Hungary has been developing its relations with China in a multilateral forum. The first China-CEE Economic and Trade Forum was held in Budapest in June 2011 and since the annual 16+1 cooperation forum was established in 2013, the Hungarian government meets with its Chinese counterparts at the highest level every year at the 16+1 summits.[2]

Regarding trade relations, China is one of Hungary's most important trading partners. Chinese trade volumes have steadily increased over the last one and a half decades, particularly after 2004 (Hungary's accession date to the EU), declined slightly as a result of the financial crisis in 2008 than increased again from 2009. Although trade relations are indeed on the rise, it has to be emphasized that the vast majority (around 80%) of Hungary's export still targets the countries of the European Union, mainly Germany (25-30%) and Hungary's export to China represents less than 5% of the total. Similarly, a bit less than 80% of Hungary's imports come from the EU, with more than 25% from Germany alone, while only around 6% of imports come from China.

1 The Eastern Opening Policy's objective was to reduce the dependency of Hungary's economy on trade with the West, particularly with European Union member states, through increased commerce with countries in the East, particularly China.

2 Éltető A - Szunomár Á: Chinese investment and trade – strengthening ties with Central and Eastern Europe. INTERNATIONAL JOURNAL OF BUSINESS AND MANAGEMENT 4:(1) pp. 24-48, 2016 (available at https://iises.net/international-journal-of-business-management/publication-detail-434)

Figure 1. Trade between China and Hungary, 2000-2016, million USD



Source: Atlas of Economic Complexity

Certainly, the European Union has a dominant role in the trade of the CEE countries, including Hungary. The share of Asian countries is much smaller, but their role has increased during recent years: increases in trade with Asia have shown stronger growth than with the EU or other non-EU regions.[3] The weight of Asian trade volumes is generally more significant in imports than in exports of CEE countries, including Hungary. Asian trade dynamics are largely determined by trade with China, which has become Hungary's most important partner in Asia. In recent years, China's share in Hungary's export destinations increased but the increase is even more significant in imports.

Hungarian exports to China are partly dominated by engines since the mid-2000s, although their share in exports has been decreasing recently (the export share of engines used to be between 28 and 40% for years, but started to decrease after 2014; now it is less than 10% of exports to China). One possible reason for this decrease is that the Hungarian affiliate of the Volkswagen Group (Audi Hungaria) sharply decreased its delivery of engines to the Chinese affiliate of the VW Group. This decrease affected the total amount of Hungarian exports to China. At the same time, transport vehicles, especially cars and parts of motor vehicles, are gaining an increasing share in the export mix since 2014, and are now above 30%. Electronics (electrical transformers and other apparatus) represent the third most important export category of Hungary to China: a bit less than 15% of Hungarian export comes from this category.

In the past few years the export of agricultural products to China gained a certain impetus. Chinese authorities usually undertake a long period for examination before allowing such products into the Chinese market. Hungary received permission to export beef (being the first in the EU, although there is no significant delivery so far) and milk products (being third after Poland and Bulgaria) and more and more firms are permitted to export pork too.

On the import side, the leading product group for several CEE countries is electronics, mainly telecommunication equipment (telephones, transmission apparatus and relating spare parts). This is also the most significant product category for Hungarian imports from China, taking up 60-70% of the total for several years. In recent years it is between 50-55%. The second most important product category is machinery, especially LCD televisions and computers, taking up to around 25% in recent years.

The pattern of trade between China and CEE has changed somewhat in the last decade. In certain cases, volumes increased and in other areas they decreased. These structural changes generally resulted in the increase share of high-tech goods in trade in certain CEE countries. The volume and overall share of high-tech exports to China has been the highest in the case of Hungary. In general, the CEE-China trade is much more high-tech intensive than the CEE-EU trade.[4]

The high technology intensity of trade is mainly due to the aforementioned large flows of automotive, electronics and telecommunications products. This is based on the activity of multinational companies in the global production networks.[5] The bulk of foreign trade between Hungary and China has been and still can be traced to certain products and certain

3 Éltető A - Toporowski, P: Global value chains - shaping trade between Visegrad Countries and Asia. Europe-Asia Studies, 2013 (available at www.etsg.org/etsg2013/Papers/297.pdf)

4 Éltető, A - Szunomár Á: Trade and investment between the Visegrad and East Asian countries with a special emphasis on China and Hungary. In: Antal J (ed.) Small states - big challenges: the experience of the EU and Visegrad region. Prague: Nakladatelství Oeconomica , 2015. pp. 79-95.

