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Is the Automotive Industry the Remedy for Hungary's Economic Problems?*

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In recent years, Hungary has managed to attract a number of significant investments from large automotive companies. For a country immersed in a crisis this is an opportunity to not only survive the downturn, but also—if followed by further innovation—to modernise the whole economy. Due to the current visible trend of shifting production centres from Western Europe to the east, Poland should also compete for foreign automotive capital by expanding the offer of encouragement and support, as well as by reforming its domestic market.

When Daimler AG signed a letter of intent with Ferenc Gyurcsány's government in June 2008, for the construction of a Mercedes Benz plant in Kecskemét, it was a crucial moment for the Hungarian automotive industry. The project was successfully implemented in March 2012, and almost year later the very first sporting Mercedes CLA produced entirely in Hungary rolled off the production line. Daimler's decision encouraged other companies already in Hungary to expand their investments. In June a new, fully-equipped factory for Audi, which until recently was the largest European motor manufacturer, will open in Győr. Similar plans were also presented by Opel (for the expansion of the engine plant in Szentgotthárd), Robert Bosch (construction of a centre for innovation in Budapest) and Knorr-Bremse (enlargement of the production hall and laboratories in Kecskemét). If this dynamic is maintained, Hungary will become a major manufacturing hub in Central Europe.

The Automotive Industry in Hungary. The automotive sector, of which 90% is foreign owned, is of great importance for the Hungarian economy. Although domestic sales are not impressive (the number of new car registrations is one of the lowest in the EU, despite an increase of 17.6% in 2012), the role of the automotive sector in export and industry is substantial (in both cases 20-25%). Especially important is the production segment. Firstly, because Hungary is among the EU countries with the highest share of the automotive industry in GDP (4%, rising to 10% after taking into account the production of parts and accessories), and secondly, due to the plan of a gradual re-industrialisation, carried out by the government of Viktor Orbán. Automotive—the only branch of industry apart from IT and telecommunications that is developing rapidly despite the economic crisis—has already became the driver of government objectives; according to some analysts, GDP may increase this year by about 3.5% thanks to the investments of Daimler and Audi.

Hungary is attractive to outside producers—mainly those from Germany—for several reasons: labour is cheaper than in the West, there is an extensive and well-integrated "star-shaped" hub infrastructure (the road and railway networks meet in Budapest and are connected to other major cities), it is strategically well-placed at the crossroads of Central Europe, the Balkans and post-Soviet area, and has automobile traditions that reach the end of the 19th century—all of which are among the country's most important assets. Equally important is the presence in Hungary the largest suppliers of automotive parts and accessories, the close cooperation of companies with universities of technology, and the involvement of central and local authorities.

The Orbán Government's Policy on Automotive Companies. In Hungary, the automotive industry has been considered by the state as a priority since the beginning of the transition period, when (especially after the collapse of the production of three national companies—Ikarus, Csepel and Rába) an urgent need to open the market to foreign

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entities emerged. A strategy of active acquisition and promotion of foreign capital, which in the 1990s resulted in the appearance of Opel, Suzuki and Audi in Hungary, was maintained during both the Socialist governments (2002–2010) and by Fidesz, who came to power in May 2010.

An example of the compromise attitude of the Orbán government is Hungary's more flexible labour code, which was introduced under pressure from corporations, and the extension of three-year vocational training in secondary education along with a non-theoretical part (the so called VET). The automotive companies, keen to better train their staffs, took part in the consultation before this programme, which is based on a German model that combines learning theoretical and practical skills. Direct subsidies from the national budget and EU funds, granted to both Daimler and Audi, remain among the most effective tools of state support, too. A package of tax concessions has also been in effect for several years, particularly advantageous among which is an 80% exemption from corporate income tax, based on the value of investments and the jobs created.

