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# Three Years of the EU Membership - The Case of Hungary

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## *Introduction*

The day of accession (01.05.2004) of Hungary to the European Union was much more a political hallmark of the process of integration into the European economic and political structures, which started more than ten years earlier than an economic cut-off point. This integration process was gradual and progressively extended to more and more areas of the economic and political activities of the country in the course of more than a decade. This integration process resulted in that the economic and political systems were almost fully transformed by the time of EU accession. It meant that the de facto integration process into the EU economic structures was to a great extent completed by 2004 and the accession represented actually a de jure recognition of the already existing results of this development. The date of EU accession is, of course, a historical dividing line; it closed a 15 year period of transition and opened up a new one which marks different political and historical situations and conditions in Hungary.

The 15 years prior to the EU accession were very critical because of the serious problems and challenges caused by the transition process. The economic transition implied not only the implementation of various elements of a market economy but also the transposition of the EU's acquis communautaire. The latter steps aimed at a future accession to the EU. The preparation for the EU accession was also a process, whose activities were widening onto more and more areas of the economy and at the same time continuously deepening making the economy more integrated into the EU. The economic transformation and the preparation for EU membership were almost completed by the time of accession.

The political aspects of the transition and preparation for EU membership were more complicated and it seems that there are still tasks to be completed. On this basis, one can identify several political and economic costs and benefits of the EU accession process as well as costs and benefits of being a member of the European political and economic integration.

The most important political and economic benefits of EU membership have been the following; joining a group of countries of higher economic development can boost the economic development, being member of a community can promote and guarantee political stability and security, being part of the largest market of the world can improve the competitiveness in the world markets, integrating in the EU can provide modernisation impetus and EU financial support, etc. There are various costs which occurred already during the accession process: e.g. the problems of the necessary structural changes, the loss of relative independence in economic policy decision making, the troubles caused by the implementation of a substantial number of binding duties and obligations.

Besides the economic costs and benefits there have been also some political aspects, which should be taken into consideration when one assesses the impacts of EU membership on Hungary and its population.

One of the most important things is that a basic relationship between the EU and Hungary and its population has changed. The « we » and the « EU » approach or sometime antagonism between the two should have been long disappeared. The fact is, that a new public perception that Hungary and its population is already part of the EU has not become strong enough yet. The public mentality is changing too slowly.

Contrary to the slow adjustment of public mentality the government administration has changed and adjusted to the new conditions rather rapidly and successfully. New types of formal and informal relations, co-operation between the eurocrats in Brussels and the public administration in Budapest have developed. The changes have not caused any substantial or serious problems for the functioning of the Hungarian administration in spite of the fact that about one third of the economic policy competence was delegated to the EU administration in Brussels. The fact is that the economic policy competence was already reduced by the on-going globalisation and regionalisation processes. These two very important recent phenomena of the global economy have already reduced particularly the national competence on such area as economic policy tools, which can influence the development of the national competitiveness under such global conditions when there is an increasing competition among national economic policies.

### *1. First contributions to the European integration some political aspects of EU membership*

As one of the new member states, Hungary made its contribution to the current process of political and economic integration in Europe. This contribution had various aspects in the political and economic fields.

In spite of several pessimistic forecasts the enlargement process went through smoothly. The expected negative impacts and effects did not take place or at least not at a large scale. There was no crisis in the functioning of the EU institutions quite to the contrary the decision making process was properly operating. One could not witness any massive invasion of labour force from the new member states to the old ones and particularly not from Hungary. The new Eastern borders of the EU were effectively controlled and there was no increase in illegal migration from the non-EU countries. Criminality was not boosted by the accession of ten countries.

In June 2004, very soon after the EU enlargement, the citizens of the 25 EU member states elected their representatives to the EU Parliament. The Hungarians also voted in the Europe wide elections. The ratio of those Hungarians who appeared to cast their votes to the total number of registered voters was 38.5 %. It was surprisingly low.

The result of the elections was, however, less surprising. Out of 24 seats in the European parliament, only 11 seats were allocated to the ruling coalition (9 socialists and 2 liberal democrats), and 13 seats to two opposition conservative parties (12 FIDESZ representatives and 1 MDF). The outcomes of the elections showed some signs of disappointments of the Hungarian population concerning the ruling coalition government and the EU membership.

Another symbolic event of the further progress of EU integration was the elaboration of the first EU Constitution. The text of the Constitution was drafted by the European Convent and was finalised and signed by the heads of state and government of the member states. At this latter stage Hungary could achieve that the recognition of minority rights were included in the text. Then, the ratification process of Constitution Treaty started. Meanwhile many politicians and people all over the Europe criticised Constitution Treaty, the Hungarians expressed less criticism against it. Hungary was the second EU member state whose Parliament ratified the Constitution Treaty. It can be considered as a kind of sign of political support given by a new member state to the process of further development of the political integration in Europe.

A public debate in the professional circles on the new Financial Perspective (2007-2013) got some momentum when the issues of CAP (Common Agricultural Policy) and the regional policy were in the focus. Hungary, like several new EU member states has strong interests to preserve the former support mechanisms of both policies. As a country having substantial agricultural production potential and below EU average development level, Hungary is entitled to benefit from both financial sources. It is an unfortunate situation that Hungary is more interested in maintaining the old allocation mechanisms of the EU budget than in reforming them in line with proposals which would give more emphasis in the distribution of financial resources among the EU budget items to the policy goals declared in the Lisbon Agenda aiming at improving the global competitiveness of the EU.