5 Éltető A - Toporowski, P: Global value chains - shaping trade between Visegrad Countries and Asia. Europe-Asia Studies, 2013 (avalable at www.etsg.org/etsg2013/Papers/297.pdf)

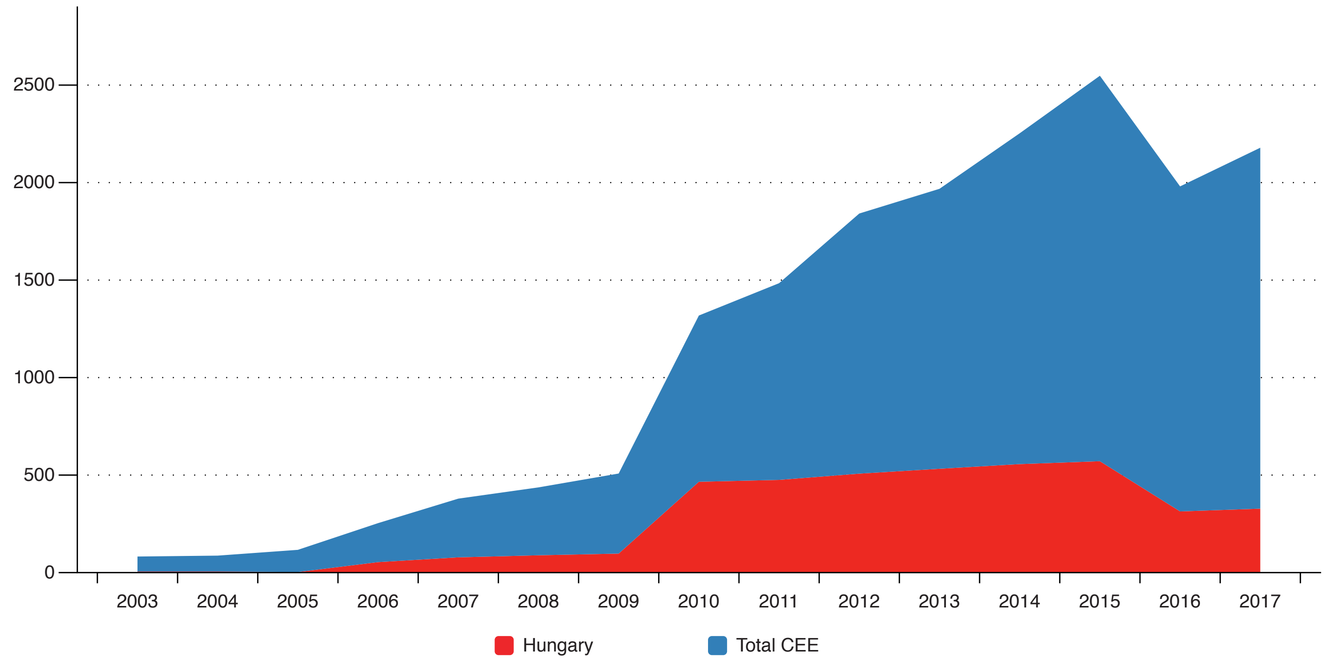
(multinational) companies. Because the volume of trade is relatively small (compared to for example trade with the EU or specifically Germany), one decision of a global company concerning relocation or change in internal deliveries among affiliates can significantly change the trade volumes of a given country vis-á-vis China. Relocating plants from Hungary, for example, decreased Hungarian export capacity to Asia significantly in 2012-13.

