ECONOMIC EFFECTS IN HUNGARY WITHIN INTEGRATION IN EUROPEAN UNION

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ABSTRACT

Eastern European Countries after the breakup of the Soviet Union have expressed widely interest in European Union integration, this includes Hungary as well. The study is going to analyze the economic development of Hungary before and after the membership in European Union. It is discussed whether economic cooperation between Hungary and European Union members have changed, that is increased or decreased after joining European Union. The main objective of the paper is assessment of the level of development of Hungary within the European Union integration. The paper provides a comprehensive and contemporary comparative analysis of the economic performance, the economic structure and the trade relations between Hungary and European Union countries, allowing us to detect basic trends and developments. We will compare the economic performance of Hungary and other European Union members, looking at aggregate figures from integration in European Union such as foreign trade, Foreign Direct Investment, Gross Domestic Product and its structure, level of structural unemployment and employment, inflation and level of income.

KEYWORDS: European Union membership, Foreign Trade, Foreign Direct Investment, Gross Domestic Product, Unemployment

1. INTRODUCTION

European integration is a political and economic process, open to all European countries that are willing to have signed the founding treaties and take all EU laws. In accordance with Article 237 of the Treaty of Rome: "Any European State may apply to become a full member of the European community".

In 1993, following requests from the former communist countries to join the EU, the European Council established three criteria called Copenhagen criteria[1], which the candidate country had to meet in order to become full members of the EU. Until the day they join, new members must fulfill:

- **Political criteria** – which basically means establishing stable institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- **Economic criteria** – a functioning market economy and capacity to cope with competitive pressure and market forces within the Union;
- **Ability to take the obligations from membership**, including support for the objectives of the Union. They must have a public administration capable to manage and apply EU laws in practice.

Political criteria must be met in order the European Council to decide the opening of negotiations with one candidate country for EU accession. Given that the new member state (NMS) were ex-communist countries that came out from the former Soviet Union and as such were faced with a number of challenges, primarily political and economic, for which were taken out reforms, from the EU side were established a series of instruments and policies for sustainability and implementation of the reforms. In that context were identified pre-accession strategy, funds and accession negotiations, which provided the necessary framework and instruments.

A) Accession negotiations

[1] In June 1993 was held a meeting at the European Council in Copenhagen, Denmark, and the adopted criteria for membership of new countries into the EU are called Copenhagen criteria.

Accession negotiations are vital for monitoring and assisting the candidate countries in preparing for accession and in assessing how ready they are to join the EU. Each country is assessed on its own merits in terms of compliance with the accession criteria. Negotiations helped the candidate countries to prepare for fulfilling the obligations of membership to European Union. They also allowed the Union to prepare for expansion in terms of absorption capacity, i.e. planning the operation of the EU with the new member states.

Negotiations are regarding the adoption and implementation of the Community *acquis*[2], which is monitored by the Commission of the European Union. *Acquis* is divided into chapters, and includes a lot of chapters on different areas to which new candidate countries must show progress. For each chapter is negotiated individually, and are defined measurable reference criteria for opening and closing of each chapter.

Negotiations are held in the bilateral intergovernmental conferences, between Member States and the candidate country. Common negotiating positions are defined for each chapter related to issues for the competence of the Community. The results from the negotiations (with the outcome of political and economic dialogue) are incorporated into a draft accession treaty, after negotiations for all chapters are closed.

B) Pre-Accession Strategy

Pre-accession strategy offers a "structured dialogue" between the candidate countries and the EU institutions during the accession process, providing a framework and tools necessary for all parties. The strategy is separate for each individual candidate country.

Pre-accession strategy derives from a meeting of the European Council in Luxembourg (December 1997), when it was formed pre-accession strategy for the ten candidate countries of Central and Eastern Europe. It consists of:

1. Bilateral agreements;
2. Accession Partnership and National Programme for the Adoption of *acquis*;
3. Participation in Community programs, agencies and commissions;
4. Political dialogue;
5. Evaluation of Commission (“monitoring");
6. Pre-accession assistance;
7. Co-financing from international financial institutions (IFIs).

Pre-accession assistance is helping countries that are candidates for membership in the European Union to achieve the entry requirements (Copenhagen criteria). Significant investment is required if the candidate countries should improve their institutions and standards in accordance with *acquis* of the Community.

For the period 2007 - 2013, the Instrument for Pre-Accession Assistance (IPA) is the only mutual fund that replaces the pre-accession instruments for the period 2000 to 2006 (PHARE, SAPARD for structural measures in agriculture, ISPA for infrastructure development in environmental and transportation, and the special pre-accession instrument for Turkey), as well as CARDS Programme for the Western Balkans[3].