The membership significantly improved the political conditions and possibilities for a further regional cooperation among the Visegrad countries (the Czech Republic, Hungary, Slovakia and Poland). The Hungarian government gave priority to this relation in many respects and urged very often the other countries of the group to forge stronger unity. The particular national interests and actual political actions of these countries, however, prevented them from achieving significant progress in this field. In spite of these political obstacles the regular summit meetings and cooperation at various levels of the state organs had some undoubtedly positive impacts on the relations among these countries.

As it was experienced, to be a candidate country and to be a member country is sometime very different position. Hungary was considered to be rather successful prior to the accession in gaining benefits from the co-operation with the EU and its member states. As a member state, Hungary is seen to be less efficient by many observers because it has not been able to represent and to assert its economic interests in every field well enough. The particular skill of coalition building with other member states within the EU during the negotiations of certain policy issues should be still acquired. Moreover, it has happened often that other new member states turn to be competitors and not partners. This situation deteriorates the bargaining position of Hungary. One can consider the ratio of implementation of Internal Market rules as a certain kind of degree of integration into the EU and strength of commitment to carry out the common targets. The Internal Market plays a key role in achieving the EU's objectives of creating more growth and jobs, as well as bringing forward the integration process in Europe by creating market conditions under which the resources can be allocated more efficiently and better trading opportunities can be offered to business. But the Internal Market can only achieve its full potential if legislation agreed at community level is effectively implemented and correctly applied by all member states. The latest records show that Hungary performed relatively well in implementing agreed Internal Market rules into its national law. The deficit of Hungary is much below the 1.5 % interim target agreed in 2001. This is due to the continued efforts to implement and exchange best practice, as set out in a 2004 Commission Recommendation. According to the Commission evaluation the implementation not always meant correct transposition and application of these Internal Market rules. This is the reason why there are some infringement proceedings against Hungary, too. The overall evaluation may indicate that Hungary was the 8th or 9th best performing among the 25 member states.

Table 1
Internal Market Scoreboard – the performance of Hungary

| | performance of Hungary | rank of Hungary | best performing other member state | worst performing other member state |
|---|---|---|---|---|
| Transposition deficit as at 11 November, 2006 (1634 directives) | | | | |
| transposition deficit (in %) | 0.9 | 9 | 0.3 | 3.0 |
| number of directives | 15 | | 5 | 49 |
| Performance in meeting 0 % target for directives whose transposition is over 2 years late, as at 11 November, 2006 | | | | |
| number of directives | 1 | 9-12 | 0 | 9 |
| Average number of implemented recommendations, as at 11 November, 2006 | | | | |
| no. of recommendations | 21 | 4 | 22 | 10 |
| Number of open infringement proceedings, as at 11 November, 2006 | | | | |
| no. of open cases | 22 | 8 | 11 | 161 |

Source: European Commission IP/07/126

## *2. Economic performance of Hungary in the context of EU accession*

### *2.1 Macroeconomic aspects*

In several areas the new EU member states have showed better economic performance than the old member states. The economic growth rates (GDP) in the new member states have been about 2 to 7 percentage points higher than in the old member states. The new member states have made more progress in the fields of economic liberalisation and introducing reforms than the old ones. Moreover, the new member states have been more accurate and active in transposing and implementing the new community rules (regulations and directives) which are the most recent pieces of the acquis communautaire. Hungary has showed a mixed picture. Her relative economic performance (e.g. GDP growth rate, budget deficit, external balances, etc.) has deteriorated compared to the other new member states since the accession to the EU but it has been better in some aspects compared to that of several old member states.

Table 2
Main macroeconomic indicators of Hungary (in %)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006[1] |
|---|---|---|---|---|---|---|---|
| GDP growth rate | 5.2 | 4.1 | 4.3 | 4.1 | 4.9 | 4.2 | 3.4 |
| budget deficit in % of GDP | -3.0 | -3.5 | -8.4 | -6.4 | -5.4 | -6.2 | -8.9 |
| current account deficit in % of GDP | -8.6 | -6.1 | -7.1 | -8.1 | -8.5 | -6.8 | -4.0 |
| consumer price index | 9.8 | 9.2 | 5.3 | 4.7 | 6.8 | 3.6 | 3.2 |
| unemployment rate | 6.4 | 5.7 | 5.8 | 5.9 | 6.1 | 7.2 | 7.3 |

Note: [1] estimated
Source: Hungarian Statistical Office, Statistical Yearbook

Of course, the EU accession influenced the economic performance of the new member states, including that of Hungary. It is, however, very difficult to distinguish the economic impacts of EU accession from the impacts of other factors. To tell that certain favourable or unfavourable economic development was exclusively due to the EU membership is hardly possibly. It can be, however, supposed that prior to the accession positive impacts of EU integration were stronger than the negative ones. These positive impacts included a gradual abolition of tariffs, opening-up markets, increase in FDI, building up of the institutions of a market economy, increasing competition, etc. Some of these positive impacts gradually was phasing out and ceased to exist after certain time. Moreover, some negative impacts of EU integration after the accession became even stronger. The Hungarian economy became more dependent on the changes in the business cycle of the old member states, particularly that of Germany.

Since 2004, not only the global economic situation has been weak but the Gdp growth rates of the old EU member states have been also moderate. Such global macroeconomic situation did not support at all the economic dynamism in the new member states. In Hungary, economic stabilisation policy measures had to be introduced very soon after the EU accession. The declared main aim of the Hungarian economic policy was to reduce domestic demands and to shift the economy back onto an export-led economic growth path. The external and internal conditions brought about declining economic growth rate in Hungary. This situation deteriorated the public perception of EU membership.