2. CHINESE-HUNGARIAN INVESTMENT RELATIONS

Hungary's Eastern opening policy doesn't concentrate only on developing trade relations and economic opportunities but also on attracting investment from emerging Asian countries, of which China is considered to be an investor of growing importance. The role of Chinese capital in Hungary compared with the total amount of invested capital is still very small, but in the last few years these capital inflows have accelerated significantly.

Chinese investment in Hungary started to increase after the country joined the EU in 2004. According to Chinese statistics, a truly rapid increase occurred, from 0.65 million US dollars in investments in 2005 to 370.1 million US dollars in 2010. In 2010, Hungary itself took 89% of total Chinese capital flow to the CEE region, and around half of the stock.[6]

Figure 2. China's OFDI stock in CEE, including Hungary, 2003-2017, million USD, Chinese statistics

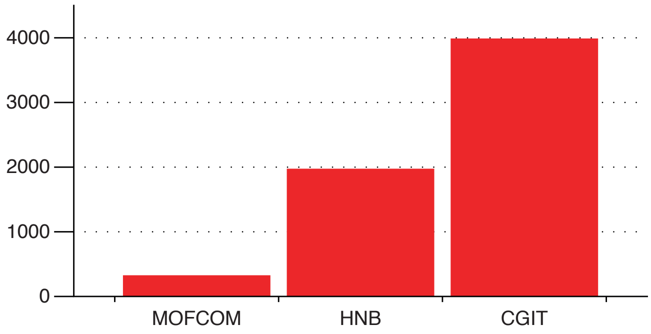


Source: MOFCOM

Nevertheless, this amount is far greater than in the graph above, when taking those statistics into consideration that traced the chains of ownership of the companies investing, since a significant portion of Chinese investment is received via intermediary countries or companies, and therefore appears elsewhere in Chinese statistics. According to the Hungarian National Bank's statistics, Chinese investment stock in Hungary was about 1,8 billion USD by 2017, while China Global Investment Tracker, a database owned by the Heritage Foundation, cites an even higher figure: 4 billion USD in investment stock.

6 Chen X: Trade and economic cooperation between China and CEE countries. Working Paper Series on European studies, Institute of European Studies, Chinese Academy of Social Sciences, Vol. 6, No. 2., 2012

Figure 3. China's OFDI stock in Hungary, 2003-2017, million USD, comparing statistics



Source: MOFCOM/Hungarian National Bank/China Global Investment Tracker

Chinese investors typically target secondary and tertiary sectors in Hungary. Initially, Chinese investment has flowed mostly into manufacturing (specifically assembly), but over time services have attracted more and more investment too. For example, there are now branches of Bank of China and Industrial and Commercial Bank of China, as well as offices of some of the largest law firms in China, Yingke Law Firm (since 2010) and Dacheng Law Offices (since 2012). The major Chinese investors targeting the country are primarily interested in telecommunication, electronics, chemical industry, transportation and energy markets.

MAIN INVESTMENT TRENDS AND PROJECTS

Although Chinese multinational companies represent a relatively small share of total FDI stock in Hungary, they have saved and/or created jobs and contributed to the economic growth of Hungary with their investments and exports during recent years. Furthermore, many of them (e.g. Lenovo, ZTE, Huawei, Bank of China) have turned their Hungarian businesses into European regional hubs of their activities.[7]

Table 1. Chinese FDI in Hungary - major characteristics

Main form of investment	Greenfield / brownfield, M&A, joint ventures
Main sectors	Chemical, IT / ICT, electronics, wholesale and retail, automotive, banking, hotels and catering, logistics, real estate
Most important Chinese companies	Wanhua, Huawei, ZTE, Lenovo, Sevenstar Electronics, BYD Electronics, ZMJ, Comlink, Yanfeng, China-CEE Fund
Company form of investors	both state-owned and private
Preferred locations	Central Hungary, Northern Hungary
Employees	from 350 to 3000 per branch

Source: own compilation

A major part of China's FDI stock in Hungary originates from an investment made by the Chinese chemical company Wanhua, which acquired a 96% stake in the Hungarian chemical company BorsodChem through its Luxembourg subsidiary in 2011. This subsidiary also later made additional investments for the development of BorsodChem. It is the largest Chinese investment in CEE so far. This acquisition positioned Wanhua as one of the major producers of raw materials in the automotive, insulation, construction and furniture sectors. In addition, this investment was also an important sign that Wanhua had chosen Hungary as its regional headquarters.

