

A TEMPORARY LOSS OF PACE OR THE “MIDDLE INCOME TRAP” - A COMMENTARY ON THE TASKS FOR HUNGARY’S ECONOMIC DEVELOPMENT

Péter Ákos Bod

ABSTRACT

The latest Hungarian economic growth data, though favourable, do not let us forget that in the longer term growth is weak compared to the preceding period – as well as to the performance of the East-Central European region, which is more dynamic than the European average. In order to make sense of the past decade’s relative loss of pace and lay the foundations for future development policy, it is worth placing Hungary’s case in the context of the slowing tempo typical of middle-income countries. The economic development policies currently pursued by the government are aimed at increasing output in the processing industry, and by extension exports, while relevant international experience advises that it is the higher value-added activities of the global value chain, particularly business services, which should be developed further. In this way real wages and income levels could be increased, and the economy would be less exposed to the fluctuations of international cycles.

JEL codes: E60, F43, L50

Keywords: economic growth, convergence, industrial policy, middle income trap, productivity, value chain

INTRODUCTION

In the case of an open economy, we can speak of economic growth and development – particularly on a time horizon extending beyond the prevailing business cycle – only within an international comparative framework. This is obviously true of the Hungarian economy, which is known for its very high degree of openness to the outside. The application of a longer time horizon and measuring against external standards helps us navigate the issue of how to qualify the performance of an economy at a given time, an apparently straightforward question that is nevertheless often subject to diametrically opposed interpretations. Let us take the question of economic conditions in Hungary. Hungarian economic data from the 2014–15 period to date, according to one authoritative economic analysis, qualify as very favourable by European comparison (EC, 2015). At the same

time, in the light of longer-term comparative data, Hungary can be placed among the countries with slower growth in the East-Central European (ECE) region; we will discuss the dimensions and issues of classification later.

The ECE region itself has been showing growth achievements surpassing the average among European Union member countries for some considerable time. At the same time, average growth in the EU is fairly modest by global comparison, so that even with a growth index exceeding the EU average the ECE region still does not belong among the most particularly dynamic groups of countries in the world economy. Against this backdrop, it is easy to understand, despite the Hungarian government's own confident, even enthusiastic assessments citing the latest data (albeit often growth indices of only a few quarters), why an anxious debate over Hungary's economic performance has been ongoing for some time among domestic economists. That the Hungarian economy has been losing ground on other countries in the immediate region – and particularly the faster-growing “emerging” countries – is thoroughly documented; academics treat this relative stagnation as an accepted fact (*Muraközy, 2013; Oblath, 2013; Palócz, 2013; Oblath, 2014*).

When there is a prolonged and perceptible deterioration in the dynamics of a nation's economy, the realm of politics tends to respond with initiatives aimed at remedying the situation, and Hungary is no exception. The events of the years preceding the 2008 financial crisis were rich in announcements of various initiatives, but poor in implementation and hence in results. Subsequently, amid changed external and domestic circumstances from 2010 onwards, we witnessed a high degree of government activity in this regard. This compares to 2008–2009, when the scope for action in economic policy was essentially limited to crisis management.

These consecutive phases in economic policy, following each other in quick succession, are naturally subject to the thorough critical analysis of academia. The above-mentioned and other authoritative experts, among factors leading to the loss of pace compared to the growth average in the ECE region as a whole in the immediately preceding decade, assign special significance to the frequent errors made in economic policy. These differed from period to period. Analyses dealing with the theme repeatedly cite excessive indebtedness and the simultaneous postponement of necessary reform measures at the start of the 2000s, while in the period since 2010 they blame a lack of consistency in government decisions and consequent deterioration in the predictability of doing business.

Moreover, the lag in growth of the Hungarian economy apparent in regional comparison is not the single troublesome factor. It is accompanied by – and has a certain causal relationship with – the deterioration of Hungary's position on international comparative lists measuring competitiveness, corruption and other economically relevant aspects (*Transparency International, 2014; Györfly, 2014*).

The year 2010 represents a kind of boundary line in the economic assessment of growth problems, as it spelled the passing of the short but deep recession that reached our country in the autumn of 2008 as a consequence of the financial crisis. It was also when a new government ascended to power enjoying huge scope for political manoeuvre and proclaiming a set of proactive governing policies. Rejecting the practice of stabilisation followed by its predecessors, it looked to robust economic growth to alleviate the social and economic problems arising from indebtedness and a general loss of dynamism.