### *2.2 Microeconomic aspects*

The opening up of the Hungarian domestic market for the global competition was one of the most important economic policy decisions at the beginning of the systemic change and transition to a market economy at the end of 1980s. The liberalisation process directly affected the microeconomic sphere in the early 1990s. Hungarian firms became more exposed to the direct impacts of the world economy and the changing conditions of the global markets. The EU accession process had also a very crucial importance because not only the exposure of Hungarian firms to the impacts and conditions of the European markets increased very substantially but due to the necessary and obligatory transposition of the market rules and regulations of the EU changed business environment and conditions very radically in Hungary like in every other new member states.

The process of liberalisation and transposition of EU rules and regulations (acquis communautaire) was gradual but sometime very radical. These changes profoundly altered the market conditions, touched vested interests of firms and sectors as well as created negative and positive impacts. Most of the changes took place during the accession process but there were changes which were completed just by the time of the accession. The expectations of the firms indicated a changing business climate regarding the impacts of EU membership. Just prior to the accession the « positive» and « negative expectations » and « no expected impact » replies were almost balanced; each of them represented roughly one third of the opinion of business people. It showed that the preparation for EU membership was completed in the larger part of the economy and a smaller part of it only had still fear of the consequences of the EU accession. A year later the picture changed in that sense that meanwhile the share of those who had fear of the accession slightly decreased the share of those who still expected some new « positive impact » declined radically and the share of those who did not expect any new impact increased substantially. These figures can be interpreted in such a way that the larger part of the economy was prepared for the membership and did not expect any particular new change. The main trends continued during the second year of the EU membership. The share of those who still expected negative impacts slightly further declined but remained significant. It can be explained by the competition of the single market, the impact of which increased.

Table 3
Business climate evaluation – types of expected impacts of EU accession

| expectations | 04.2004 | 05.2005 | 01.2006 |
|---|---|---|---|
| negative | 36 % | 34 % | 29 % |
| positive | 31 % | 13 % | 21 % |
| no impact | 33 % | 53 % | 60 % |

Legend: negative expectations: realistic; positive expectations: too optimistic; no impact: underestimated (services, construction industry, state owned companies)
Sources: Gki for 2004 and 2005, Institute of Market Research for 2006

If one regards the three types of expectations by sectors of the economy the preparedness for EU membership and the competitiveness of sectors can be evaluated. Above average positive impacts of EU membership were expected in the R&D sector, services, tourism, communication, construction industry and metallurgy whereas below average negative impacts of EU membership were expected in the following sectors: transport, vehicle dealer, petrol trading, retail trade, textile, clothing and garment.

The general public supposed that the EU membership would boost the consumer prices and the inflation rate would increase significantly. In fact, the EU accession did not have any noticeable price effect. The price level adjustment took place already during the previous decade in relations with the transition to a market economy and economic liberalisation. One thing is, however, worth to mention. Meanwhile there was no significant change in input prices the producer prices increased by an even lower rate. The producer prices could not follow the input prices because of the increasing competition due to the EU membership.

Undoubtedly, the EU membership had certain costs effects because the EU rules and regulations resulted in new or increased financial costs, e.g. higher standards of environment protection, stricter rules of safety in work and health protection, administrative expenditures, etc. Some of these rules became effective at the accession and others will enter into force gradually in the coming years because the Accession Treaty provided some concessions or derogation and transitory arrangements.

*3. Foreign trade*

The main trends of foreign trade have been favourable since the accession. Total exports have increased more substantially than total imports did. Meanwhile the exports increased by 12 to 17 % the imports grew by around 10 % annually. It resulted in a gradual decrease in the deficit of the balance of trade since 2004.

The structure of the increase in the total exports is favourable because the more substantial increases were produced by sectors having the largest value added, e.g. machinery and manufacturing. This trend can be observed in all three relations i.e. EU-15 and EU-7 (new Central European EU member states) and extra EU .

During the EU accession process a free trade was gradually established with the EU-15 and Cefta countries. On the eve of the EU accession all remaining trade restrictions vis-à-vis the other old and new EU member states were abolished and the custom tariffs of the custom union vis-à-vis the rest of the world were implemented. It seems that the changes in the tariffs contributed to shifts in the geographical distribution of foreign trade. It is still a question whether these changes alone could induce those shifts in the shares of the three relations (EU-15, EU-7, and extra EU) which can be observed in the statistics of 2003 throughout 2006.

The share of the EU-25 within the total exports of Hungary reduced from 81.1 % in 2003[1] to 71.9 % in the first five months of 2006. The share of the EU-15 declined more substantially from 73.6 % to 60.4 % as the share of the other seven Central European new EU member states increased from 7.5 % to 11.5 % during the same period. Moreover, the share of the rest of the world grew from 18.9 % to 28.1 %. Summing up, it can be seen that the share of the EU-15 in the Hungarian exports has incessantly declined and those of the other seven Central European new EU member states and the rest of the world continuously increased since the EU accession of Hungary in 2004. In value term, the Hungarian exports during this period into the countries of EU-15 almost stagnated or slightly increased meanwhile those into the other seven Central European new EU member states and to the rest of the world increased annually by about 40 % and 25 %, respectively.