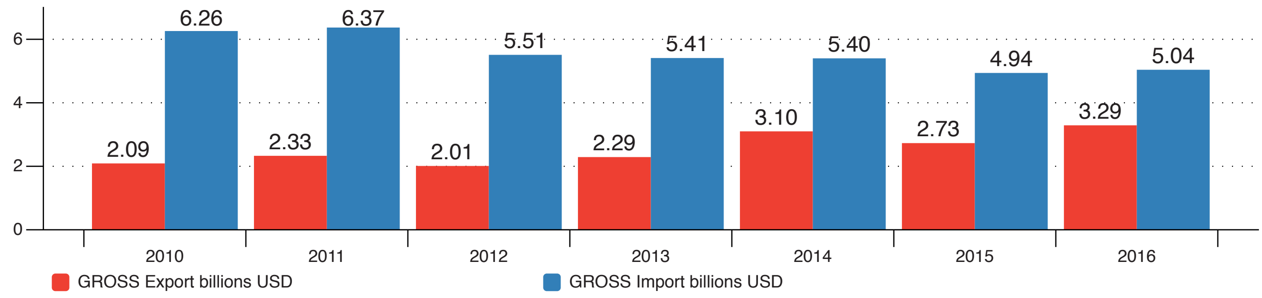
In addition to Wanhua's acquisition, additional important acquisitions have taken place over the past few years which affected Hungary as a result of foreign firms having branches already located in the country: at the end of 2017 Zhengzhou Coal Mining Machinery Group purchased Bosch's SEG Automotive Germany GmbH, the former Robert Bosch Starter Motors Generators Holding GmbH, while in late 2016 Midea acquired German KUKA with its foreign subsidiaries. Lexmark International Technology was also acquired by Chinese companies Apex Technology and PAG Asia Capital in 2016.

The second biggest Chinese investor in Hungary, and the biggest among Chinese greenfield investors, Huawei, arrived in the country in 2005, while its European Supply Centre started its operations in 2009. The Centre is Huawei's second biggest supply chain in the world and it serves as a production and logistics centre for 55 countries in Europe, North and West Africa, Russia, Central Asia and the Middle East. The company employs around 330 people directly (white-collar workers) out of whom 60% are Hungarian and the rest are Chinese nationals (on Hungarian work permits). But indirectly (as several activities are outsourced to other companies), Huawei Hungary is also responsible for 2500-2700 employees (blue-collar workers at Foxconn, Flextronics, DHL, etc.), which is around 3000 jobs in total. It has two factory units (assembly) in Komárom and Pécs, and a logistics centre in Biatorbágy. Huawei is the second largest Chinese investor in Hungary (after Wanhua), which serves all the top mobile operators (including Telenor, Vodafone, Deutsche Telekom) in the country, that is, actually 70% of Hungarian people. Huawei engages in various initiatives, such as talent development programmes as well as establishing cooperation with universities.

Besides being a potential hub for Chinese products in the European Union, Chinese companies expressed their interest in several Hungarian infrastructure-related investment in recent years, such as plans to transform Szombathely airport into a major European cargo base or develop the infrastructure of the Debrecen airport. None of them have been realized so far. The project to modernize the Belgrade–Budapest railway is a recent example of this kind, planned under a new framework, China's Belt and Road initiative. However, this hasn't been realized yet, either, since it was delayed by the European Commission because of transparency issues and questioned for its price/quality ratio domestically, too.

