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Hungarian and Chinese economic relations and opportunities under the Belt and Road initiative

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Forward

China is increasingly perceived in Central and Eastern Europe as a country which could bring economic success to the countries of the region through developing trade relations and growing inflow of Chinese investment. Within the region, Hungary is regarded as occupying a prominent position by Chinese people and the government for several reasons. Chinese relations have historically been good: over the past decade Hungarian governments have committed themselves to developing the relationship. This trend was further confirmed after the global economic crisis of 2008, when Hungary started looking for new opportunities in its recovery from recession. The "Eastern opening policy" was initiated after the crisis and partly because of it. Officially, this policy puts more emphasis on further developing Chinese–Hungarian relations than was previously the case, including increasing trade and investment. However, the outcomes of the policy – such as the construction of the Budapest–Belgrade railway line – can be evaluated in different ways.

In recent years, Chinese companies have increasingly been targeting Central and Eastern European (CEE) countries, with the Visegrad countries and Romania, Bulgaria and Serbia being among the most popular. Although when compared to China's economic presence globally or in the developed world, its economic impact on CEE countries is small but has increased significantly in the past decade: trade volumes are continually growing and the region has also seen inflows of Chinese investment. This is quite a new phenomenon but not an unexpected one: on one hand, the transformation of the global economy and restructuring of China's economy are responsible for growing Chinese interest in CEE and, on the other hand, CEE represents new challenges and new opportunities for China. An additional impetus was found in the European sovereign debt crisis which made CEE governments more open to Chinese business opportunities.

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 well before the other CEE countries, back in the early 2000s. Furthermore, they are unique in a political sense, since Hungary is the only country in Central and Eastern Europe to have adopted an official government strategy towards Asia (and China): its "Eastern opening policy". Lastly, they are unique in the sense that Hungary is the destination of the majority of Chinese foreign direct investment (FDI) in the region, whilst serving as a regional hub for several Chinese companies and having the biggest Chinese population in CEE. Nonetheless – given the nature of Hungarian domestic politics – of much greater interest is the fact that relations are also unique in terms of the long-term political support Hungarian governments, regardless of political orientation, have provided over the past fifteen years as part of their commitment to developing relations with China.

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. Therefore, the aim of this paper is to analyse the nature of China's economic presence in CEE countries by focusing on Chinese–Hungarian relations, highlighting the main motivations and Hungary's expectations and outcomes achieved so far.

Chinese–Hungarian relations: the beginnings[1]

Hungary formally recognized the People's Republic of China on October 4, 1949. During the following decade their relationship began to develop with a large number of high-level visits followed by an improvement in economic, political and cultural ties. Although the Hungarian–Chinese relationship was basically within the Soviet sphere of interest, Hungarian foreign policy did not follow Moscow policy but differed from it slightly. In international affairs Budapest cooperated closely with Beijing and supported the Chinese position on Tibet, the reunification of China ("one China" policy) and the United Nations (Security Council) membership.

By the end of the 1950s, deep ideological differences began to appear between the two countries and, after the 1960s – during the Chinese "cultural revolution" – the relationship became considerably colder. Later, with the refocusing of the Chinese Communist Party in 1978 (economic reforms and opening-up policy) the two countries were brought closer together again. The Chinese leadership was genuinely interested in Hungary's experiences of its 1968 and 1984 economic reforms. For this purpose, series of expert delegations visited Hungary in this period. In the 1980s, state and inter-party relations were normalized and high-level delegations were also reinitiated. However, this upturn did not last too long: after the democratic transition of 1989, contacts between the two countries declined again, primarily as a result of the refocusing of Hungarian foreign policy, which paid greater attention to Euro-Atlantic interests. For more than a decade, contact declined to a minimum.

A new fruitful period began at the beginning of the new millennium with the 2003 visit of the then Hungarian Prime Minister, Peter Medgyessy, to Beijing. This new wave of development was initiated independently by Hungary since the government recognized China's growing role in the global economy. This attempt – which was unique in the CEE region at that time – was well received in China because forthcoming EU membership made Hungary more attractive to them. In this spirit, various gestures and diplomatic visits were made and confidence-building measures were adopted. The results were almost immediately apparent in the growing economic relations: Chinese investments started to flow into the country and trade also took off.