In the case of the total imports of Hungary between 2003 and 2006, the same trends in the geographical composition can be observed. The only significant difference between the trends in the exports and imports was that the shifts were continuous in the former case whereas the shifts were fluctuating very much in the latter case. The share of the EU-25 in the total Hungarian imports declined from 63.1 % in 2003 to 62.2 % in the first five months of 2006. Meanwhile the share of the EU-15 declined from 55.2 % in 2003 to 53.1 % in 2006 and the share of the seven Central European new EU member states increased from 7.9 % to 9.1 % during the same period. The combined share of the countries of the rest of the world also increased from 36.9 % in 2003 to 37.8 % in 2006. In all three relations, there were relatively substantial fluctuations. Summing up, it can be observed that the share of the EU-15 in the

[1] This is a hypothetical figure as it was composed of the data of Eu-15 and those of then Eu candidate countries.

Hungarian imports has declined and those of the other seven Central European new EU member states and the countries of the rest of the world increased during this period. In value term, the Hungarian imports from the EU-15 slightly increased meanwhile those from the seven Central European new EU member states and from the rest of the world increased annually by about 15 to 20 %. The increase in the share and the value of imports from the rest of the world can be explained first of all by the purchase of oil and gas, which represents a significant part of the total imports of Hungary from Russia. The energy price increase during the recent years is reflected in the shifts in the geographic structure of total imports.

In the past several research papers analysed the changes in the foreign trade turnover of the EU member states. The experience of the EU member states showed that the higher the level of economic development the higher the level of potential trade within a customs union. Moreover, increasing economic development would boost substantially the sub-regional trade turnover within the customs union. The recent development in the Hungarian trade turnover with the other seven Central European new EU member states re-confirms these findings.

A provisional conclusion of analysing the first two and half year trends of foreign trade of the EU member Hungary can be summarised very briefly. The EU membership implied new trade policy rules because the adaptation of the common trade policy had to be completed by the date of accession. Moreover, the main trends of global economy also changed during these years. Due to the new trade policy rules and the changing world market conditions the foreign market positions of Hungary became stronger. The relative importance of the EU-15 remained but the share of the rest of world increased due to the very dynamic increase in trade turnover in this relation.

Table 4
Foreign trade of Hungary

| | 2003 | 2004 | 2005 | 2005 (I-V)[1] | 2006 (I-V)[1] |
|---|---|---|---|---|---|
| EXPORTS | | | | | |
| total | | | | | |
| value (mio €) | 38,100 | 44,672 | 50,246 | 20,531 | 24,127 |
| growth rate | 4.4 % | 17.2 % | 12.5 % | | 17.5 % |
| intra EU-25 | | | | | |
| value (mio €) | 30,935 | 35,457 | 38,335 | 15,078 | 17,339 |
| growth rate | 3.6 % | 14.7 % | 8.1 % | | 15 % |
| share in total | 81.1 % | 79.4 % | 76.3 % | 73.4 % | 71.9 % |
| intra EU-7 [2] | | | | | |
| value (mio €) | 2,855 | 3,858 | 5,429 | 2,037 | 2,783 |
| growth rate | 17.5 % | 35.1 % | 40.7 % | | 36.6 % |
| share in total | 7.5 % | 8.6 % | 10.8 % | 9.9 % | 11.5 % |
| extra EU | | | | | |
| value (mio €) | 7,161 | 9,215 | 11,911 | 5,453 | 6,788 |
| growth rate | 7.9 % | 28.0 % | 29.3 % | | 24.5 % |
| share in total | 18.9 % | 20.6 % | 23.7 % | 26.6 % | 28.1 % |
| IMPORTS | | | | | |
| total | | | | | |
| value (mio €) | 42,263 | 48,668 | 53,159 | 21,977 | 25,566 |
| growth rate | 6.1 % | 15.2 % | 9.2 % | | 16.3 % |
| intra EU-25 | | | | | |
| value (mio €) | 26,663 | 32,565 | 35,858 | 14,077 | 15,906 |
| growth rate | 4.8 % | | 10.1 % | | 13 % |
| share in total | 63.1 % | 66.9 % | 67.5 % | 64.1 % | 62.2 % |
| intra EU-7 [2] | | | | | |
| value (mio €) | 3,357 | 4,344 | 5,189 | 1,894 | 2,315 |
| growth rate | 14.1 % | 29.4 % | 19.5 % | | 22.2 % |
| share in total | 7.9 % | 8.9 % | 9.8 % | 8.6 % | 9.1 % |
| extra EU | | | | | |
| value (mio €) | 15,600 | 16,103 | 17,301 | 7,900 | 9,660 |
| growth rate | 7.6 % | 3.2 % | 7.4 % | | 22.3 % |
| share in total | 36.9 % | 33.1 % | 32.5 % | 35.9 % | 37.8 % |
| BALANCE OF TRADE (mio €) | | | | | |
| total | - 4,200 | -3,996 | -2,912 | -1,446 | -1,378 |
| intra EU-25 | 4,272 | 2,892 | 2,478 | 1,001 | 1,493 |
| intra EU-7 [2] | -501 | -486 | 236 | 134 | 587 |
| extra EU | -8,439 | -6,888 | -5,390 | -2,447 | -2,871 |

Note: [1] extra EU data for the period Jan-June
[2] EU-7 : the other 7 Central European new EU member states
Source: Eurostat and own calculation

*4. Commodity structure of foreign trade*

The commodity structure of the Hungarian foreign trade went through significant changes during the last decade. Both the total exports and the exports to the EU was characterised by two main trends. First, the shares of natural resource intensive products and unskilled labour intensive goods declined from about 50 % in 1989 to approximately 10-12 % in 2003 and from about 20 % to 15-18 %, respectively. Second, the shares of technology intensive goods and human capital intensive products increased from about 20 % to 45 % and from about 10 % to approximately 25 %, respectively during the same period. These trends practically continued after the accession.