7 Szunomár, A; Völgyi K; Matura, T: Chinese investments and financial engagement in Hungary. Working Paper Nr. 208., Institute of World Economics, Centre for Economic and Regional Studies, Hungarian Academy of Sciences, 2014 (available at: http://vki.hu/wp-208.pdf)

Figure 4. Hungary – China trade



Source: ATLAS OF ECONOMIC COMPLEXITY (AEC)

3. FOREIGN INVESTMENT SCREENING IN HUNGARY

As Chinese companies' investments are likely to continue in the future, CEE countries are facing a dilemma between encouraging and welcoming it, on the one hand, and safeguarding strategic sectors and industries of their national economies, on the other. In the European Union, only 14 of the 28 member states, mostly Western European countries, have any kind of national investment screening mechanism in place for the sake of allowing governments to attempt a balance between these two considerations. Since these mechanisms reflect national characteristics and vary significantly in scope and design, the European Commission put forward a proposal in September 2017 to regulate the matter more systematically by establishing a collective screening framework,[8] providing oversight for investment projects or programs "of Union interest."[9] While official documents do not single out Chinese companies to justify the need for such protective regulation, the EU's concerns and suspicions about Chinese investors nonetheless provide an important rationale for an effective Union-wide investment screening mechanism.[10]

In this European context, the Hungarian government has passed a bill in parliament to establish a national investment screening procedure, which came into effect 1 January 2019. Act LVII of 2018 on the supervision of foreign investments violating the national security interests of Hungary introduces a mandatory review process and conditions the acquisition of stakes by foreign entities in strategically sensitive businesses upon prior approval by the relevant minister designated by government decree.[11] The threshold for the size of the foreign stake at which the investment must be announced is 25% in the case of any Hungarian company, and 10% in the case of publicly listed Hungarian companies. In addition, if an acquisition by a foreign entity were to result in decisive or overwhelming influence, as stipulated by the Hungarian civil code, the investment is likewise subject to the same procedure. Economic activities under the protection of the act include the armaments and defence industry, the production of dual-use goods, the financial services industry and the banking sector, the energy industry, water utilities, as well as information technology.

Upon receiving the notification of the foreign entity, the designated minister has 60 days to conduct an investigation in order to identify the ownership structure and assess the effects and implications of the planned investment. If extraordinary circumstances require, the 60-day period can be extended by an additional 60 days, potentially lengthening the review process to 120 days. Ultimately, the minister decides on the basis of whether or not the investment infringes upon Hungary's security interests. In the case of a rejection, the foreign entity can appeal against it at the Budapest-Capital Regional Court. However, the grounds upon which the appeal can be made are strictly procedural, and the court cannot overturn the decision but can only require the minister to conduct the review process again. A failure to notify the minister in advance of the planned investment and to comply with the legal requirements of the screening mechanism can lead to a penalty of HUF 10 million, to be paid by the foreign entity.

While the exact consequences of the act are still difficult to foresee, some of its implications are clear. Hungary is at the forefront of expanding and

8 "Proposal for establishing a framework for screening of foreign direct investments into the European Union"; European Commission; 13.09.2017 (available at https://eur-lex.europa.eu/resource.html?uri=cellar:cf655d2a-9858-11e7-b92d-01aa75ed71a1.0001.02/DOC_1&format=PDF)

9 "EU Framewrok for FDI screening"; *European Parliament*; February 2019 (available at http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/614667/EPRS_BRI(2018)614667_EN.pdf)

10 Brattberg, Erik, Soula, Etinne:"Is Europe Finally Pushing Back on Chinese Investments?"; *The Diplomat*; 14.09.2018 (available at https://thediplomat.com/2018/09/is-europe-finally-pushing-back-on-chinese-investments/)

11 The full and up-to-date text of the act is available in Hungarian at: https://net.jogtar.hu/jogszabaly?docid=A1800057.TV&timeshift=fffffff4&txtreferer=00000001.TXT (accessed 28 October 2018).

strengthening cooperation with China in the CEE region, yet foreign direct investment from Chinese companies is a modest 2.4% of the total FDI stock in Hungary.[12] EU partners still dominate the Hungarian economy, with German investments amounting to roughly 25% of the total. It was only on 28 October 2018, at a meeting between the Prime Minister of Japan and his counterparts from the Visegrad 4 countries, that the Hungarian PM made clear that cultivating good relations with China is a priority in Hungarian foreign policy. In something of a diplomatic fiasco, the Hungarian side was unwilling to support a joint statement with critical references to China's behaviour in the South China Sea, leading to a more neutrally-phrased version of the document that the Japanese side decided not to sign.[13] The diplomatic charm offensive towards Beijing means that the new Hungarian screening mechanism is decidedly not meant to discourage Chinese companies from investing in the country.