[1] The next two sections are partly based on the paper of Szunomár (2015): Blowing from the East. International Issues & Slovak Foreign Policy Affairs, Vol. XXIV, No. 3/2015, pp. 60-78

The Medgyessy government created a special envoy post within the Prime Minister’s Office to develop Hungarian–Chinese relations and coordinate the China-related work of the government’s institutions and public administration.

The first outcomes of Hungary’s new China policy were the arrival of a branch of the Bank of China in Hungary (2003), the creation of the Bilingual Chinese–Hungarian Primary School in Budapest (2004) and the launch of direct flights between Budapest and Beijing (2004). All of these were unique in the region at that time. There were many other consequences of this period, including for example the establishment of a Chinese wholesale trade center in Budapest for quality Asian exporters and manufacturers, which indicate the strong renewal of the relationship.

Although China was neglected by the first Orbán government (1998–2002), it has been favored by the second (2010–2014) and third (2014–). Viktor Orbán continually emphasized the importance of the East, even during his election campaign, saying that “[…]an Eastern wind is blowing in the world economy” to which the Hungarian economy needs to adapt. Prime Minister Orbán visited China at the end of 2010. This meeting was returned by Premier Wen Jiabao’s visit in Budapest in the summer of 2011: Wen made a European tour to three countries only: Hungary, Great Britain and Germany. His journey was started in Budapest and was designed to buy European debts and “help” Europe by shoring up its investments. These meetings of high-ranking officials were followed by numerous other visits from both sides in the coming years[2].

After these visits and steadily strengthening relations, expectations on the Hungarian side were higher than ever. The domestic media echoed the importance of the country’s role as a gateway to China while the international media reported on the new Chinese–Hungarian “special relationship,” causing mixed feelings among Hungary’s neighbours and the EU institutions. Against this background, Hungary launched a new foreign economic policy in the spring of 2012, which aimed to diversify Hungary’s foreign economic relations.

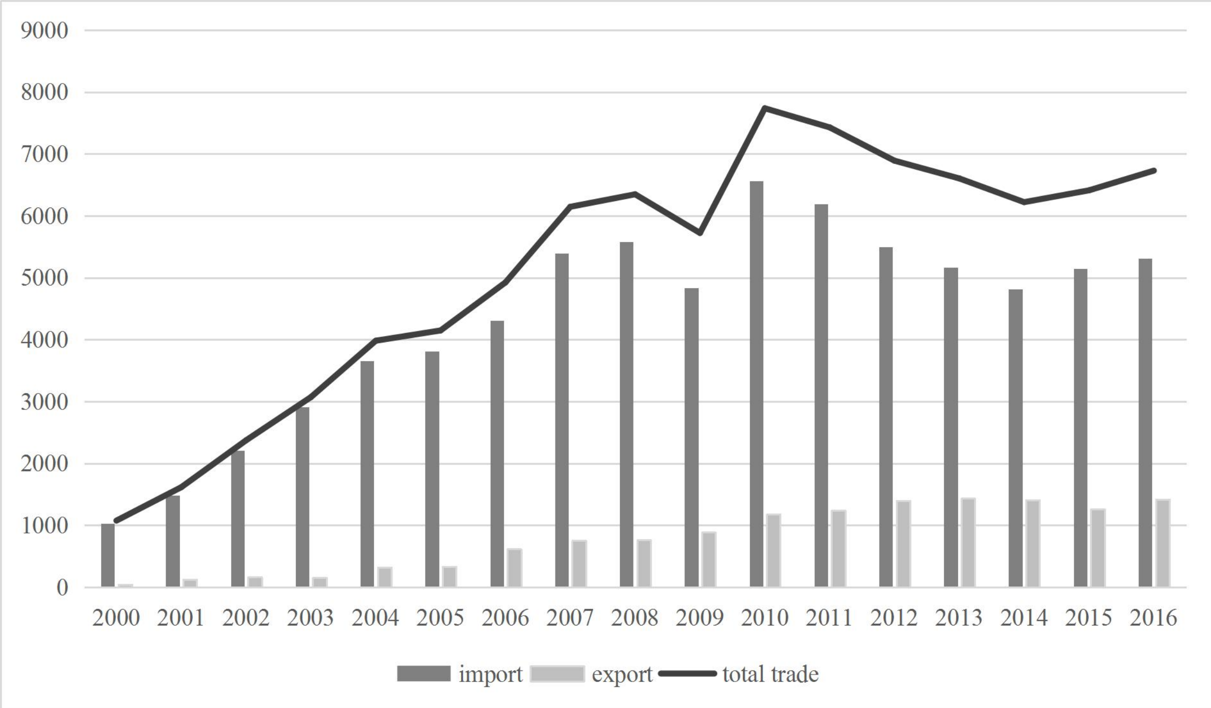
“Eastern opening” strategy: a new momentum