As it was shown above, the Hungarian foreign trade with the new member states grew faster than with the old member states after the EU enlargement. The Hungarian exports into this group of countries have increased faster than imports from them since the accession. The Hungarian exports were made up dominantly by manufacturing products whereas the imports was characterised by a significant increase in food and agricultural products.

Since the EU accession, the changes in the commodity structure of the Hungarian foreign trade have had some characteristic features. While the general competitiveness of the Hungarian exports improved the position of the agriculture sector deteriorated because its imports were increasing more dynamically than its exports into the EU markets. The Hungarian agricultural products were not less demanded but the competition in the Hungarian agricultural product market increased substantially because of the rapidly growing imports. That is, the increase in the exports of agricultural products was by two percentage points higher than the total export growth, and meanwhile the increase in the imports of agricultural products was twice as much as the growth of total imports. The position of the exports of Hungarian agricultural products improved in the non-EU markets only. It could be resulted in by the protectionist effects of CAP (Common Agricultural Policy).

In the case of the imports of Hungary, it was the supply of agricultural products from the other seven new Central-European EU member states which increased to the largest extent among the commodity groups. The exports of Hungarian agricultural products to these seven new member states increased also substantially but not as much as the imports. It seems that the complete abolishment of trade barriers for agricultural products on the day of accession had still effects even two years later. As the imports increased more than the exports the outcome is that the Hungarian market position deteriorated.

The trade turnover of machinery and transport equipments produced some changes in the main trends. Due to very dynamic increase these products became the most important export items in the total exports of Hungary during the last decade. Since the accession the annual growth rate of their export to the EU-15 has declined. In the last year it practically stagnated. Meanwhile the exports of these products into the other parts of the world substantially increased. In 2005, the growth rate of the value of the exports of these products into the new member states and into the non-EU countries was 52 % and 36 %, respectively.

Table 5
Commodity structures of exports and imports of Hungary

| EXPORT | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| | | | | | | |
| Total exports, fob, HUF mn [1] | 7942804 | 8748170 | 8873970 | 9643710 | 11232376 | 12425491 |
| Total exports, fob, EUR (ECU) mn [1)2)] | 30545 | 34082 | 36523 | 38041 | 44630 | 50093 |
| | | | | | | |
| **SITC commodity groups** [1] | | | | | | |
| Food and live animals | 6,5 | 7,1 | 6,5 | 6,2 | 5,7 | 5,5 |
| Beverages and tobacco | 0,4 | 0,4 | 0,3 | 0,3 | 0,3 | 0,3 |
| Crude materials, inedible, except fuels | 2,1 | 1,8 | 1,8 | 1,8 | 2,0 | 1,8 |
| Mineral fuels, lubricants, etc. | 1,8 | 1,9 | 1,6 | 1,6 | 1,9 | 2,7 |
| Animal and vegetable oils, fats, waxes | 0,3 | 0,2 | 0,2 | 0,2 | 0,2 | 0,2 |
| Chemicals and related products, n.e.s. | 6,6 | 6,6 | 6,6 | 6,9 | 7,4 | 8,1 |
| Manufactured goods class. by materials | 10,7 | 10,6 | 10,3 | 10,3 | 10,1 | 10,2 |
| Machinery and transport equipment | 60,0 | 57,6 | 58,7 | 61,1 | 62,4 | 61,9 |
| Miscellaneous manufactured articles | 11,5 | 12,8 | 13,1 | 10,6 | 9,6 | 9,2 |
| Commodities not classified by kind [3] | 0,0 | 1,0 | 0,9 | 0,8 | 0,3 | 0,2 |

| IMPORTS | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| | | | | | | |
| Total imports, cif, HUF mn [1)2)] | 9064022 | 9665060 | 9704100 | 10695408 | 12218949 | 13145545 |
| Total imports, cif, EUR (ECU) mn [1)2)3)] | 34856 | 37654 | 39939 | 42189 | 48550 | 52996 |
| | | | | | | |
| **SITC commodity groups** [1)2)] | | | | | | |
| Food and live animals | 2,5 | 2,7 | 2,8 | 2,8 | 3,3 | 3,6 |
| Beverages and tobacco | 0,2 | 0,2 | 0,2 | 0,3 | 0,4 | 0,5 |
| Crude materials, inedible, except fuels | 2,0 | 1,8 | 1,8 | 1,8 | 1,7 | 1,6 |
| Mineral fuels, lubricants, etc. | 8,4 | 8,2 | 7,5 | 7,7 | 7,3 | 10,2 |
| Animal and vegetable oils, fats, waxes | 0,2 | 0,2 | 0,2 | 0,2 | 0,1 | 0,2 |
| Chemicals and related products, n.e.s. | 8,8 | 9,0 | 9,3 | 9,7 | 9,5 | 9,6 |
| Manufactured goods class. by materials | 16,5 | 16,3 | 16,4 | 16,1 | 16,0 | 14,4 |
| Machinery and transport equipment | 51,5 | 51,6 | 52,0 | 51,6 | 52,9 | 51,1 |
| Miscellaneous manufactured articles | 9,8 | 9,5 | 9,4 | 9,4 | 8,4 | 8,5 |
| Commodities not classified by kind [4] | 0,0 | 0,5 | 0,4 | 0,5 | 0,4 | 0,4 |

Source: Central Statistical Office, Foreign Trade Statistical Yearbook

*5. Structural development and modernisation of the Hungarian economy*

One of the most important expected positive impacts of the EU accession was an additional acceleration of the modernisation process and structural development of the Hungarian economy. Most of these expectations were fulfilled. Being part of the internal market of the EU enabled four mechanisms to exert positive effects on catching up: product and process specialisation in products and service markets; foreign direct investment (FDI); competitive exposure; and the reduction of distortions.