In recent years, the Hungarian government has embraced a protectionist and interventionist market attitude with the purpose of reducing foreign ownership in crucial economic sectors. Two notable examples are the banking sector, where allegedly excessive profits warranted the government's intervention, and restrictions on the foreign purchasing of Hungarian farmland.[14] The act on the supervision of foreign investments makes it possible for the government to expand its discretionary power over other areas of strategic significance. The review process conducted at the ministerial level means that the decision will be influenced by high political considerations, whereby factors other than national security are expected to affect the outcome. The lack of transparency and a clear definition of what constitutes an inviolable security interest for Hungary also inevitably exposes the process to the political preferences of the government.[15] Ironically, even if shady ownership chains of foreign companies are often used to explain the need for a national screening mechanism, the very process by which they are disentangled and revealed does not promise to be any more transparent. It is also noteworthy that certain activities enumerated in the act have long already been tied to prior government approval, even if only at the level of the relevant national regulator rather than the minister.

The Hungarian act also differs from the European Commission's proposal in a few important ways. The EC proposal emphasizes transparency, non-discrimination and predictability as three key principles underlying the screening process. As much as the screening mechanism is intended to protect key economic sectors, it should also work to alleviate fears of foreign investors that the EU is no longer open for business. Furthermore, the proposal complements ordinary security considerations by adding a reference to public order, expanding the grounds upon which a particular investment plan must be screened. While the EU prides itself on being one of the "most open investment regimes," third countries also often do not reciprocate by providing similar access to their markets for European investors. This state of affairs is clearly detrimental to the European Union, so the proposal appears to be a warning and an intervention against such unfair market access practices. While the Hungarian act does not concern itself with these considerations, it should be kept in mind that the screening mechanism at the level of the EU would work in tandem with those of the member states. The EU would essentially rely on member state reports about the outcome of a particular screening process, and the contribution of other member states and the Commission would be limited to issuing comments and opinions about the process. Ultimately, the right of decision about giving the green light to a particular project would still reside in the capital of the member state where the investment is planned. It should be noted that even though the proposal was approved on 28 May 2018 by the EP's International Trade Committee,[16] it has yet to take its final shape and therefore remains subject to changes. To our knowledge, the Hungarian government has yet to adopt an official position with regards to the EU's proposal.

4. CONCLUSION

Within the CEE region, Hungary's relations with China have been unique in several ways. They are unique in a historic sense, since Hungary was one of the first countries to formally recognize China, and the Hungarian government started to re-establish relations with China in the early 2000s, well before the other CEE countries. Furthermore, they are unique in a political sense, since Hungarian governments, regardless of political orientation, have been working on developing relations with China for almost two decades, and Hungary was the first in the CEE region to adopt an official government strategy towards Asia (and China specifically): its "Eastern Opening policy". Lastly, they are unique in the sense that Hungary is the destination of the majority of Chinese foreign direct investment

12 Szunomár, Ágnes;"Chinese economic influence in Hungary – Rhetoric versus realities"; *Institute of World Economics Blog*, 20.09.2018 (available at https://vilaggazdasagi.blog.hu/2018/09/20/chinese_economic_influence_in_hungary_rhetoric_versus_realities)

13 "Orbán miatt diplomáciai fiaskóval ért véget a V4–Japán miniszterelnöki találkozó"; *Index*; 24.10.2018 (available at https://index.hu/kulfold/2018/10/24/kina_orban_japan_v4-ek_diplomaciai_fiasko/)

14 "Hungary Openess to Foreign Investment"; *Export.gov*; (available at https://www.export.gov/article?id=Hungary-Openness-to-Foreign-Investment)

