



Late payment and circular debt in Hungarian business life

This analysis by IEER concerns the experience of Hungarian businesses with late payment and circular debt. The results are based on IEER's July 2019 Quarterly Business Climate Survey, which involved 404 domestic respondents. Based on the answers, 68,6% of businesses had at least one partner that paid late in the first half of 2019, and 34% of respondents made late payments themselves to their suppliers in the examined period. The issue of late payment most often hits large companies (with more than 250 employees) and industrywise construction and providers of other business services are the most affected. All-in-all it can be inferred that the after the favourable period last year, the trends in having more business partner who pay late is starting to creep back to its prior 2018 level. By the same token, proportion of their income arriving late has become threefold, compared to the last period measured. However, the number of companies that failed to pay in time to their suppliers at least once due to the late payment of their customers basically remained unchanged since July 2018.

In the course of IEER's July 2019 Quarterly Business Climate Survey, 404 domestic respondents were surveyed about late payment and circular debt.

68,6% of the surveyed companies had at least one business partner that paid late multiple times in the first half of 2019. As it could be observed in Figure 1, the rate of the same companies was 55% in the second half of 2018 and 63% one and the half year before, in 2018 January meaning that the amelioration of the previous period was not here to stay and the ratio is resembling more to its levels prior 2018 July. The proportion of companies with more than half of their partners paying late also increased considerably. In July 2019, 10% of companies were such, whereas the same ratio

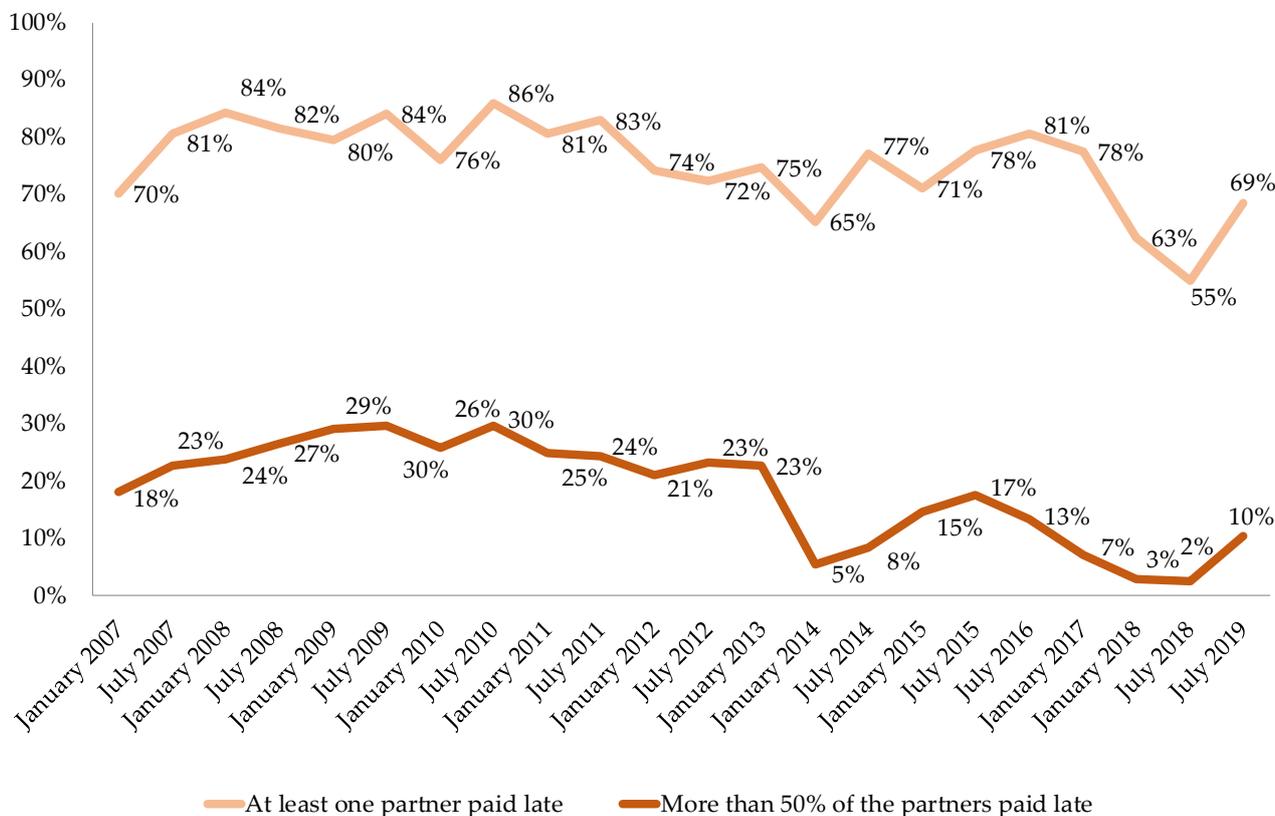
was much lower before: 2% and 3% in July 2018, and January 2018, respectively.