One of the most important measures of competitiveness is the increase in productivity. Hungary has been able to maintain its second position among the eight Central-European new EU member states since the accession. The level of labour productivity of Hungary exceeded the 70 % of the EU average in 2005 which meant a 2 percentage point increase compared to the level in 2004. The improving competitiveness is indicated by the unit labour costs statistical figures as well. After having stagnated in 2004 the unit labour costs decreased in 2005. It was resulted by a declining gap between the real wage increase and the real GDP growth rate.

Table 6
Labour productivity in manufacturing industry (annual growth rates in %)

| | |
|---|---|
| 1993 | 18,1 |
| 1994 | 19,7 |
| 1995 | 10,7 |
| 1996 | 5,1 |
| 1997 | 11,8 |
| 1998 | 12,0 |
| 1999 | 11,1 |
| 2000 | 20,3 |
| 2001 | 4,3 |
| 2002 | 4,4 |
| 2003 | 4,4 |
| 2004 | 13,2 |
| 2005 | 12,7 |

Source: Hungarian Statistical Office, Statistical Yearbook

The foreign direct investments (FDI) have substantially contributed to improve the competitiveness of the Hungarian economy. The inflow of FDI increased substantially after the EU accession and it reached a record breaking size in 2005. This trend continued in the following year as well. A detailed analysis of the three components of FDI sources proves that Hungary has remained an attractive place for investments in spite of the increasing macroeconomic imbalances.

The structure of the FDI has changed in positive sense because the share of assembly plants among the FDI company units has decreased and the shares of company units producing higher value-added products or those units which specialised in R&D activities have increased since the EU accession.

A FDI can be analysed whether it is well embedded into the local economy and is linked to the local firms (suppliers) or not. The factor endowments, relative costs, has differed between the EU-15 and Hungary, so called « vertical » FDI exploited this advantage through concentrated output in Hungary and exports to the EU-15. Under such conditions the roles of local suppliers are limited. This situation could be witnessed also in Hungary. The so called « horizontal » FDI is based on scale economies at the company level[2]. Experience of previous enlargements showed that « vertical » strategies became dominant for quite a while after the accession because of the prevailed disparity. The shift from « vertical » to « horizontal » strategies in Hungary has started since the EU accession.

Table 7
FDI inward stock (mn Eur) and annual increase calculated on two different bases

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| stock[1] | 24,578 | 31,045 | 34,575 | 38,329 | 45,956 | 51,590 |
| annual increase | 1,530 | 6,467 | 3,530 | 3,754 | 7,627 | 5,634 |
| equity capital, reinvested earnings and loans[2] | 2,998 | 4,391 | 3,185 | 1,888 | 3,633 | 5,559 |

Notes: [1] figures are based on declarations of firms (International Investment Statistics)
[2] figures are based on balance of payments statistics of Hungary
Source: Wiiw

Besides the technology import the intra-industry specialisation in the single market showed positive effects on the modernisation of the Hungarian manufacturing industry and economy. The technology import has increased substantially since the EU accession. The on-going fast intra-industry specialisation has exerted an upward pressure on the productivity, wages, of workers with skills demanded for export production.

Prior to the accession process some sectors of the manufacturing industry enjoyed high national protection. The EU trade protection is not only far lower but also declining secularly since the mid-1980. The sectors, which are most exposed to this trend are the textiles and clothing, steel, etc. So adjustment has taken place through steady exit of firms and workers. This process has speeded up since the EU accession. The shares of these sectors have declined more rapidly within the manufacturing industry.

The rationalisation has been combined with product innovation and better market responsiveness. This process has speeded up since the accession. Moreover, the catching-up process is conditional on radical diversification leading to absorption of

[2] It implies that headquarters tend to establish in less developed member states and several (low-scale) plants are scattered through Europe, in order to be closed to consumers. Large, rich and growing markets are then the most attractive.

the human resources left idle. From this point of view the qualification of the labour force has particular importance.

The modernisation and structural adjustment process received an additional boost by the EU accession. The structural changes within the manufacturing industry speeded up. The shares of the relatively low value-added sectors declined. These sectors are usually of raw-material and labour intensive (e.g. food products, textiles, leather, wood and paper, etc.). In contrary to this trend the shares of high value-added sectors in the total production of manufacturing industry increased (e.g. electrical and optical equipments, chemicals, transport equipment, etc.). Most of the FDI took place in these sectors since the EU accession. They increased the technical quality of products, the demand for high skilled labour, and the competitiveness of these firms.

Table 8
Structure of production in manufacturing industry (in % of total)