The principal measures aimed at enhancing economic dynamism included the transformation of the system of welfare provision to increase employment; the introduction of a single low rate of personal income tax, and major reductions in the levels of direct taxes in general; the transformation of the structure of EU funds and accelerated drawdown of these funds; and priority state support for industrial activity and, in a broader sense, the proclamation of “reindustrialisation.” The government was also partly asserting the principles of increased economic dynamism when it included in its platform a shift in the direction of Hungary’s foreign trade and financial partnerships towards regions of dynamic growth (the “eastward opening”).

At the same time, the stabilisation of the balance of public finances using unique and non-standard tools has had a detrimental effect on the growth process, since economic players have viewed the government’s frequent improvisations and regulatory hyperactivity as injurious to legal security and predictability. As the combined consequence of a stream of economic policy initiatives, business and investor uncertainty has increased, as extensive corporate surveys have amply demonstrated (see, for example, DUIH, 2014).

Hungary’s slowing pace: a unique case or part of a pattern?

The declining tempo of economic growth is not unique to Hungary. The international financial disturbances of 2008–2009 had a powerful impact on the growth performance of the entire global economy, and not only to a temporary extent. Beyond the cyclical effects, there were also structural consequences; after 2009, for example, in what was by then a renewed phase of growth, the ratio of exports to GDP declined (*Constantinescu–Mattoo–Ruta*, 2015). In itself this has a restraining influence on the growth indices of countries which are especially open economically, with growth paths defined by continuously increasing exports. Hungary’s economy falls into this category; besides individual factors, this structural aspect may also play a part in the evolution of its growth performance since 2008. An examination of Hungarian macroeconomic indicators shows that the increasing volatility of economic variables linked to external openness is itself a factor

explaining the decline in tempo (see in particular *Oblath*, 2014a). In favourable periods, outwardly very open economies grow more rapidly than similarly developed but less open ones. However, when external conditions take a turn for the worse, they suffer deeper recessions, while sudden direction shifts in economic processes themselves weaken their ability to sustain growth (even without further changes such as political cycles).

The European economy as a whole, which influences Hungarian growth in many ways (and of course that of the other countries in the region), suffered a serious decline in the wake of the 2008 financial crisis, showing a weak and fragile growth performance in the years following the crisis. With respect to the weakness of the European economic trend, some opinions hold that the major decline of recent years and the relatively weak dynamics of the recovery phase are not attributable to cyclical factors, but rather that we must prepare for a lasting period of stagnation not only in Europe, but also in the other rich, developed (core) countries of the global economy (*Teulings–Baldwin*, 2014). Accordingly, this is not an issue affecting only a group of countries or a continent; the danger of prolonged stagnation may be lurking for all those countries that have achieved a high level of development and income. In this way, the question of the actual *income level* enters the discussion of growth capacity and tempo as an explanatory factor; the above-mentioned volume of studies on the secular stagnation awaiting developed countries places precisely this aspect at the focus of its analysis.

All this has seemingly led us far astray from an explanation for the measurable decline in the long-term pace of growth of the Hungarian economy, since our country cannot be regarded as rich: on international lists it generally falls into the *middle-income* group, or *upper-middle income* group if the categories are broken down further. The phenomenon of relative stagnation, does not, after all, appear to be affected by the income level issue, since numerous countries in our region in a similar situation and with a similar level of development have shown a better growth performance than Hungary for a longer time on average. And yet it may still be significant that Hungary is a moderately developed country according to macroeconomic indicators describing the income and wealth situation, since many international comparative analyses show the usual pace of growth routinely slowing once an economy rises above a certain level of development (see, for example, *Eichengreen–Park–Shin*, 2011). The authors found that when GDP per capita reaches the USD 15,000 level, the pace of economic growth abruptly diminishes. However, they merely demonstrated the statistical connection, without discussing the factors explaining the phenomenon or whether an antidote exists – and if so, what it might be.

A wealth of statistical data and observations support the idea that what we are dealing with is a straightforward *growth trap* with respect to the moderately de-

veloped countries (Gill–Kharas, 2007). Researchers on this topic perceive this trap lying in the fact that growth in most of the affected economies is slowing or even stopping, meaning that the bulk of these countries are unable to join the group of developed, high-income countries within the foreseeable future, and are stuck instead on the level they have reached.

The basis for forming a group can be any predetermined *threshold value* – although a comparison to some *relative position* (determined on the level of other economies) provides a more realistic assessment of the condition of a given nation’s economy. At global organisations such as the World Bank or the International Monetary Fund, the benchmark for comparison is the United States, with its very high level of national income per capita: in this context, we can speak of groups of low-income, middle-income and high-income countries.¹ These categories, as well as more refined subcategories, are created according to a given methodology. In a rapidly changing world, the classifications are naturally open to debate: the World Bank lists Hungary in the “upper middle income” group alongside Bulgaria, Romania, Serbia and Bosnia, while the formerly planned economies of Latvia, Poland, the Czech Republic, Slovakia and Croatia are placed in the group of developed (“high income”) countries – as is Russia, despite an economic structure far removed from the diversified nature of most developed economies, as well as social indicators (e.g. life expectancy at birth) which would place it among the middle-income group.