First, it has to be emphasized that Chinese–Hungarian relations have produced clear economic results already in the first decade of the 2000s’. China is one of Hungary’s most important trading partners in terms of imports: since 2005, it has ranked fourth or fifth (except for in 2010, when it held third place). By 2012, the Chinese share of Hungary’s total imports increased by more than two-and-a-half times, and the value of imports rose more than five-fold on 2003. Between 2003 and 2008, Chinese imports increased by an average annual rate of 24 per cent. Since 2010, the value of imports has been between 3.9 and 4.3 billion euros annually. The value of Hungary’s exports to China is significantly lower than its imports.

[2] Chinese President Xi Jinping and Hungarian Prime Minister Viktor Orban most recently met at the Belt and Road Forum, in Beijing in May 2017, but as Hungary will host the next 16+1 summit in November 2017, further meetings will take place.

Nonetheless, it has been increasing since the turn of the millennium (see Figure 1)[3]. China is Hungary's 15th most important import partner – and foremost among Asian countries, with Hungarian exports to China representing around 2 per cent of Hungary's total exports.

Figure 1. Hungary's trade with China, 2000-2016 (EUR million)



Source of chart data: Eurostat

Although Hungary is not a priority target of the intensive Chinese FDI outflows of recent years, since the turn of the millennium Chinese investments show a growing trend here. Chinese investment to Hungary started to increase significantly after the country joined the EU in 2004. According to Chinese statistics, it means a really rapid – more than a hundredfold – increase from 5.43 million USD in 2003 to 571.11 million USD in 2015 (see Figure 2.). According to *Chen* (2012), in 2010, Hungary itself took 89 percent of the whole Chinese capital flow to the region. Although this share has been decreasing since then as other countries of the CEE region became also popular destinations for Chinese FDI, but the amount of Chinese investment in Hungary has continued to increase and it is by far the highest in the CEE region.