| **NACE** | **2001** | **2002** | **2003** | **2004** | **2005** |
|---|---|---|---|---|---|
| | | | | | |
| Food products, beverages and tobacco | 16,2 | 16,5 | 15,5 | 14,1 | 12,3 |
| Textiles and textile products | 3,2 | 3,0 | 2,6 | 2,3 | 1,9 |
| Leather and leather products | 0,6 | 0,6 | 0,5 | 0,4 | 0,4 |
| Wood and wood products | 1,2 | 1,2 | 1,2 | 1,1 | 1,0 |
| Pulp, paper & paper prod; publishing & printing | 4,5 | 4,3 | 4,1 | 3,6 | 3,6 |
| Coke, refined petroleum prod. & nuclear fuel | 5,0 | 4,4 | 4,1 | 5,0 | 6,6 |
| Chemicals, chemical prod. & man-made fibres | 6,9 | 6,9 | 7,1 | 7,0 | 7,5 |
| Rubber and plastic products | 3,7 | 3,9 | 3,8 | 3,6 | 3,6 |
| Other non-metallic mineral products | 2,8 | 3,0 | 2,9 | 2,6 | 2,8 |
| Basic metals and fabricated metal products | 8,1 | 7,5 | 8,0 | 8,7 | 8,2 |
| Machinery and equipment n.e.c. | 4,3 | 5,6 | 5,5 | 5,2 | 5,2 |
| Electrical and optical equipment | 27,3 | 27,1 | 28,4 | 30,4 | 30,4 |
| Transport equipment | 15,0 | 14,5 | 15,4 | 14,8 | 15,4 |
| Manufacturing n.e.c. | 1,3 | 1,5 | 1,1 | 1,1 | 1,1 |
| | | | | | |
| | 100,0 | 100,0 | 100,0 | 100,0 | 100,0 |

### *6. Impacts of financial transfers from the EU budget: Structural Funds, Cohesion Fund and CAP*

One of the most attractive impacts of EU accession was the increasing access to EU financial resources. The less developed Central European countries, like Hungary need the financial support coming from the EU budget so that they would be able to catch up with the higher development levels of the old member states. During the pre-accession period Hungary also received financial supports from the PHARE, ISPA and SAPARD programs and after the accession it became entitled to benefit from the budgets of EU community policies. During the first two years the total amount of received financial supports was less than it was originally expected. The less generous support can be explained by the relatively short time for gaining experience, previously unknown administrative procedure, and it happened during last years of the out-going Financial Framework (2000-06). The new Financial Framework (2007-2013) will allocate about bn 1 Eur annually during the whole period. There are some features, which make the rules of the financial support more favourable. Until the end of 2006, the ratio of national budget and EU budget contributions to the development projects was 50 to 50 %. From 2007 onwards this share will changed to 15 to 85 %. Moreover the small and medium sized enterprises will receive more attention, and the structural programmes may include urban area rehabilitation and road reconstruction.

Hungary could maintain its position in the leading group of new member states, which could benefit the most from the EU financial supports. From the European Regional development Fund (Erdf) which is the most important Structural Fund, Hungary could draw 48 % of the allocated bn 1.24 EUr for the 2004-06 years. The n+2 years rule will allow to draw the still remaining amount. This record qualified Hungary to the third place behind Slovenia (60 %) and Estonia (50 %). According to the evaluation of the Commission Hungary successfully managed its operational programmes (OPs). The most successful operational program was the « economic development and competitiveness » one but the « environmental protection », « infrastructure development » and « regional development » operational programmes performed also well. The government policy aims at utilising the whole amount of the financial support of about bn 2 Eur which is available from the Structural Funds until 2008.

The Cohesion Fund provides an additional bn 1.5 Eur for infrastructure development and environmental protection projects. The absorption rate of the available financial supports from this Fund was about 35 % at the end of 2006. This was resulted in a particularly good performance in 2005 and a weak performance in 2006. The combined ranking put Hungary on the sixth place at the end of 2006. Five new member states (the Czech Rep., Slovakia, Estonia and Latvia) outstripped Hungary.

The agriculture sector, which traditionally benefits from the EU budget caused one of the largest problems to be solved before the enlargement. The first evaluations showed that the EU enlargement had net positive effects on the agricultural sectors of both the old and the new member states. The producers and traders of agricultural goods in the old member states could extent their markets and acquire agricultural processing units in the new member states. In the new member states, the subventions and financial supports for agricultural production substantially increased, its profitability improved, compared to the pre-accession period. The issues and problems of environmental protection and the food safety received more attention. The general changes in the prevailing situation could be characterised similarly.

For the EU side the financing capacity of the budget was alarming question of the enlargement. The solution was some reform measures and the implementation of a direct payment system in the new member states, which provides substantial less financial support for their farmers from the EU budget at the beginning. This gap will be gradually reduced but not eliminated until 2013. The difference in financial support can be further reduced by additional financial support from the national budgets of the new member states (topping up) but even the combined amount does not reach the financial support level, which is provided to the farmers of the old member states.

On the new member states side the problems were more complex. In the case of Hungary the key elements of the problems have been the following. The country has a significant agricultural capacity but this sector went through a deep crisis during the last 15 years. The prevailing economic and political conditions (e.g. transition to a market economy, privatisation, changes in the demand for Hungarian agricultural products in the foreign markets, etc.) resulted in negative impacts (e.g. on the size of farms; from large scale co-operatives to many small scale private farms, quantity of production, etc.). This lower level of production determined the basis on which the financial support was calculated. The economic importance of the Hungarian agricultural sector is demonstrated by the following two statistical figures; it provided around 4 % of the GDP and employed around 5% of the total number of employed labour force in 2005.

Looking at the details of each country case, some important differences could be noticed. Several unequal competition positions have continued to exist. In Hungary also, a proportionally larger segment of the society tries to live on the income from agricultural activities than in the old member states. The problem is aggravated by the fact that the Hungarian agriculture is less productive than the generally more modernised and mechanised agriculture sector in the Western European member states. After the systemic change and the transition to a market economy the large scale agricultural co-operatives were dissolved and small scale farms were created. It resulted in that the production sphere of the agriculture is characterised by many unorganised and non-cooperative farmers in contrast to the organised, co-operating and concentrated processing units and traders in the old member states. A further element of the unequal positions is that the farmers in the new member states receive substantially less financial support in the form of direct payments than in the old member states. Moreover, a significant part of this payment comes from the national budgets of the new member states unlike the old member states where the financial support is exclusively paid from the EU budget.