The World Bank’s official classification clearly does not provide unequivocal guidance in the matter of current levels of social and economic development, and particularly not with regard to growth paths. Country classifications by other institutions, business organisations, credit rating agencies and centres of economic analysis may differ significantly from the listing quoted above. However, one thing on which they differ little is that a very substantial number of these economies – including Hungary – are very easily distinguishable from both the developing (“third world”) countries and the leading economies which constitute the centre of economic and social growth. The latter serve as the benchmark for the less-developed countries (albeit no longer to be so unambiguously regarded as models of growth).

The theoretical problem of growth in the case of Hungary, Poland and other countries at a similar level of development is the same: whether it is possible to

¹ The principles and methods of sorting into groups can be found in the World Bank’s classification document: <http://data.worldbank.org/country> (downloaded: 12 January 2015). The basis for Hungary’s classification is its annual gross national income (GNI) figure of USD 13,260 per capita in 2013, which is truly a more appropriate measure than GDP per capita. At the same time, the equivalent Polish figure is USD 13,240 – which nevertheless earns the country a place in the high income bracket.

truly get closer to the group of the most developed countries – and if so, how. As an ever-growing volume of specialised investigative studies on the subject attest, examples of countries moving from the moderately developed group to the group of highly developed, high-income economies are rare. On arriving at the middle-income level, the rapid economic growth factors of the *Lewis Model* are progressively removed: a cheap labour force and the copying or adoption of foreign technologies.² At such times, the phenomenon of decelerating growth often appears, leading to the birth of the concept of a *middle income trap* or *middle income growth trap*.

According to the calculations of Eichengreen and his co-authors, it is primarily economies at a national income level of USD 16,700 per capita which may fall into this trap, reckoning at 2005 international prices (Eichengreen et al., 2011). Although this analysis focused on the future of the rapidly developing Chinese economy, both the measures and the driving factors underlying the phenomenon are applicable to the Hungarian economy, just as they are to all the newer EU member countries. Views, debates and heuristic opinions regarding the structure and level of development of the Hungarian economy should be placed within the context of a general dilemma affecting the status of the transition.

The phenomenon of a frequently perceptible loss of momentum among middle-income countries has generated a wealth of business and academic writing. At the same time, the terminology itself is highly misleading. There is no such trap that cannot be avoided from the start, or from which there is no subsequent escape. The opportunity remains for middle-income countries to continue catching up with the more developed regions and groups of countries (the so-called beta-convergence) – only, for some reason or another, some (a few) are succeeding, while others (the majority) are not. As a turn of phrase, the idea of an economy falling into a “trap” dramatizes the fact of relative growth failure, but it could also be interpreted to mean that what has happened with the given economy (in our case Hungary) is nothing that has not already happened to a string of other countries at a similar development level: an almost “inevitable” loss of pace. The line of questioning then focuses much more on how certain economies in fundamentally similar positions have proven more dynamic and successful in avoiding (either permanently or temporarily) the trap awaiting the middle-income countries, and how countries that have fallen into this trap might somehow be able to climb out and join the few that have succeeded.

An econometric analysis by a group of IMF economists thoroughly scrutinized a set of the affected countries (defining middle-income economies as those with

2 Noble Prize winner *Sir William Arthur Lewis* identified the process of high growth when supply of labour is abundant and capital accumulation is strong.

GDP per capita between USD 12,000 and USD 16,000), and found five principal explanatory groups of factors (Aiyar et al., 2013). The first is the *quality of institutions*: here, a weak legal order, bloated public finances and diffuse, rigid regulation all slow growth. The second group contains *demographic variables*. The third group of factors comprises *macroeconomic dimensions*: openness to foreign trade, the role of investment, influx of capital and the scale of national debt. The *economic structure* also plays a role; as a factor enhancing growth, the fourth group lists the migration of the workforce from agriculture to industry and services, as well as the process of urbanization. Finally, the *distance* from the world's leading economies impacts growth performance, as does participation in regional integration.

Other researchers, such as economists linked to the Asian Development Bank, used somewhat different methods (e.g. using GNI per capita as an indicator to measure economic development and income levels) to reach slightly different results and conclusions (Felipe et al., 2012). Based on 2010 data, 40 low-income, 52 middle-income (consisting of 38 lower middle-income and 14 upper middle-income) and 32 high-income countries are listed into groups defined by set value limits: of the 52 middle-income economies, 35 find themselves in the “middle income trap” situation. This latter group does not include Hungary according to these calculation methods, which suggest that only the possibility of falling into the trap exists in Hungary's case, while both the Polish and Bulgarian economies are seen as having good prospects of joining the high-income group. It should be noted that the grouping is based on projections of economic growth performance in the preceding period and on the time required to reach the value limits (i.e. to successfully converge on the category above).