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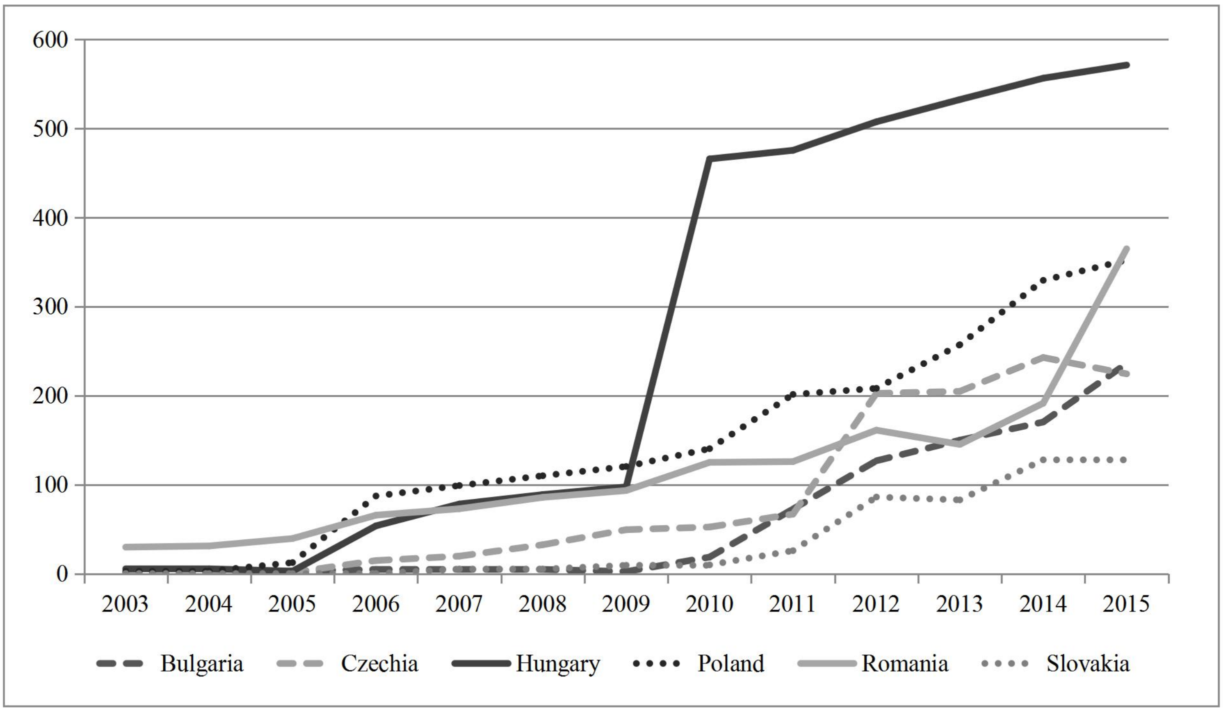
[3] If we compare all the 16 Central and Eastern European countries trade with China, it can be stated that some countries (especially the Baltic countries and Slovenia, Croatia) have quite low trade with China, while within the whole CEE region the four Visegrad countries – namely the Czech Republic, Hungary, Poland and Slovakia – show the highest trade flows, followed by Romania and Bulgaria. A common feature of CEE trade with China is the considerable deficit that is present in every country. Poland as the largest country has the highest deficit among all. This deficit has had a constant increasing trend in the past fifteen years for the CEE countries, only in the case of Hungary and the Czech Republic can we observe a decrease since 2010-2011. The value of Hungary's exports to China is indeed significantly lower than its imports with a trade deficit of 3886 million EUR in 2016.

Based on Chinese statistics, Chinese OFDI stock in Hungary was 571.11 million USD in 2015, the most recent year for which Chinese statistics were available at the time of writing this paper. Nevertheless, this amount is far greater when taking into account cumulative Hungarian data, since a significant portion of Chinese investment is received via intermediary countries or companies, therefore it appears elsewhere in national (Chinese and Hungarian) statistics. According to Hungarian reports, Chinese investment in Hungary by 2016 was about 3.5 billion USD[4]. However, the majority of Chinese investment in Hungary (as well as in the whole CEE region) is connected to a handful of big deals rather than several smaller (or bigger) ones[5].

Figure 2. China's OFDI stock in top CEE destinations, 2003–2015 (USD million)



Source: MOFCOM / NBS, PRC

As a result of the global crisis and the recent achievements mentioned above, a new and more intensive phase has begun in Hungarian–Chinese relations. In order to help Hungarian companies benefit from the rapid growth of emerging markets, several organizations have been established and a new foreign economic policy launched in Hungary with special

[4] More than 1.5 billion USD from that is the investment of the Chinese chemical company Wanhua, which acquired a 96 percent stake in the Hungarian chemical company BorsodChem through its Luxemburg subsidiary in 2010 and 2011. This subsidiary also made some investment for the development of BorsodChem later. It is the largest Chinese investment in CEE so far.

[5] Considering the motivation of Chinese investments in Hungary, the change of the institutional setting due to the economic integration into the EU has been the most important driver that has spurred Chinese FDI in the region, especially in the manufacturing sector. EU membership of Hungary (as well as other CEE countries joining the EU) allowed Chinese investors to avoid trade barriers and the country served as an assembly base due to the relatively low labour costs (efficiency–seeking, see McCaleb-Szunomár 2017). The main type of Chinese FDI in Hungary is thus market-seeking investment: by entering Hungarian market Chinese companies have access not only to EU market but also to markets of CIS, Mediterranean, EFTA.

emphasis on the “Eastern opening”. Although the Orbán government has emphasized that it would like to maintain Hungary’s strong and important economic relations with its traditional Western partners, the main objective of this policy has been to reduce Hungary’s economic dependence on trade with the West by improving economic relations with the East, particularly China. More specifically, the strategy aimed to increase Hungary’s exports to countries outside Europe to one third of total exports (from just under one quarter of total exports in 2012).