The companies affected the most in the first half of 2019 were large companies employing more than 250 workers. 67% of these companies received late payment from at least one partner (however, only 3% of the partners of the surveyed large companies were prone to pay late). By analysing data by sectors one can say that construction companies (70%), manufacturing companies and providers of business services (57% and 57%) were the most often exposed to late payment. Respectively, 7% and 11% of the partners of construction companies and business service providers paid late multiple times, which is an amelioration in the case of the construction industry, compared to the last period surveyed. Besides,

results also show that ownership structure has started to become a differentiating factor of late-paying: 60% of fully domestic companies had such partners in 2018 (on average, 9% of

their partners paid late), while 51% of companies of (partly) foreign ownership received delayed payment.

Figure 1: The rate of companies experiencing late payment, 2007-2019¹



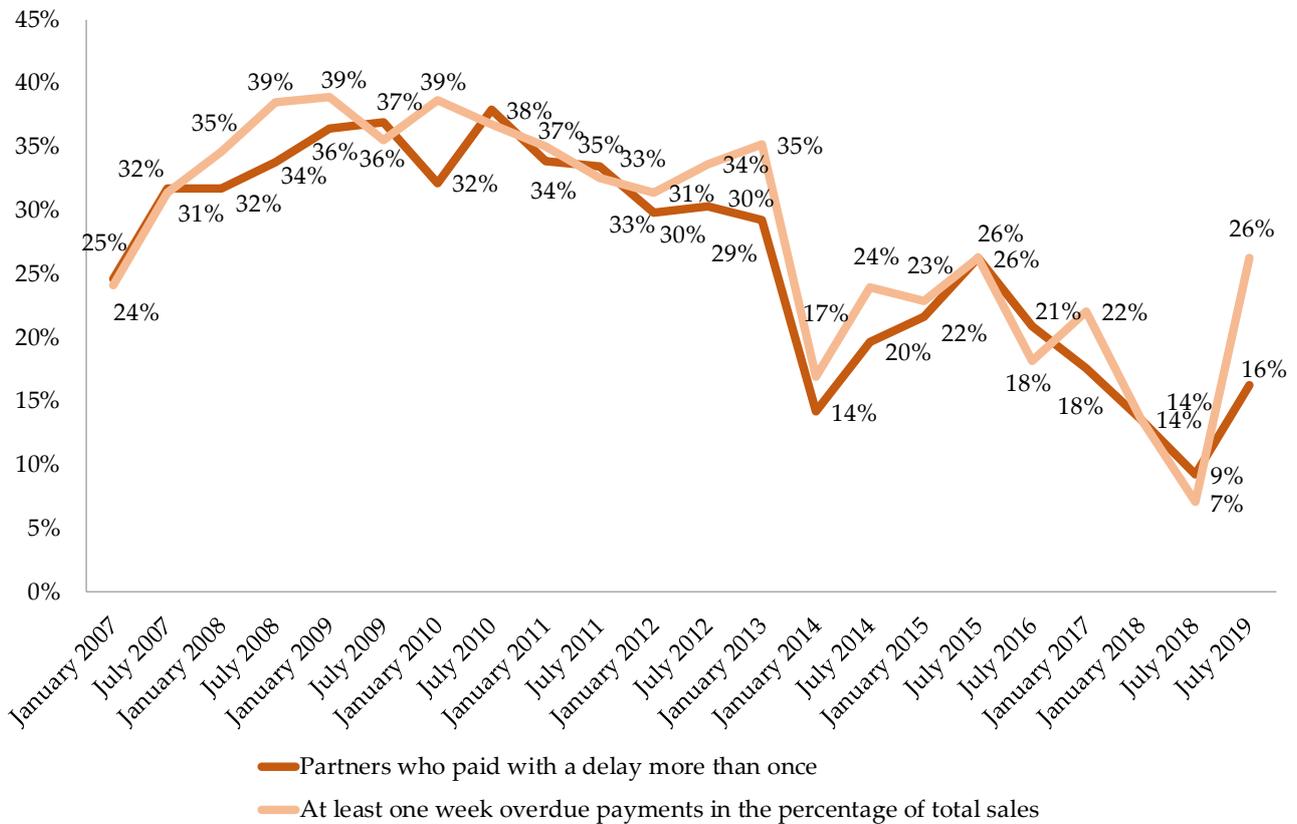
Source: IEER, 2019, 275<=N<=408

Amongst the surveyed companies, it has increased the ratio of business partners who paid multiple times with a delay. Simultaneously it has tripled the amount of money incoming more than one week past its due date, compared to the last period. This suggests that the favourable tendency of the past periods is reversed, especially in the case of the incoming amount of money past due. The results led us to the conclusion that businesses now have more late-paying

partners on average, and a larger proportion of their income is delayed (see Figure 2).

¹ In case of all time series data shown, it has to be taken into consideration that companies with more than 250 employees are present in our sample from only 2010.

Figure 2: The rate of late-paying partners and the rate of income that arrived beyond payment deadline, average, 2007-2019