European Investment Bank (EIB) and International Financial Institutions (IFIs) are also providing funding for the candidate countries. Once one country becomes a full member of the European Union, it has no right to receive pre-accession assistance and can receive temporary financial assistance in accordance with the accession treaty.

In the following sections are analyzed the economic effects of EU accession for Hungary for which we consider they are relevant sources for Republic of North Macedonia, since it has also interest to integrate in EU.

[2] *Acquis* is a French word that is translated as "*the EU as it is*", in other words means the new member states to adopt all EU treaties and laws, declarations and resolutions, common foreign and security policy, international agreements related issues with EU and decisions by the Court of Justice of the EU.

[3] For more look at: http://europa.eu/legislation_summaries/glossary/preaccession_aid_en.htm, 19.04.2013

2. METHODOLOGY

The methodology in this paper does not use any structural model, but we used available information, databases and publications to compare the stages of development of economic indicators such as Foreign Trade, Gross Domestic Product (GDP), Gross Domestic Product per capita (GDP p.c.), Foreign Direct Investments (FDI), Unemployment rate and Inflation in Hungary within its integration in the EU. In order to better study the economic growth of Hungary we analyzed several macroeconomic indicators such as the level of unemployment and risk of poverty.

In the study are used relevant data from different sources such as from the Statistical Database of the European Union (EUROSTAT), Statistical Office of the Hungary, and other relevant sources from international organizations. The paper is providing a synthesis of the available sources and for better illustration and clarity will be used rendering figures.

2.1. The procedure of accession of Hungary to the EU

With the fall of communism, Hungary expressed its intention to integrate into the European Union, and therefore signed the first agreement on trade and cooperation with the European Community (EC) in 1988.

At the end of 1994, the European Council in Essen defined the pre-accession strategy to prepare the countries of Central and Eastern Europe for EU membership. This strategy was based on three main elements: implementation of the Europe Agreements, Pre-opening and financial assistance programs and agencies of the European Community.

European Community in the 1990s signed a new contract, the association agreement, so called "Europe Agreement" with ten countries of Central and Eastern Europe, including Hungary. Treaty with Hungary was signed on 16 December 1991 and entered into force on 1 February 1994. This agreement replaced the former agreement with the EC.

Under the Europe Agreement, trade between the EU and the countries of Central and Eastern Europe has increased rapidly, because these countries re-orientated their trade markets from the former Soviet Union towards EU member states.

Commission proposed agreement for Accession Partnership with Hungary in March 1998 with a goal: to strengthen mutual relations, to establish a legal framework for the priority works specified in the Commission Opinion on Hungary's application for membership, financial resources available for helping Hungary to implement these priorities and the conditions referred on this assistance.

In March 1998, Hungary presented the first version of its National Programme for the Adoption of the *acquis* (NPAA), which described in detail the actions needed to achieve the objectives set out in the Accession Partnership and to prepare for its integration into the EU.

Pre-EU financial assistance to the candidate countries of Central and Eastern Europe include[4]:

1. PHARE[5] program
2. Investment support for transport and environment (ISPA program)
3. Support for Agricultural and Rural Development (SAPARD program)
4. Co-financing by international financial institutions (IFIs)

PHARE program was established in the Paris Summit in 1989, in order to help the Polish and Hungarian political and economic reforms, as two most reformed countries. It had two main priorities, institutional building and investment financing, with an annual budget of 1.5 billion €.

ISPA has financed major projects on the environment and transport infrastructures with an annual budget of 1.04 billion euro. SAPARD funded agricultural and rural development, with an annual budget of 520 million euro.

In December 1999, the Council of Ministers of the countries in Central and Eastern Europe approved the 8.6 billion euro loan from the European Investment Bank (EIB) for the period February 2000 - January 2007 and in January 2000 they added another 8.5 billion euro for the period of three

[4] European Commission, *Enlargement of the European Union, an historic opportunity*, Enlargement Directorate-General, Brussels. 2003.

[5] PHARE- *Pologne, Hongrie – Aide à la Reconstruction Économique (**Support for the Economic Reconstruction of Poland and Hungary**)*

years and six months. This speaks to the enormous financial support to this group of countries to better prepare before accession to EU.

European Council summit in Copenhagen in June 1993, established community programs for the Central and Eastern Europe. Community programs were designed to promote cooperation among member states in certain areas (such as in public health, environment, research and energy) and to support students and youth exchanges (such as Socrates, Leonardo da Vinci and youth for Europe).

Hungary applied formally for EU membership on 1st of April 1994. The European Council meeting in Luxembourg in December 1997 decided that on 26th of April 1998 to start accession negotiations with six countries: Cyprus, Czech Republic, Estonia, Poland, Hungary and Slovenia.