What is particularly noteworthy in this research, beyond the always debatable prognostic assumptions and issues of methodology, is the analysis of variables illustrating development or stagnation: here, structural changes in output and exports are given great weight. The research of Felipe et al., follows the traditions of the classics of development theory (Lewis, Rostow, Kuznets, Kaldor) in prescribing a *greater proportion of more complex, higher-value, more knowledge-intensive products* to help countries successfully ascend to a higher level of productivity (and thus higher income). This notion of development is a process of generating new capabilities and new activities and scaling back others, which – if successful – results in higher real wages and encourages companies to switch to more capital-intensive production processes (op. cit., p. 46).

Convergence within limits

Based on the surveyed literature, it can plainly be seen that it is expedient to view the problems of Hungarian growth within a broader context, to attribute its concerns not exclusively to the consequences of errors in economic policy or other idiosyncratic factors, but rather to interpret them as a case study of the growth trap into which moderately developed economies can fall. Economic performance and growth potential as it stands today is anyway only partly explained by the economic course and economic policies followed in the preceding period, by the prevalence of “path-dependency.” The deterioration of economic growth capacity is typical of the region as a whole – albeit to varying degrees. At the same time, it is also true that in terms of convergence with the developed (West European) region the differences have increased recently.

The question can of course be asked: Is convergence rational as a goal of economic policy? Should not economic policy and development focus more on the economic structure and the institutions which provide the framework of economic life? In the discourse on the economic situation, the majority of both the general public and political and economic decision-makers regard the importance of convergence with the top rank as self-evident. And yet it is far from self-evident that the evolution of an indicator measuring a given country against others, against a defined reference country or particularly against some calculated value (the EU average, the United States level) should be the deciding factor in qualifying the assessment of a national economy’s performance and the direction of its economic policy. Instead we might think that the basis for qualifying a given national economy’s circumstances might lie in its performance so far and the status it attained earlier. Or that public opinion might gauge the success of a set of economic policies by the answers it offers to the country’s impending strategic tasks or structural and social policy challenges, and not by how the country stands in comparison to *others*.

Nevertheless, in both amateur and professional assessments of the situation, we have ample experience of the important role assigned to the convergence phase. What is more, it is no exaggeration to state that the speed and scale of convergence is *the strategy itself*, or an integral component thereof; meaning that it is as if the region’s countries are characterised by some kind of compulsion to measure up to others.

There are naturally many important reasons explaining this phenomenon. One of the obvious specific features of the globalization process is the simultaneity of business, political and intellectual processes, and thence the culture of constantly comparing economic and social indicators. Following their own internal logic, the organisations of integration – the European Union pre-eminently among

them – set the convergence of the less-developed members as their objective, devoting resources and specific policies to promoting this. In a less institutionalized way, every significant international organisation, convention and grouping (OECD, G20, IMF) regards progress achieved in the hypothetical convergence progress as a qualitative facet of the member countries' development.

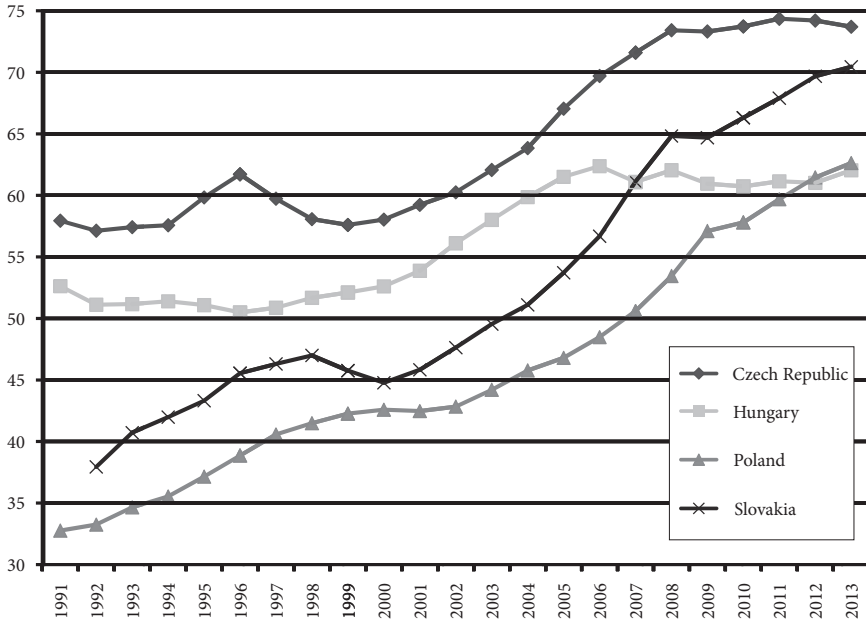
In the following we will take the convergence phenomenon and its inherent value to social policy as a given, as something which is therefore present somehow in the thinking of business and government decision-makers and opinion-formers. Under conditions in Hungary, the strength of the convergence notion is particularly easy to justify since the market economy (capitalism) emerged from the outset within the Austro-Hungarian Monarchy, albeit at a level below its more advanced territories, so that the making of continuous comparisons could scarcely have been avoided.