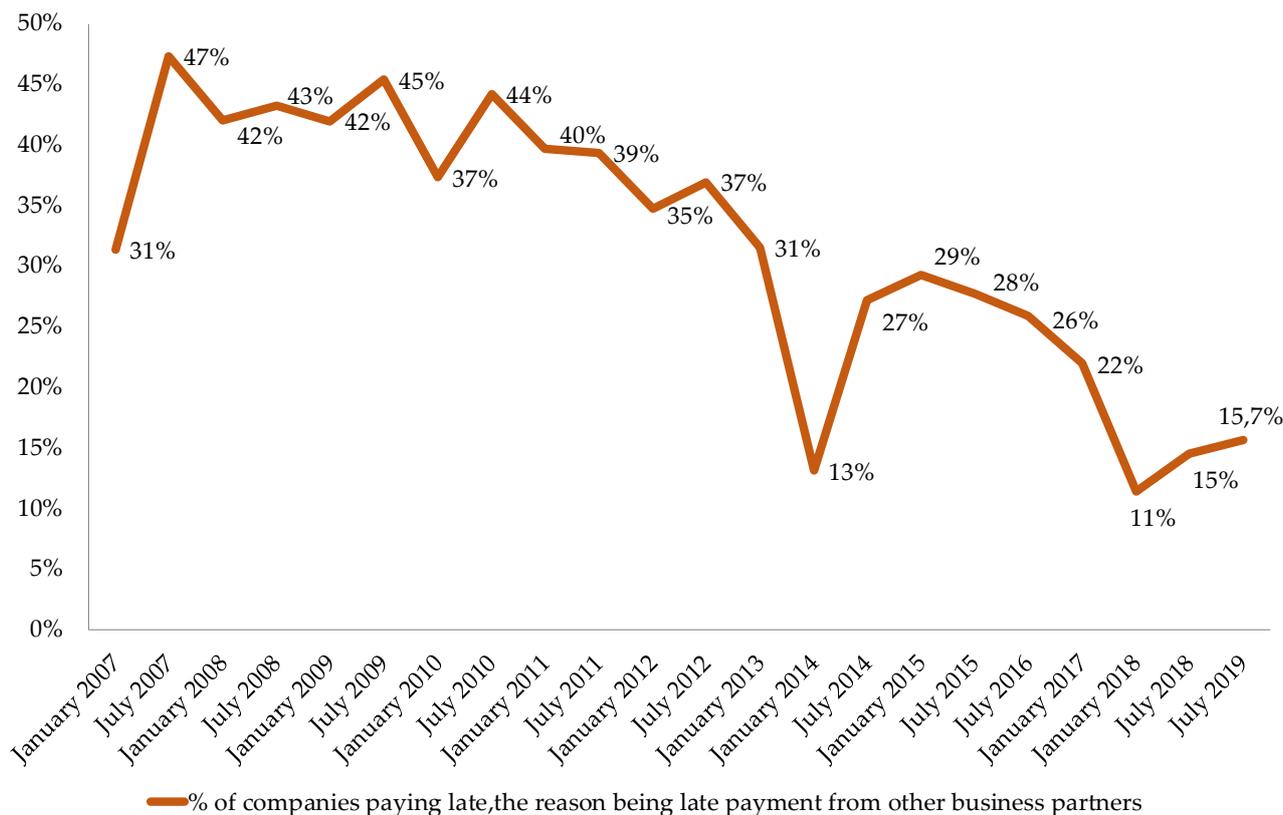


Source: IEER, 2019, 256<=N<=408

The proportion of companies that failed to pay at least once to their suppliers in time due to the late payment of their customers has basically remained unchanged. While the proportion of such companies had been 11% in January 2018, and 15% in July 2018, 15,7% of respondents in July 2019 reported to have experienced at least one case in the previous year (see figure 3). The rate of companies experiencing circular debt was 4% for 250+ businesses, 16% for 100-249 employee size companies, and 15% for 50-99 employee size companies and for the smallest companies

(between 20 and 49 employees) this number amounts to 23%. Among the sectors it was construction industry and other business service provider sector that had the highest proportion of companies which were unable to pay in time owing to a business partner's delayed payment (22% and 23%). 17% of domestically owned companies and 13% of (partly) foreign owned companies reported that in the year before the survey was taken, they had encountered the problem of delayed payment to their suppliers as a result of circular debt.

Figure 3: The proportion of companies which were late to pay at least once as a result of being paid late, 2007-2019



Source: IEER, 2019, 296<=N<=417

34% of respondents reportedly owed money in the first half of 2019 at least once to at least one of their suppliers. This rate shows a that the drop experienced in July 2018, compared to the periods before, did not stay on the long-term but the tendency of the years prior seem to return - in January 2018, July 2017 and 2016 January the proportion of companies that paid late to a supplier at least once was 17%, 30% and 45% respectively, so it has definitely been a considerable fall.

The severity of the problem caused by circular debt has not changed according to 71% of respondents; 20% said it had decreased and 9% claimed that it had increased over the previous period. The ratio of companies experiencing circular debt as an increasing problem has gone

back to its pre July 2018 levels. (This figure was surprisingly low, only 7,5% but the figure from periods before are similar to our latest one, in this respect: 8% in January 2018, 8% in 2017 January, 10% in 2016% January.) The rate of companies that reported improvement was the lowest (12,9%) among medium size enterprises (100-249 employees) and the highest (26%) among companies employing 50-99 workers. As far as economic sectors are concerned, managers in the construction industry (50%) were the largest group to report while only the 8.7% of other business provider services report that the problems caused by circular debt among their partners had become less severe.