During the preparation for membership, the European Commission issued 5 regular reports to the Council of Europe for the progress of candidate countries including Hungary. The fifth and lastprogress report was published on 9th of October 2002[6]. In this report, the Commission gave details for all 26 chapters of the *acquis* adoption and negotiations were considered closed to all chapters in Hungary. The European Council meeting in Copenhagen on 12 and 13 December 2002 had officially closed the negotiations for accession of Hungary and nine other candidate countries.

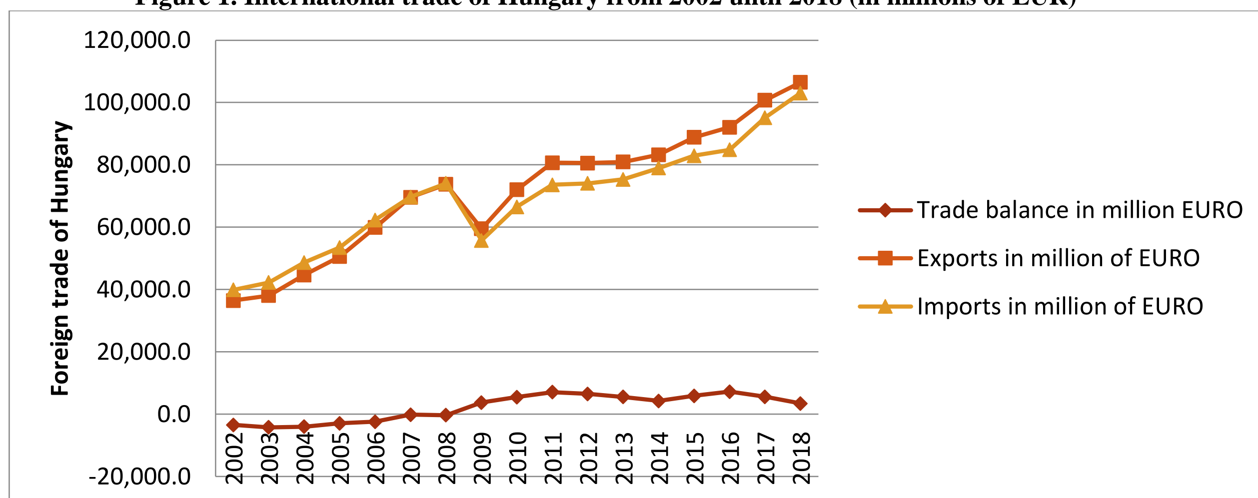
The European Parliament has approved the expansion of the EU on 9th of April 2003, and the Accession Treaty was signed on 16 April 2003, during the European Council meeting in Athens.
Hungary joined the European Union on 1st of May 2004, and subsequently nine other new member states - have joined the Schengen zone, ensuring the free movement of people from 21st of December 2007. EU membership it gave new opportunities to Hungary in terms of accession to the Cohesion Fund that was worth 25.7 billion euro for the period 2007-2013.

3. RESEARCH RESULTS

3.1. Economic effects in foreign trade of Hungary from EU accession

Hungary's economy is highly dependent on foreign trade, especially with the EU states. After its accession to the EU, exports and imports of goods to GDP increased dramatically, reaching the highest value in 2018 according to the database of Eurostat, (2019). Export of goods reached 106 billion Euro in 2018, while imports increased to 13 billion that shows a trade balance of surplus of 3.4 billion Euro. For the 16-year period, the only year of decline was 2009 due to the global financial and economic crisis. Exports of goods of Hungary in 2018 increased by 3 times compared to the year 2000. The data shows that the membership in EU had positive affect in terms of foreign trade. The financial and economic crisis had a major impact on the level of exports of goods of Hungary in 2009.

Figure 1. International trade of Hungary from 2002 until 2018 (in millions of EUR)