In order to achieve these goals, the strategy relied on active state intervention to diversify Hungarian exports and its markets, while also developing the export capability of small and medium-sized enterprises (SMEs). The foreign economic strategy emphasized developing trade and technology relations with China and other countries such as India, Russia, South Korea, Turkey, ASEAN member states, Arab countries and the CIS. An additional goal was to grow indirect exports to Asian emerging markets, meaning that Hungarian companies are to become suppliers of large European (e.g. German, Austrian and Scandinavian) exporters with strong positions in emerging markets (Éltető-Völgyi, 2013).

To enhance SME entry into the Asian markets, state-owned trading houses were opened to help Hungarian SMEs sell their products abroad. By creating trading houses, the government sought to enable Hungarian companies with solid capital to enter new emerging markets. In export development, trading houses function as mediators between Hungarian SMEs and foreign buyers. Therefore, at the beginning of 2013, the state-owned National Trading House was established and nearly 30 trading houses have been opened in countries like China, Saudi Arabia, Russia and Kazakhstan. In addition, potential cooperation with private trading houses has also been considered (Éltető-Völgyi, 2013).

The foreign economic strategy also recommended developing economic diplomacy, that is, strengthening and broadening the network of economic attachés abroad and encouraging more aligned cooperation between export financing state banks, the Ministry of National Economy and the Trade and Investment Agency. Beside these institutions, greater importance is to be attached to the different chambers, committees and business forums. As a result, new departments have been established within the Hungarian Chamber of Commerce and Industry. Moreover, the work of joint economic committees (intergovernmental organizations) has been renewed and there is a growing number of meetings between high-ranking politicians (both in Asia and in Hungary) as well as business forums underpinning Hungary’s strong commitment to the “Eastern opening.”

In China’s case, this process began well before the “Eastern opening policy” (EOP) was officially announced in 2012. 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 were established to intensify bilateral business relations. In addition, for some years now Hungary has been developing its relations with China via a multilateral forum: the first China–CEE Economic and Trade Forum was held in Budapest, in June 2011. Following that, the first meeting between the leaders of China and CEE countries was organized in Warsaw, in April 2012.

Hungary's EOP is not simply aimed at developing trade relations and opportunities but also at attracting investment from emerging Asian countries, of which China is considered to be an investor of growing importance. Therefore, Hungary provides state subsidies and incentives for potential investors outside the EU, including China. Back in the 1990s, Hungary's "customs free zones" proved highly attractive to greenfield foreign investors. Export-oriented automotive, electronics and other companies represented a large share of the country's foreign trade (McCaleb-Szunomar, 2017). Now Hungary is the only country in the region to have introduced a special incentive for foreign investors from outside the EU, who can apply for residency visas if they fulfil the required level of investment in Hungary.[6] Moreover, Hungary has the largest Chinese diaspora in the region (around 20,000 Chinese people) which – according to the extant literature – is a known factor to attract Chinese foreign direct investment (Buckley et al, 2007).

Since the EOP was initiated, both trade volume between Hungary and China as well as investment flows from China to Hungary increased, although only moderately (trade volume – both import and export – even decreased between 2012 and 2014). The underlying reasons may have little to do with government strategies. For example, Hungarian companies, especially Hungarian SMEs, have little impact on the development of trade relations, as trade – more than 80 per cent of it – between Hungary and China is based on business performed by Hungary-based multinational companies using global production networks (Éltető-Toporowski, 2013), i.e. the bulk of foreign trade between CEE countries and China is still linked to particular products and multinational companies – automotive, electronics and telecommunications. Regarding investments, although there have been some new projects, since the announcement of the EOP there has been expectation that high value investment projects, similar to the former investment by Wanhua or Huawei, would be announced. This setback is partly due to the eurozone crisis and partly due to some loss of trust in business circles. The reason behind this is probably the diverging economic interests of the two sides: Hungary would gladly welcome Chinese greenfield investment and cheap financial support, while recently the Chinese are more interested in mergers and acquisitions as well as infrastructure projects through providing credit lines (Szunomár et al, 2014). Another explanation for the loss of momentum is that neighbouring countries have become more active in building relations with China and in creating more business opportunities from which China can choose.