Within the conceptual framework of macroeconomic convergence, the speed of income convergence to the EU average and the relative level reached are the measures of its success, most often based on the progress of the per-capita GDP indicator. As a thorough study by *Gábor Oblath* (*Oblath*, 2014b) demonstrates, methodological problems make assessment of the convergence process more difficult, namely that: 1) price levels differ in the countries involved in the international comparison, and likewise do not change at the same pace either; 2) population numbers may also evolve differently; and 3) GDP is not an adequate measure of income conditions, so that other indicators should be used (such as GNI or other macroeconomic indicators revealing changes in the terms of trade). The study emphatically recommends examination of the progress of *productivity* (domestic product per capita or per completed working hour).

Oblath's assertion – in accordance with other researchers on the issue – is that the Hungarian economy has substantially underperformed in the area of European convergence compared to the Visegrád countries that constitute a natural basis for comparison. In eight of the 22 years between 1991 and 2013 no convergence at all was discernible, while in only six of the remaining 14 years was rapid convergence on the EU15 apparent based on per-capita indicators. However, adding nuance to these findings is the fact that Hungary's population declined in the meantime, while that of the EU15 increased (*Oblath*, op. cit., p. 48). In evaluating the evolution of Hungarian macroeconomic indicators, the author highlights two groups of factors: on the one hand, the unsustainable growth in gross and net external debt in proportion to GDP (between 2002 and 2008) and the subsequent debt reduction; and on the other hand, the relative slowness of progress in the quality of institutions.

Chart 1

Economic convergence in the Visegrád countries, based on GDP per capita, at purchasing power parity, as a percentage of the EU15



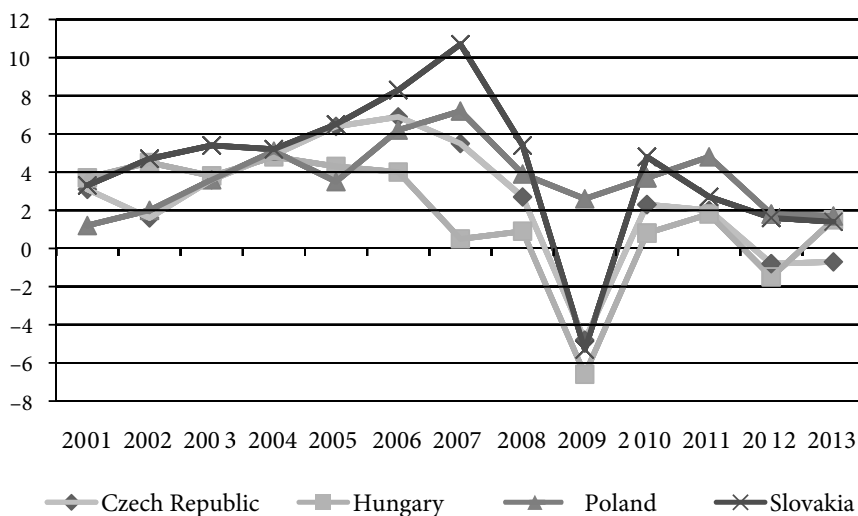
Source: Oblath (2014b), data from AMECO system

To judge the success or failure of the Hungarian convergence process, it is worth knowing that in the 1960s the Hungarian economy stood at about 50% of the GDP per capita level of today's EU15, while by the 1980s the Hungarian figure had risen to 65%–70% (Oblath, op. cit., p. 10). It is true that the period in question saw the then Hungarian People's Republic rapidly run up a large-scale external debt, for which the Republic of Hungary following the change of regime would face the reckoning. Unfortunately, it is also true that between 2004 and 2006 the 65% level was reached again, and temporarily surpassed, only at the cost of renewed severe external indebtedness.