The Common Agricultural Policy (CAP) has certain features, which are not favourable for the Hungarian producers. First, the CAP disfavours or does not provide financial support for certain products, which are important in the product range of the Hungarian agriculture. Pork, poultry, vegetable and fruits sectors belong to this group of products. Second, the allocation regime is biased towards big farms at the expense of small farms. The Hungarian farm structure is characterised by the domination of the latter. These conditions of the CAP result in disadvantages for the Hungarian farmers and the foreseen reforms of the system will not probably reduce but increase them. It is no wonder that there is a strong pressure from the farmers' side to preserve the generous elements of the present CAP and to refuse any further concessions in WTO negotiations.

After the accession, particular problems were created by the delay in the building up and than in the proper functioning of the CAP institutions in Hungary. The delay was caused partly by organisational reasons and an objective one connected to the necessary decision whether the country opts for SPS or SAPS. These problems deteriorated the credibility of the implementation of the CAP and generated social tension and several demonstrations of farmers. Further problems derived from the fact that the market competitiveness of certain sectors of the agriculture deteriorated in spite of the increasing financial supports (e.g. husbandry declining production and profitability). In the case of plant cultivation the crops improved, income and profitability increased but there were years when there was overproduction of certain crops, which caused declining prices and consequently deterioration in the profitability and income position of the concerned farmers. The growing imports from the other EU member states increased the competition in food product market and the dissatisfaction of the local producers in Hungary.

The net budgetary position of a member state vis-à-vis the EU budget can be calculated in three different ways. The three methods include basically the same figures on the revenue side of the national budget whereas they differ as far as the cope of expenditures and costs side is concerned. The narrowest interpretation of calculation of expenditures and costs for the member states includes the payments on the basis of GNI and Vat only out of the four own sources of the EU budget. The wider interpretation of the calculation includes the cuts in customs tariff revenue, the annual operating costs of the enlarged institution system and the effects of payments of membership fees to EU institutions and agencies and other international organisations on the national budgets. The third method takes into consideration an even wider range of costs, e.g. the financial burden of the co-financing requirements of Structural Funds and Cohesion Fund on the national budget on the one hand, and the reduction in financial needs from national budgetary sources for development purposes due to the inflows of amounts from the Structural Funds and Cohesion Fund.

The balances of these three methods of calculations may differ substantially. Using them to calculate the net budgetary position of Hungary we can reach to the following results. The balances calculated on the basis of the narrowest interpretation of costs were positive for Hungary in each year after the accession. The wider interpretation of costs and expenditures resulted in a deficit in 2004 but turned into sufficed already in 2005 and further increased in 2006. Calculation based on the third method is impossible because of the present statistical observation mechanism.

Table 9
Net budgetary position of Hungary (in mn Eur)

| | method based on narrow interpretation of costs | method based on wider interpretation of costs | Method based on the widest interpretation of costs |
|---|---|---|---|
| 2004 | 163.1 | -115.84 | n/a |
| 2006 | 359.3 | 493.8 | n/a |

Source: calculations of Ms. N. Fenyővári (2007)

This favourable net budgetary position may contribute to a faster economic development and structural change in Hungary than it could happen before the EU accession. It seems to be a reasonable argument that first of all it is not the amount of the EU financial support, which should be particularly increased but Hungary should concentrate its financial resources in accordance with the priorities of the community policies and improve the absorption capacity of the economy and last but not least the necessary changes in the structure of the budget should be completed.

## *7. Concluding remarks: what is missing - what is to be achieved*

The EU membership opened up new economic and political possibilities and in return for them it has required political and economic changes. The effects and the first experience of the membership can be shown in certain aspects but cannot be seen clearly in others. A longer term perspective will be certainly more productive in this sense. There are economic areas where the EU membership has not produced fully its expected effects. The principle of free movement of labour has not been fully implemented because of the political and economic fears of the old member states. Hungary could not join the third stage of the EMU and did not introduce the Euro because of the inadequate economic performance and missing macroeconomic preconditions. Hungary in its Convergence Program undertook the obligation that the preconditions will be fulfilled by the end of this decade and the process of joining to the Emu can be completed during the first years of the next decade. Becoming part of the Eurozone will further strengthen the economic and political integration of Hungary in the EU.

If one tries to summarise the first impacts of the EU accession the most important points are the following. The largest challenge was the increasing competition almost in all markets. There is a high trade intensity between Hungary and the other EU member states, which has been partly modified since the accession. Hungary’s real economy very much integrated in the EU and sometimes more deeply than several old member states did. The Single Market of the EU and the community policies to support cohesion has shown their first positive impacts; the Gdp/capita compared to the EU-25 average increased from 25 % in 1995 to 60.4 % in 2005. The process of economic catching-up and modernisation has continued.

Hungary has been an active member of the EU at official level. The public opinion has, however, shown a mixed picture. There has been a decline in popularity partly because the EU was used as a kind of scapegoat in several unpleasant political situations. The public interests declined in « high policy » issues (e.g. declining participation rates in the referendum on the EU accession and then on members of the European Parliament), but has increased in “low policy” issues (i.e. problems which consider the everyday life). The future economic and political tasks of the country are very closely linked to the EU. The macroeconomic balances have to be restored or improved. Active participation is needed in the preparation of fundamental reforms of the EU (e.g. budget, institutions, Constitutional Treaty, community policies). The public awareness about European integration has to be further increased. In spite of all these problems and difficulties the EU membership of Hungary can be regarded as a success both from political and economic points of view.