Nevertheless, the government is satisfied with the results of its EOP. As Prime Minister Orbán said:

With regard to the Eastern opening, I can tell you that it has been implemented. I can say for a fact that it has been completed. The gate is open in an eastern direction, it must be passed through and we must take care to ensure that nobody shuts it.[7]

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[6] Third country nationals are allowed to acquire Hungary's permanent residency status by investing in Special Hungarian Government Bonds that have a minimum 5-year maturity. The minimum initial investment per bond holder was 250,000 euros but later on this was raised to 300,000 euros.

[7] See "Viktor Orbán's speech at an extraordinary general meeting of ambassadors of Hungary," March 9, 2015. Available online: http://www.kormany.hu/hu/a-miniszterelnok/beszedek-publikaciok-interjuk/orban-viktor-beszede-a-missziovezetoi-munkaertekezleten

Belt & Road: Chinese-Hungarian relations in a new framework?

The Belt and Road initiative (formerly known as the One Belt, One Road) is an example of economic and infrastructural collaboration covering the whole of Eurasia. One part of it, the Silk Road Economic Belt provides opportunities for CEE countries that wish to participate in implementing the strategy. In fact, the initiative is a set of instruments to facilitate connectivity in terms of trade, investment, finance and flows of tourists and students (Summers, 2015). Connected to this initiative, the "New Silk Road" project – the Silk Road Economic Belt and the 21st Century Maritime Silk Road – has become the cornerstone of China's public diplomacy. The Silk Road Economic Belt provides opportunities for CEE countries that wish to participate in implementing the strategy. The railway line from the Chinese city of Chengdu to Łodz in Poland has been in operation since April 2013, while Budapest and Belgrade have also shown great interest in infrastructure building since the very beginning (Liu, 2014).

The Chinese government often emphasizes that it treats Hungary as a hub for Chinese products in the European Union. Consequently, it expressed its interest in several infrastructure-related investment recent years, such as plans to transform Szombathely airport into a major European cargo base, or develop the infrastructure of the Debrecen airport and to support the modernization project of the Belgrade-Budapest railroad connection.

The project to modernize the Belgrade–Budapest rail link is a recent example of one of the successful elements of both the Hungarian government's EOP and China's Belt & Road initiative. The aim is simple: to reduce travel time between Budapest and Belgrade to 2.5–3 hours, and to establish closer trade links by transporting Chinese goods – delivered by ship to the Chinese-run Greek port of Piraeus – to Western Europe via Serbia and Hungary. The underlying motivations and potential outcomes are, however, more complex.

The geographic positions of Hungary and Serbia mean they are suited to handling the transit traffic between China and Europe and occupy an important role in implementing the Chinese grand strategy.[8] Consequently, at the end of 2014, the prime ministers of Hungary, Serbia, China and Macedonia signed an agreement in Belgrade at the third Central and Eastern Europe–China summit on the construction of a rail link between Budapest and Belgrade. Regarding practical issues, the cost of investment for the whole section is around 3 billion USD, the Hungarian section will cost around 1.5 billion EUR, 85 per cent of that will be financed from Chinese loan. According to recent estimates it will take between two and two and a half years to construct the track.

China's motivations are easy to understand, as the New Silk Road project will allow them to expand their political and economic sphere of interest: they will be able to counterbalance the Trans-Pacific Partnership (TPP), and once the alternative transport routes are completed they will be in a more favorable strategic position, able to work off some of

[8] See for example: "China–CEE cooperation gathers momentum," *Xinhua*, June 8, 2015. Available online: http://news.xinhuanet.com/english/2015-06/08/c_134308024.htm

their industrial overcapacity accumulated in recent years. In addition, the Budapest–Belgrade railway project may provide a reference for further Chinese investment in the broader region. A more interesting question is: what is it that motivates the Hungarian (and Serbian) side?