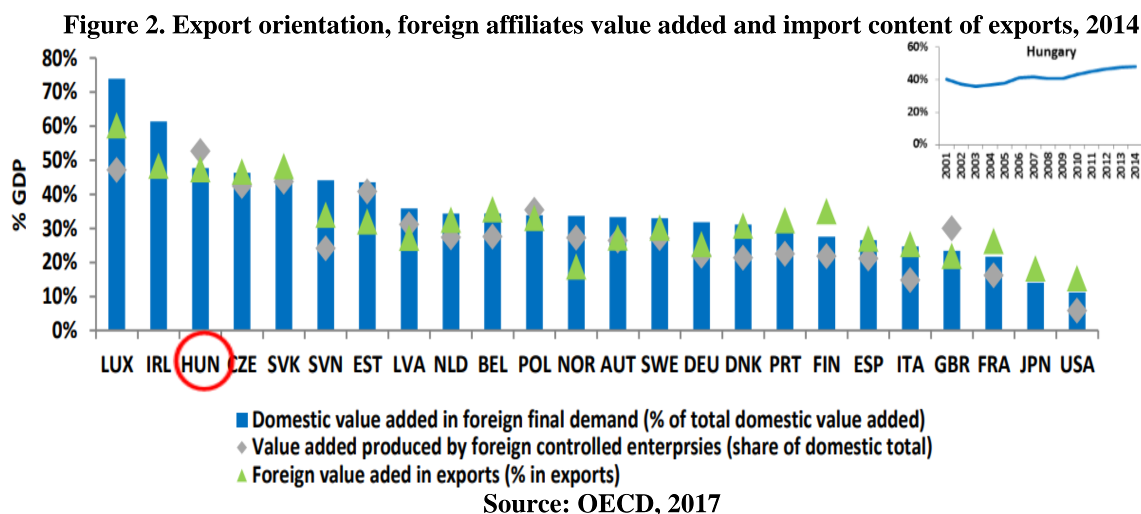


Source: Eurostat, 2019

[6] EC, "Regular report, on Hungary's progress towards accession", Brussels, SEC (2002) 1404, 2003.

Exports (in value added terms) contribute around 48% of Hungarian GDP, this is one of the highest in the OECD, which likely reflects high levels of inward investment and their high export intensity, contributing to Hungary's relatively high integration in GVCs as measured by its import content of exports. The chart insert illustrates that Hungarian export orientation has been increasing over time (OECD, 2017).

Figure 2. Export orientation, foreign affiliates value added and import content of exports, 2014



Source: OECD, 2017

3.2. Foreign direct investment, GDP and its structure in Hungary

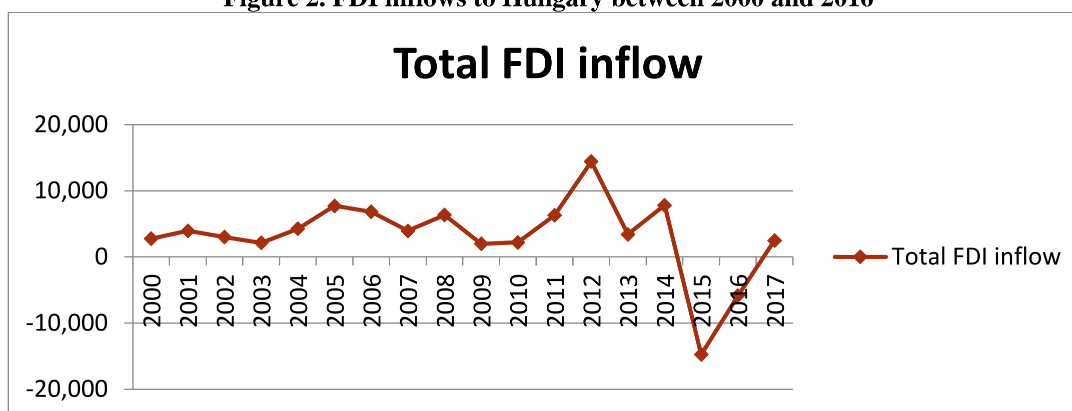
There is a real fact that Hungary as one of the Central European countries, had reached rapid economic growth during the decade of transition from central planning economy to a free market economy. The role of foreign direct investment in this process was very important, because these investments enabled integration into the world economy (Alfaro et al, 2004).

Similar to other countries that joined the EU in 2004, also in Hungary, the growth of the economy it is made during the last twelve years. Membership in the EU, NATO[7] and OECD[8] heavily affected the continuity of the increase in foreign direct investment and growth of real GDP.
EU membership has two important implications in terms of Foreign Direct Investments (FDI). *First*, it allows countries with small domestic markets to expand their market and to attract European funds for investments (in agriculture, infrastructure). *Second*, membership suggests political, economical and legal stability, but the absence of effective institutions may delay the effective accumulation and transfer of knowledge (Radulescu&Druica, 2011).

Hungary's exports and inward investment are more focused on manufacturing than services. The computer electronics and motor vehicles industries are Hungary's top exporting industries; both have high shares of value added produced by foreign-owned firms and high import content in their exports, an indicator of Global Value Chains (GVC) integration (OECD, 2017). The extent of Hungary's integration into the global flow of foreign direct investments can also be considered as an indicator of Hungary's integration into the EU. The figure 2 summarizes data currently available at UNCTAD about Hungary related to FDI inflow. With the exception of 2014, Hungary registered increase in FDI during 2000-2016.

[7] On 12March, 1999, Hungary, together with the Czech Republic and Poland officially joined NATO.
[8] On 7 May, 1996, Hungary became a member of the Organization for Economic Cooperation and Development-OECD.