15 "Vajon hatékony lesz a külföldi befektetések ellenőrzése?"; 15.07.2018 (available at https://arsboni.hu/vajon-hatekony-lesz-a-kulfoldi-befektetesek-ellenorzese/)

16 "Foreign investment to be screened to protect EU countries' strategic interests*"; European Parliament*; 28.05.2018 (available at http://www.europarl.europa.eu/news/en/press-room/20180528IPR04446/foreign-investment-to-be-screened-to-protect-eu-countries-strategic-interests)

(FDI) in the region, whilst serving as a regional hub for several Chinese companies and hosting the biggest Chinese population in CEE.

Indeed, Hungary has achieved good results in its economic relations with China over the past decade. Nonetheless, some successful deals have led to further – sometimes excessive – expectations, for example over Chinese involvement in infrastructure development.

When searching for possible factors that make Hungary a favourable investment destination for China, the cost and quality of labour is to be considered first: a skilled labour force is available in sectors for which Chinese interest is growing, while labour costs are lower in Hungary than the EU average. In addition to the traditional macroeconomic factors, institutions also play a role. An interesting aspect that is inducing investments in CEE is institutional stability (e.g. protection of property rights), which is in line with the findings of Clegg and Voss,[17] who argue that Chinese OFDI in the EU shows "an institutional arbitrage strategy" as "Chinese firms invest in localities that offer clearer, more transparent and stable institutional environments". The role of state subsidies and incentives should be also mentioned here as a potential factor of attraction for Chinese FDI. Especially before EU membership, but also afterwards, governments and local authorities applied sometimes tailor-made incentives to attract large investors, such as customs free zones or special economic zones with support services, tax allowances, partial funding for employee training or residence visas.[18]

Moreover, Hungary's Chinese diaspora, which is an acknowledged attraction for Chinese FDI in the extant literature,[19] is the largest among CEE countries. As a result, Hungary received relatively large amounts of FDI over the past decade and a half, and these investment flows started earlier than for others in CEE. Compared to other investors in the region, Chinese companies also seem to pay more attention to the level of political relations; political gestures and measures are still important in developing relations with China. Hungary, which is one of the major recipients of Chinese OFDI in the CEE region, has had historically good political relations with China, and they started earlier than in other CEE countries of the political relation.

The Hungarian national investment screening act is part of a broader European tendency in which the protection of sensitive industries and sectors is increasingly deemed to warrant a specific legal instrument in the form of investment screening. Making sure that much-needed foreign direct investment is not scared away, the Hungarian government will have to walk a fine line between prioritizing security considerations and those of the country's economic and financial needs. The adoption of the act on the supervision of foreign investments is an important first step, even if the review process it establishes may suffer from a number of shortcomings. The lack of transparency, the role of the minister as chief arbiter, and the absence of objective criteria for interpreting national security interests, not to mention the potential loopholes yet to be discovered, all point in the direction of a highly politicized process whereby larger political and diplomatic considerations may easily overwhelm other concerns. On the other hand, the Hungarian government's pro-Chinese foreign policy, as well as the Eastern Opening agenda, create the impression that the act itself was not adopted to counter or restrain China's growing economic footprint in the CEE region. Therefore, the Hungarian act may prove to be an exception to the growing sentiment in Europe that the single biggest threat to our most vulnerable businesses comes from China.

17 Clegg J - Voss H: Chinese overseas direct investment in the European Union, Chatham House Publications, 2012 (available at http://www.chathamhouse.org/sites/default/files/public/Research/Asia/0912ecran_cleg gvoss.pdf)

18 Hungary is the only country in the region that introduced special incentive for foreign investors from outside the EU, which is a possibility to receive a residence visa when fulfilling the requirement of a certain level of investment in Hungary (300000 EUR)

19 Buckley Pet al.: The Determinants of Chinese outward foreign direct investment", in; Voss, Hinrich; and Zhen, Ping (2007) Journal of International Business Studies, 38, pp. 499-518.