The importance of Europe, particularly Central and Eastern Europe, to the project was emphasized long ago by China and welcomed by several CEE countries, including Hungary. Hungary was the first European country to sign a memorandum of understanding with China on promoting the Silk Road Economic Belt and Maritime Silk Road, during Chinese Foreign Minister Wang Yi's visit to Budapest in June, 2015. The Hungarian government was very keen on the railway project and when it signed the construction agreement in 2014, Prime Minister Orbán called it the most important moment in cooperation between the European Union and China.[9]

Infrastructure development is a hot topic in all CEE countries; however, there are other resources – for example EU funds – to finance them. The reconstruction of the railway track on the Hungarian side is useful in itself, but is it worth it for Hungary, if it is financed from Chinese loans, and will mostly likely be implemented by Chinese firms? For now, it seems that the only benefit Hungary can expect from construction comes in the form of the transit fees which will hopefully cover the loan repayments. However, being a transit country is not the only option: Hungary could build support infrastructure along the railway line to serve as a logistics and/or assembly centre (since it already has experience in this field). As *Matura* (2015) points out, by evaluating what will be delivered by rail and from where, Hungary could create factories, logistics centres and industrial or economic zones to attract Chinese (or other) investors. This strategy would not only better exploit the potential of the line but could create further jobs and manufacturing in the country.

Conclusion

As described above, Hungarian governments – regardless of political orientation – have committed themselves to developing relations with China. Hungary is regarded as occupying a more prominent position by Chinese people and the government than its geopolitical position would indicate. Hungary is open to many types of cooperation, taking every opportunity to promote economic relations, while the government supports China over many sensitive issues, such as lifting the arms embargo or granting market economy status to the country. Furthermore, the Hungarian government never meets government-level diplomatic delegations from Taiwan or Tibet and – in order to prove its strong commitment – it tends to remove anti-China protesters from the streets of Budapest when a high-level Chinese delegation visits the Hungarian capital. Thus, it is understandable that most Hungarian politicians strongly believe that their efforts and strong support have created an irresistible investment environment for China.

[9] See for example here: C. Keszthelyi, "Belgrade–Budapest rail construction agreement signed," *Budapest Business Journal*, December 17, 2014.

On the one hand, the results are obvious: Hungary's efforts are acknowledged by Chinese leaders, the value of Hungarian exports is increasing year on year and Hungary has by far the highest level of Chinese investment, not only among the Visegrad Four but in the entire CEE region. On the other hand, other countries in the region have also began developing their relations with China and have achieved more success recently (e.g. Poland's and Czech Republic's strategic partnership with China), which raises questions to the 'special' nature of the Chinese–Hungarian relationship. Furthermore, if one takes a closer look, it becomes clear that the majority of Chinese investment is connected to some big deals, not several small, medium as well as major ones. It means that the success of Hungary as an attractive destination for Chinese FDI is questionable, or at least its position is easy to lose. There might be even diverging economic interest between the two sides: Hungary would gladly receive Chinese greenfield investment and cheap if not free financial support, meanwhile the Chinese are more and more interested in infrastructure investment through their own credit lines. These miscomprehensions must be resolved in the future in order to enhance cooperation.

As detailed above, Hungary is willing to deepen a pragmatic cooperation with China, however, for the time being this objective appears rather in the field of rhetoric and politics, while the economic results lag behind in recent years (Szunomár et al, 2014). *Liu* (2013) argues that Hungary had developed an advanced and comprehensive strategy towards China because of strategic considerations: to mitigate the lash caused by its uncomfortable ties with the EU. In fact, the Hungarian government proudly repeats its forerunner role in the region and its intention to be the bridgehead of the China-CEE cooperation, however, other countries of the region also began to develop their relations with China and achieves more and more success recently.

A healthy balance should be sought between Hungarian needs and Chinese plans and Hungarian companies should be helped in reaping the benefits of greater export opportunities. Instead of pursuing excessively high demands, Hungary should be more specific and patient in its expectations, producing more initiatives on its own. The "Eastern opening policy" is unique in the region, but it is too general in terms of the countries to which it applies. Therefore, as the majority of Hungarian scholars dealing with China suggest, given its size and importance, China deserves a separate strategy.

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