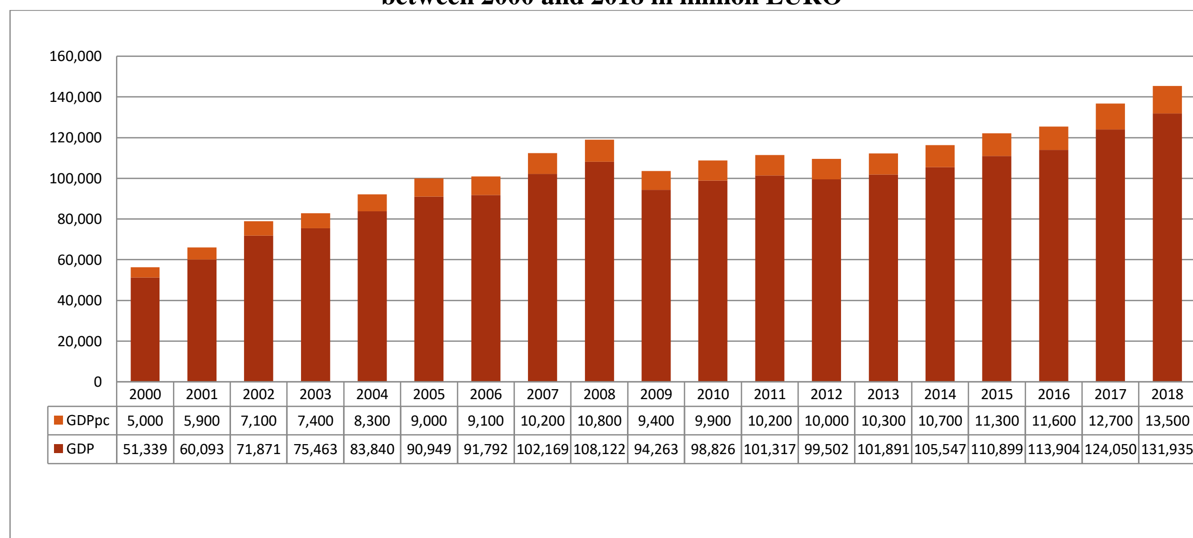
Figure 2. FDI inflows to Hungary between 2000 and 2016



Source: UNCTAD, Data Center (2019)

In 2000 the GDP of Hungary was 51,339 million EURO and increased to 131,935 million EURO in 2018 as it can be seen in Figure 3. Accordingly to this trends, GDP per capita from 5,000 EURO in year 2000 increased to 13,500 in 2018.

Figure 3. Gross domestic product at market prices and Gross domestic product per capita of Hungary between 2000 and 2018 in million EURO



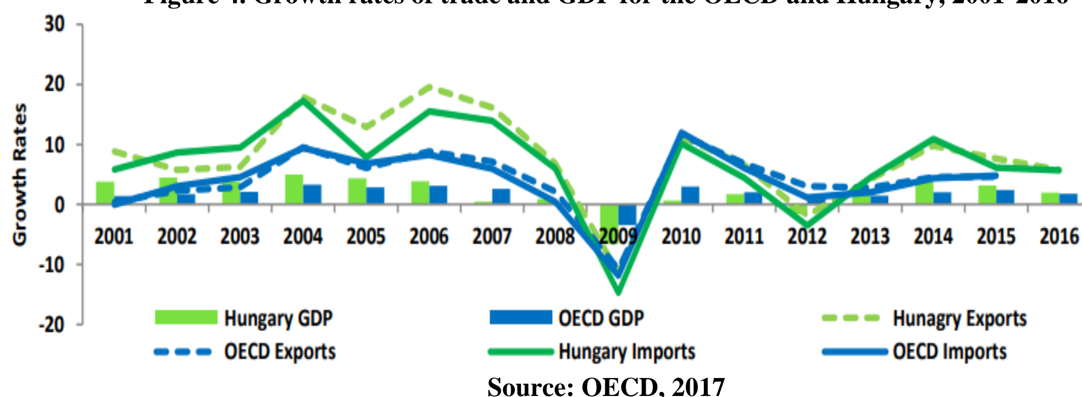
Source: EUROSTAT, 2019

The production was the main objective of almost all investments in the early 1990s, especially in the privatization of Hungarian companies. Since then, however, the services are at the forefront, partly because privatization in the services sector began later than in manufacturing. Overall FDI was in manufacturing the automotive sector and machinery, electronics, chemicals, metallurgy, pharmaceuticals and processing of metals, rubbers and plastics.