Instead of a detailed explanation and analysis of the reasons for the relative underachievement between the mid-2000s and recent times, it is enough here to highlight the progress of Hungary's gross domestic product compared to its natural countries of reference. Even without knowledge of the political cycles and changes in direction of economic policy, a number of specific features of the fluctuation in Hungary's performance are clearly apparent. One such feature is the strong moderate growth (of around 4% annually) with which Hungary entered the second decade of the political transformation; at the same time, we know that

after 2001 this was accompanied by the rapid escalation of external debt until the end of 2006, so that for several years the economy produced indicators above the natural rate of growth. In the wake of the first substantial budget adjustment (in autumn 2006), economic growth stalled, while the other countries of the region showed rapid growth that was unusually strong even by European standards.

Chart 2
Annual growth in GDP volume in the ECE region



Source: Eurostat, Real GDP growth rate, annual % change, <http://ec.europa.eu/eurostat/eurostat/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tipsna10> (downloaded on 17.02.2015)

In response to the financial crisis unfolding in autumn of 2008, the output of most European economies declined (Poland being a notable exception). The Hungarian slump was deeper than both the European and regional average. The years following the crisis brought a fragile upswing, before the Hungarian economy fell into a recession in 2012, only reaching a growth rate (of 3.5%) corresponding to the global average in 2014. Hungary thus lagged behind the other Visegrád countries between 2005 and 2013. Its slump during the crisis was deeper than the others, while its performance in the few years both before and after the crisis was weaker: this is the statistical illustration of Hungary's underachievement.

Economic structure, institutions, economic policies

But what are the underlying factors shaping economic statistical indicators, particularly those that can be influenced by economic policy actions? Does it help our analysis if we frame the problem within the middle-income context? Research

and analysis of the topic has undoubtedly gained impetus in the past 25 years since a number of very large, powerful and thus globally significant economies joined the category to which the middle-income definition applies. The development prospects of the so-called BRIC group of countries (expanded to BRICS, and then to BRIICS with the inclusion of Indonesia) have been a particular focus of attention. If these countries or other developing countries in their wake (or a majority thereof) were to manage to rise to the income group above, it would have great significance for the global economy. As, naturally, would the disruption of these countries' earlier growth rates if, having reached this imaginary threshold, they begin to stagnate. It is therefore understandable that intensive research on these themes is ongoing under the aegis of the IMF, World Bank and OECD (OECD, 2014a).

Although the problems of Hungary's economic development differ sharply from those of the aforementioned large developing countries with their vast populations, such large-sample international analyses nevertheless provide a foothold in assessing the Hungarian situation. It is worth noting, for example, that the comprehensive OECD-sponsored study generally focused not on income levels, but rather on productivity in the economies of the affected groups of countries, even striving to provide a long-term prognosis (for 35 years) of potential development paths. As the report puts it, although there is no common conceptual framework to describe the trap in question, it is quite clear that economies on the middle-income level often suffer a loss of pace, as well as a significantly decelerating rise in their *total factor productivity* (TFP). This can be largely attributed to the fact that it is increasingly hard for them to climb higher on the *value chain* (OECD, op. cit., p. 9).

Although significant masses are initially able to migrate from agriculture to industry (mainly processing), and from there to the service sectors, with an almost automatically rapid growth in output (and increasing labour productivity and real wages), diversification into higher value-added activities is no longer a foregone conclusion once these major structural movements are complete. Moreover, some of the BRIICS countries – possessing specific natural resources and riding the wave of raw material price increases in the early 2000s – tended instead to specialize further in production activities, even though shifting further towards higher value-added operations would not only have promoted a steady rise in their income level, but would have simultaneously made the given national economy more resistant to external shocks (OECD, op. cit., p. 13).

The diagnosis of dependence on production sectors does not apply to the Hungarian economy. What does apply, however, is that there is a strong correlation between increased industrial productivity on the one hand, and the proportion of business services and productivity growth in the service sectors on the other. It is

noteworthy that while in Indonesia the input of business services accounts for just 2 thousandths of the total input of the processing industry, the equivalent figure in the French processing industry is more than 13% (op. cit., p. 21) – and in developed economies demand for business services (IT, marketing, market research, customer services, R&D, HR) continues to expand rapidly.