The obvious disparity in treatment of the automotive companies compared to the banks, telecoms and hypermarkets, which in 2010 were charged with a progressive crisis tax, is on the one hand due to the authorities' belief that re-industrialisation is a condition of economic recovery; a similar diagnosis was presented by the European Commission in October 2012. On the other hand, though, the preference for the automotive industry can also be explained by the fact that Hungary is seeking a closer bond with Germany, the biggest car manufacturing nation in Europe. Although Hungary's economic dependence on this state is now very high (around 30% of exports go to Germany, while German companies invested about €4.7 billion in Hungary in 2010-2012), further cooperation will be—according to the prime minister's 2nd February statement—the strategic objective of the next two decades too. The government also hopes that the opening for the German investments will help in establishing a "special partnership" in diplomatic relations. Although Budapest could by these means gain a valuable ally in the escalating dispute with the European Commission on amendments to the Hungarian Constitution, rapprochement with Germany at the political level seems to be unlikely because of the objections of Berlin itself to the internal changes in Hungary.

Attempts to Rebuild Rába's Potential. Part of the government's strategy was also the reclamation by the state of a 74% stake in Rába, one of the oldest car manufacturers in Europe. Despite serious doubts about the profitability of the transaction, this step is an example of the government's policy of re-nationalisation (previously the role of state was increased in, amongst others, the energy company MOL, Budapest waterworks, Ferencváros football club and TakarékBank). In the case of Rába, having the government gain control may be associated with a desire to avoid the fate of Ikarus, which soon after privatisation suspended production, and the need to raise the importance of indigenous automotive companies. Rába has recently produced mainly axial connections for buses, agricultural and military vehicles. The involvement of the state as well as a strategic partnership with Volvo, signed in February, indicate that the company's ambitions are bigger: according to the agreement, Rába will gradually return to bus manufacturing for the domestic market (250–300 units per year from 2014). If this target is met, an increase in foreign activity is also expected, which in the long term could lead to Rába competing regionally with the Polish Solaris.

Perspectives for Hungary. Although a flourishing automotive industry alone will not contribute to the economic reconstruction of the country, in combination with structural changes and an improvement of the situation in other areas, it will certainly help to overcome the crisis. However, despite the positive economic conjuncture, Hungary is facing two threats. First, the reliance on a recovery of a single industry means a sudden collapse of that industry will hit the entire economy; quite significant is the example of the Czech Republic in 2008–2009, where unexpected reduction of automotive production in the West resulted in a scaling-back of domestic companies' plans, lay-offs and a slowdown in exports. Second, investments in production are temporary, if they are not followed by the development of innovation and new technologies. In the ranking of EU innovation prepared by the European Commission in March 2013, Hungary came in at number 21. Nevertheless, the long-term presence of German automotive companies, which spend most on research, and their cooperation with the Hungarian universities, as well as the government's declaration of increasing public expenditure on innovation (from 1.2% of GDP in 2011 to 1.8% in 2020) mean that Hungary has a real chance to modernise its economy in the long-run.

Recommendations for Poland. Currently, the trend of shifting production centres from Western Europe to the east is visible due to lower labour costs. Poland must take part in this race for new automotive investments. Therefore, the government in Warsaw—in addition to active engagement in attracting foreign capital by using so-called "technological diplomacy"—should consider taking action to reform the domestic market (including flexibility of the labour code, changes in VAT deduction amount), and to broaden the range of incentives and support for investors. In addition to the extension of special economic zones (SSE), direct subsidies and tax concessions should be weighed. It is also recommended that the activity of the Inter-ministerial Group for the Improvement of Competitiveness of the Automotive Industry be intensified, including an invitation to a group of representatives from the sector. Moreover, it seems to be beneficial to keep strengthening relations with the BRICS countries, mainly China and India, whose rapidly growing automotive industries may be interested in expansion in Central Europe. A good opportunity for that would be the China Expo Poland in 2013, which will be held in Warsaw in September, and in which the leading Chinese car manufacturers and exporters will participate.