Comparative advantages of investing in Hungary is the proximity to the European market for products, services and logistics, excellent infrastructure and scientific parks, good balance of labor cost and quality, government incentives (cash subsidies, tax incentives and competitive tax system) and friendly economic investment policy. The main investors in Hungary come from Germany, the Netherlands, Austria, France, USA, Great Britain, Belgium and Switzerland.

Like many European economies, Hungarian trade contracted significantly at the height of the global crisis and again during the euro crisis. Having outpaced OECD growth in trade for the pre-crisis years, Hungarian growth was below or close to the OECD growth after 2010. While Hungarian trade again outpaced the OECD rates from 2013, their growth slowed in 2015. In 2016, Hungarian growth in exports was 5.8% and 5.7% for imports, marginally below 2015 values (OECD, 2017).

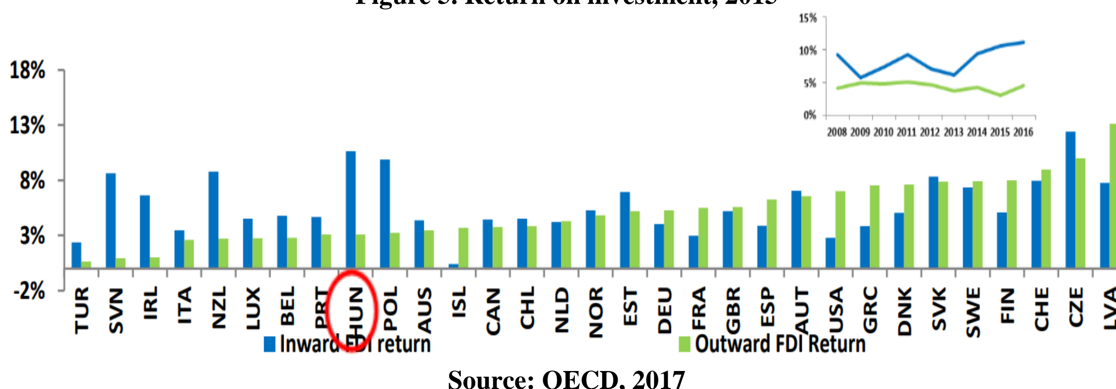
Figure 4. Growth rates of trade and GDP for the OECD and Hungary, 2001-2016



Source: OECD, 2017

In 2015, Hungary received USD 1 billion in income from its outward investment, comparable, as a share of GDP, to approximately 1%. Hungary's rate of return at 3.1% (green bar), on its outward FDI is below the OECD median, and is lower than it was in 2011 (see chart insert). On the other hand the return to foreign investors in Hungary was 10.6% in 2015, one of the highest in the OECD (OECD, 2017).

Figure 5. Return on investment, 2015

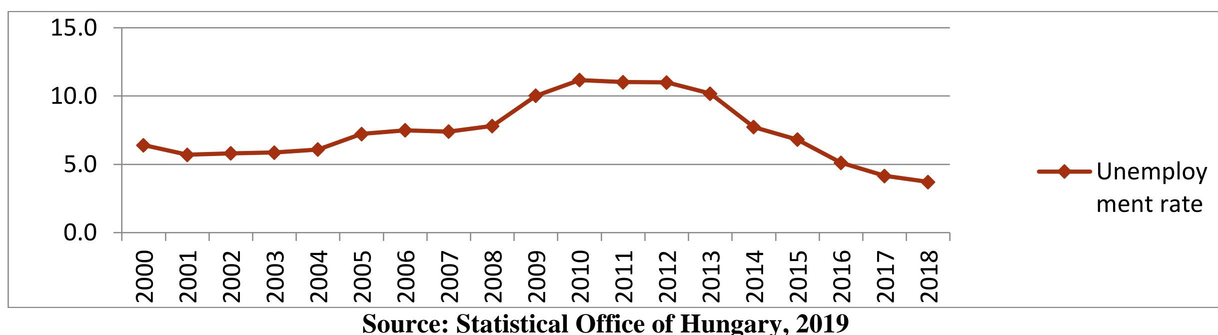


Source: OECD, 2017

3.3. Unemployment and structural employment in Hungary

The level of unemployment in Hungary was lower than in Slovakia and Slovenia, but higher than in the Czech Republic, for the entire period from 2000 to 2018. The highest unemployment rates were registered after joining the EU, reaching the highest rate in 2010, 11.2 percent and lowest rate in 2018, 3.7 percent (Statistical Office of Hungary, 2019).