Recommendations put forward for another milieu can still have relevance for circumstances in Hungary, particularly when we know that economic policy responses to the loss of tempo often bring only temporary improvement – and not even that if they neglect the economy’s structural aspects. It is instructive to consider what happened during a similar period of decelerating pace at the beginning of the 1980s in Hungary (see *Bod*, 1981). As their response to the unexpected stalling of economic growth, the country’s economic leadership announced that capital must be concentrated in industrial developments with a comparatively rapid return. This seemingly sensible principle routinely prioritized manufacturing ahead of infrastructure and research. The kind of manufacturing that promised a rapid return was that which used familiar technology, where the products did not demand any great training requirement. Although it is relatively easy to acquire a presence on the global market for products that are less demanding in terms of technology, marketing and workforce, competition is also strong. The conditions for success in these product groups are tough: low wage levels, strong working discipline, precise cost calculation, and the ability to rapidly switch products and technology. Cheap wages, quick and disciplined reproduction, a strong inclination to economize: neither then nor subsequently was it possible to build a successful modernization strategy on these virtues and capabilities under Hungary’s circumstances *within the framework of European civilization*.

My research then found that profit margins attached to the subsequent phases of the value chain – from raw materials through simple bulk production to sophisticated products and services – formed a U-shaped curve: the rate of return on the unsophisticated products that provided the bulk of Hungarian manufacturing exports was situated around the low point of the U-shaped curve. The problem was not that the industrial activity shifted towards the right on the curve within our economic structure, but that the shift was *not enough* (*Bod*, op. cit., p. 34). This same idea reappeared in another form decades later, when development agencies recommended specialization in the phases that *follow* production and assembly, as well as those that *precede* the manufacturing phase, in order to evade the trap of moderately developed countries (World Bank, 2008).

The financial crisis after 2007 accelerated a rethink of what were earlier seen as evident aspects of economic development. Among the reasons for the crisis could be listed the “bubble” in the financial intermediary system, accompanied in many European countries by the decline of industry. In this way, the concept of rein-

dustrialization appeared in the wake of the crisis, attributed to Vice President *Antonio Tajani* under the previous European Commission, before the *Jean-Claude Juncker*-led Commission then went on to proclaim the renaissance of industry (EC, 2014). Europe’s southern periphery was genuinely affected by deindustrialization from the beginning of the 1990s, to a degree differing from country to country, so that renewed growth in the share of industry – and within this manufacturing – rightly appeared on the agenda. It was in this context that the EU expressed the ambition to grow the share of the processing industry to 20% of GDP by the year 2020. Hungary’s situation is entirely different, however, since this proportion is almost 25% here: we lead the way in this regard together with the Czech Republic, Germany and Ireland, the latter having a particularly highly developed assembly sector (*Stöllinger et al.*, 2013).

As regards pitting industrial activity against so-called “speculative” services, this would only make sense in Hungary if the proportion of these services – those of a financial nature among them – were to exceed reasonable limits, necessitating a correction. An international comparison reveals, however, that the notion of deindustrialization is not applicable to the current Hungarian economic structure.

In theory, of course, the share of the processing industry can be increased further, particularly if there is major demand on external markets for products that carry a comparative advantage for Hungary. At the same time, the external market for services is expanding strongly. Services comprise a dynamic segment of the world’s foreign trade; moreover the market for these is less volatile, so that economies specializing in the provision of services are less exposed to cyclical fluctuations – which, in knowledge of the previously cited study by *Gábor Oblath*, might prove an important factor in growing and stabilizing the Hungarian economy.

In their analysis of development trends in European industry, *Stöllinger* and co-authors demonstrate convincingly that the share of services in the expenditures of the modern European processing industry is increasing, and thus demand in service sectors is growing accordingly (*Stöllinger et al.*, 2013, p. 7). However, the services bought by industrial concerns are largely sourced in the given country: on European average, the share of domestically sourced services is 87%, while a further 4% derive from other EU member states and 9% from third countries (op. cit., p. 7). Hungary’s task arising from this is to make the country more attractive as a destination for locating high value-added services with high productivity and paying favourable real wages. The domestic (national) share of European export activity is continuously decreasing, meaning that the share of foreign manufacturing and service capacities used for exports is growing; in other words, *the global value chain is getting longer* (IW, 2013, p. 72). With the geographical advantages enjoyed by Hungary (and the Visegrád Group), we might gain significant additional growth impetus from this trend.

Here, too, successful further progress has its own tough preconditions, the fulfilment of which is by no means a foregone conclusion. It is no accident that the ascent from the group of middle-income countries is no easy matter, or that if there is to be convergence at all, it will take a very long time to arrive. Modern industries and connected services are sensitive to the physical, legal and financial infrastructure alike, and require specific knowledge (both individual and network-based). In determining the course of development of general linguistic, intermediate and advanced training, these medium and long-term processes must be taken as a basis, and not the phenomena of the crisis years after 2007. Otherwise, the transition towards the next level of development might stretch beyond the unavoidable, or the danger of falling into the trap which lurks for each nation might become a reality.

REFERENCES

- AIYAR, S. – DUVAL, R. – PUY, D. – YIQUN WU – LONGMEI ZHANG (2013): Growth Slowdowns and the Middle-Income Trap. IMF Working Paper No. 13/71, Washington D.C.
- BOD, P.A. (1981): A Meditation on Common Views of Industrial Policy. *Valóság* XXIV (11), pp. 28–38.
- BOD, P. A. (2014): Unconventional Economic Policies. Budapest: Akadémiai Kiadó.
- CONSTANTINESCU, C. – MATTOO, A. – RUTA, M. (2015): The Global Trade Slowdown. Cyclical or Structural? http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2015/01/07/000158349_20150107092019/Rendered/PDF/WPS7158.pdf (downloaded on 12.01.2015).
- EICHENGREEN, B. – PARK, D. – SHIN, K. (2011): When Fast-Growing Economies Slow Down: International Evidence and Implications for China. NBER Working Paper No. 16919.
- EUROPEAN COMMISSION (2014): For a European Industrial Renaissance, COM (2014) 14 final: <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52014DC0014> (downloaded on 13.01.2015).
- European Commission (2015): European Economic Forecast – Winter 2015. European Economy 1/2015: http://ec.europa.eu/economy_finance/eu/forecasts/2015_winter_forecast_en.htm (downloaded on 06.02.2015).
- FELIPE, J. – ABDON, A. – KUMAR, U. (2012): Tracking the Middle-Income Trap: What Is It, Who Is in It, and Why? Levy Economics Institute of Bard College, Working Paper No. 715.
- GERMAN-HUNGARIAN CHAMBER OF INDUSTRY AND COMMERCE (2014): Results of the DUIHK's 20th economic survey. http://www.ahkungarn.hu/fileadmin/ahk_ungarn/Dokumente/Bereich_CC/Publikationen/Konjunktur/2014/Konj2014_hu_web.pdf (downloaded on 03.09.2014).
- GILL, I. – KHARAS, H. (2007): An East Asian Renaissance: Ideas for Economic Growth. Washington D.C.: World Bank.
- GYÓRFFY, D. (2013): Institutional Trust and Economic Policy: Lessons from the History of the Euro. Budapest: Central European University Press.
- GYÓRFFY, D. (2014): A Revolution for the Status Quo: Was it Worth It? *Portfolio.hu*, 21 March 2014.
- IW (2013): Industry as a Growth Engine in the Global Economy. Final Report. Köln: Institut der deutschen Wirtschaft.

- MURAKÖZY, L. (2013): An Age of Uncertainty. In: Muraközy, L. (ed.): *Every Whole is Broken*. Budapest: Akadémiai Kiadó.
- OBLATH, G. (2013): In How Many Years? – On the Nature and Duration of Convergence. *Statisztikai Szemle* 91 (10), pp. 925–946.
- OBLATH, G. (2014a): Economic Instability and Regional Underachievement – The Case of Hungary. *Külgazdaság*, LVIII (5-6), pp. 5–42.
- OBLATH, G. (2014b): Economic Transformation, Impulse and Breakdown. In: Kolosi, T. – TÓTH, I. GY. (eds.): *Social Report 2014*. Budapest: TÁRKI, ISSN 1216-6561, www.tarki.hu/adatbank-h/kutjel/pdf/b323.pdf.
- OECD (2014a): *Perspectives on Global Development 2014. Boosting Productivity to Meet the Middle-Income Challenge*. Paris: Pocket Edition. <http://www.oecd.org/development/pgd/pgd2014.htm>
- OECD (2014b): *2014 Global Forum on Development*. Paris: Background Notes, pp.1–5., <http://www.oecd.org/site/oecdgfd/backgroundnotes-gfd2014.htm>.
- PALÓCZ, É. (2013): Some Real Economy Components of Hungary's Economic Underachievement. In: MURAKÖZY, L. (ed.): *Every Whole is Broken*. Budapest: Akadémiai Kiadó.
- STÖLLINGER, R. – FOSTER-MCGREGOR, N. – HOLZNER, M. – LANDESMANN, M. – PÖSCHL, J. – STEHRER, R. (2013): A 'Manufacturing Imperative' in the EU – Europe's Position in Global Manufacturing and the Role of Industrial Policy. WIIW, Research Reports No. 391, pp. 1–26.
- TEULINGS, C. – BALDWIN, R. (eds.) (2014): *Secular Stagnation: Facts, Causes, and Cures*. CEPR Press. A VoxEU.org eBook.
- TRANSPARENCY INTERNATIONAL (2014): *Corruption Perceptions Index 2014*. <http://www.transparency.org/whatwedo/publication/cpi2014> (downloaded on 06.12.2014).
- World Bank (2008): *Commission on Growth and Development: The Growth Report*.