Figure 4. Unemployment rate in Hungary between 2000 until 2018



Source: Statistical Office of Hungary, 2019

3.4. Inflation rate in Hungary

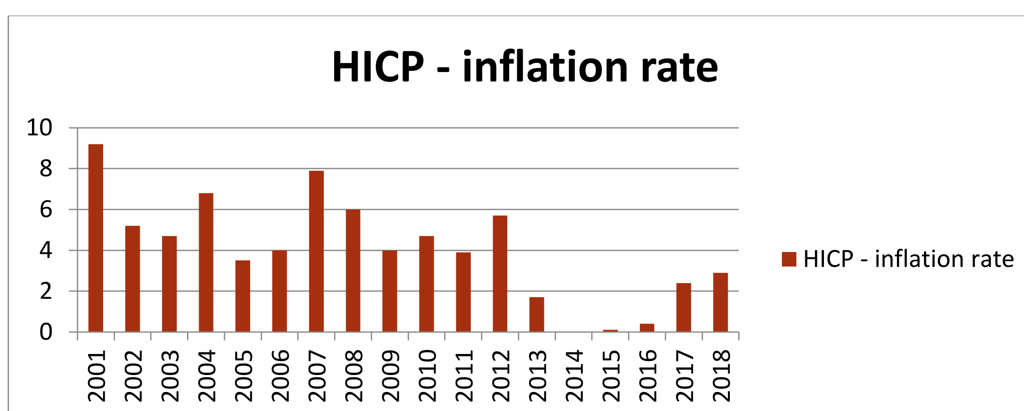
The rate of inflation in Hungary before joining the EU it was very high. In recent years there have been dramatic changes in the rate of inflation, not only in Hungary, but globally. In 2008, after the global financial crisis began, prices were climbing at an annual rate of about 5% and about 6% in Hungary. But less than a year later, prices have dropped by about 2% in Hungary according to CPI9 measure.

What was staying behind those big changes of inflation? In mid-2008, the record high oil prices have lifted transport costs, the food, through growth in commodity prices in stores and higher household bills for energy.

Prices also depend on the economic cycle. That was shown in the second half of 2008, corresponding to the decline in economic activity.

According to the Eurostat data Hungary faced an average rate or HCPI10, which varied from 9.2 percent in 2001, compared to prices in the same period last year, actually was the highest inflation rate recorded for the period 2001 to 2018 year, and the lowest inflation rate of 0.0 percent in 2014. In 2018 inflation rate increased to 2.9 percent.

Figure 5. HICP - inflation rate in Hungary between 2000 until 2018



Source: HICP, EUROSTAT, 2019

3.5. Level of income in Hungary

Low rate of employment, however, does not necessarily mean a low rate of poverty risk. In this context, the new Member States differ among themselves, where the level of employment tends to be relatively low, and the risk of poverty is relatively high in Poland, it is around the EU average in Hungary and below average in Slovakia.

For measurement of monetary poverty the European Council in December 2001, in Laeken, Brussels, established common European statistical indicators of poverty and social exclusion, known as the Laeken indicators, as a composite of 18 common European indicators. Laeken most important indicators of poverty and social exclusion are:

1. Risk of poverty rate,
2. Risk of poverty line,
3. Quintile's share of income (S80/S20),
4. Gini coefficient, and
5. Relative gap average exposure of risk of poverty.

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[9] CPI – Consumer Price Index.

[10] The HICPs (the Harmonized Index of Consumer Prices) are economic indicators constructed to measure the changes over time in the prices of consumer goods and services acquired by households. The HICPs give comparable measures of inflation in the euro-zone, the EU, the European Economic Area and for other countries including accession and candidate countries. They are calculated according to a harmonised approach and a single set of definitions. They provide the official measure of consumer price inflation in the euro-zone for the purposes of monetary policy in the euro area and assessing inflation convergence as required under the Maastricht criteria.

The primary data source since 2003 is European Union Statistics of Income and Living Conditions (EU-SILC), which is based on the regulations and is funded by the European Commission. EU SILC is multi-dimensional tool, focused on revenue, but includes also housing, material poverty, labor, health, demography, education, in order to study the multi-dimensional approach of social exclusion.

EU SILC was launched at different times[11]. Hungary started to implement this program in 2005. It is implemented by living conditions survey (SILC Survey year) and uses registered and administrative data from the state statistical offices of each country, in this case from Hungary for the year when survey is done (reference year for income).

In Hungary the level of individuals exposed to the risk of poverty is low, but is higher than the Czech Republic, Slovakia and Slovenia and it belongs to the group of countries with least people at risk of poverty from the countries of the OECD[12], also from EU members. Hungarian citizens with average incomes of less than 60 % of the country's average in 2018 were only 12.8 percent. This level decreased by 0.6 percentage points compared to 2017, when there were 13.4 percent of the population living below the poverty line.

Figure 6. Exposed to the risk of poverty after social transfers in Hungary from 2005 to 2018, in percent (covering all ages and both genders)

Source: Income and living conditions of households, EUROSTAT, SILC, 2019

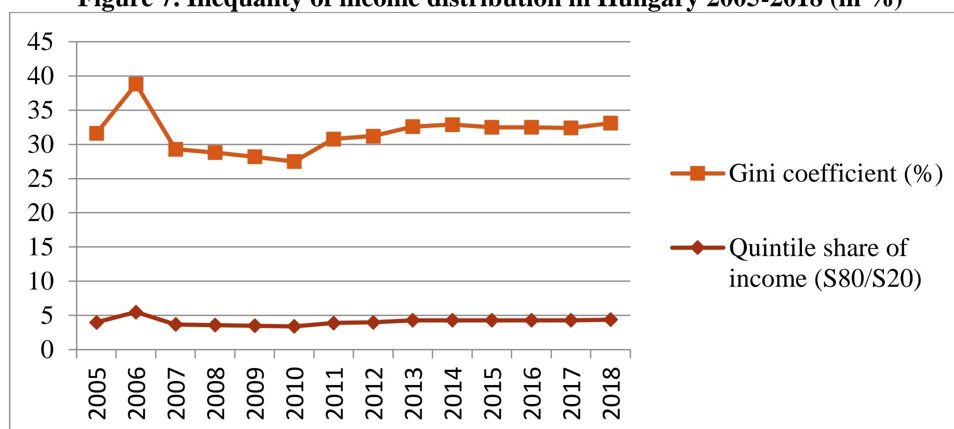
The value of the quintile share of income was relatively changeable over the entire period from 2005 until 2018. The highest value was in 2006, 5.5 and lowest in 2010, 3.4 percentage points. In 2018, the share of income quintile was 4.4 percentage points, which means that 20% of the population were taking on average 4.4 times higher revenue in contrast to the population with the lowest income.

Comparing to the one year before, in 2018 the value of the Gini coefficient increased to 28.7, i.e. the gap between rich and poor was 28.7%. This level of distribution of income is less than the year 2006 when it reached 33.3%. Revenues were slightly better distributed among households in year 2010, 24.1% (Eurostat, 2019).

[11] *2003*: Belgium, Denmark, Ireland, Greece, Luxembourg, Austria and Norway (total of 7 countries). *2004*: 7 countries plus Estonia, Spain, France, Italy, Portugal, Finland, Sweden and Iceland (total 15 countries). *2005*: 15 countries plus the Czech Republic, Germany, Cyprus, Latvia, Lithuania, Hungary, Malta, Netherlands, Poland, Slovenia, Slovakia and the United Kingdom (total 27 countries). *2007*: 27 countries plus Bulgaria, Romania, Switzerland and Turkey (total 31 countries). *2010*: 31 countries plus Croatia (total 32 countries).

[12] Repor of OECD, "Society at a glance 2011: OECD social indicators", 2011.

Figure 7. Inequality of income distribution in Hungary 2005-2018 (in %)



Source: EUROSTAT, 2019

4. CONCLUSION

One of the main goals for economic integration of the member states of the EU is common progress through the expansion of the European common market, by increasing competition in goods, services and factors of production, as well as long-term economic growth. Exports of goods of Hungary in 2018 increased by 3 times compared to the year 2000. The data shows that the membership in EU had positive affect in terms of foreign trade.Exports (in value added terms) contribute around 48% of Hungarian GDP, this is one of the highest in the OECD. With the exception of 2014, Hungary registered increase in FDI during 2000-2016. In 2000 the GDP of Hungary was 51,339 million EURO and increased to 131,935 million EURO in 2018. Accordingly to this trends, GDP per capita from 5,000 EURO in year 2000 increased to 13,500 in 2018. The level of unemployment in Hungary was lower than in Slovakia and Slovenia, but higher than in the Czech Republic, for the entire period from 2000 to 2018. The highest unemployment rates were registered after joining the EU, reaching the highest rate in 2010, 11.2 percent and lowest rate in 2018, 3.7 percent. In recent years there have been dramatic changes in the rate of inflation, not only in Hungary, but globally. In 2008, after the global financial crisis began, prices were climbing at an annual rate of about 5% and about 6% in Hungary. But less than a year later, prices have dropped by about 2% in Hungary. In Hungary the level of individuals exposed to the risk of poverty is low, but is higher than the Czech Republic, Slovakia and Slovenia and it belongs to the group of countries with least people at risk of poverty from the countries of the OECD. In 2018, the share of income quintile was 4.4 percentage points, which means that 20% of the population were taking on average 4.4 times higher revenue in contrast to the population with the lowest income. Comparing to the one year before, in 2018 the value of the Gini coefficient increased to 28.7, i.e. the gap between rich and poor was 28.7%.

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