Germany's role in CEE value chains: trade and investment

Global value chains are far from being linear lines of production processes rather they come to be increasingly complex systems of hubs and spokes. This is the case for Europe and more specifically Central-Eastern Europe, where Germany plays a central role of connecting these countries into global value chains. This role is especially prevalent for Visegrad 4 countries. While Germany is the largest FDI supplier, which has a potential to improve technology and know-how of production in the home country, this does not always manifest directly in the value added content of exports. An explanation could be that rather intermediary goods than finished goods are exported, which have a lower value added content.

Introduction

Nowadays, large part of the production is realized through global value chains, which are overarching many countries and different continents. In these rather complicated chains and systems of productions would be a difficult task to trace where value is created and by which players it is absorbed, mostly due to the fact that these chains contain and intertwined relationships among the countries.

The most straightforward way to imagine is that these value chains organize according to geography: so rather being a linear line they constitute a network of hubs and spokes, with one country being the center hub for a given region.² This concept can be well illustrated by

the “flying geese” model. The term was coined by a Japanese economist, Kaname Akamatu³ and it illustrates how Asian countries (especially with the leading role of Japan) catch up to Western economies through the mechanism of import, production and export. Production for export shifts from more developed countries to less developed ones, where less developed countries are dependent on their economically advanced counterparts for the virtue of including or connecting them into global value chains. When it comes to Central-Eastern Europe, Germany as a sizeable economy takes up on this role of a regional hub, thus connecting CEE countries into global value chains.

Germany's relation with CEE (and more importantly with V4) countries

With the fall of the communist regime, from the 1990's onwards Germany's role has gradually shifted and became more significant as an investment partner with relation to CEE countries. There were two main motivating factors enabling the shift in the trade

relationships: the geographical closeness which kept the flow resources easy and the relatively cheap labor of the countries of the ex Eastern block. These two reasons allowed for an especially close relationship with the countries of the Visegrad 4 (V4), compared to

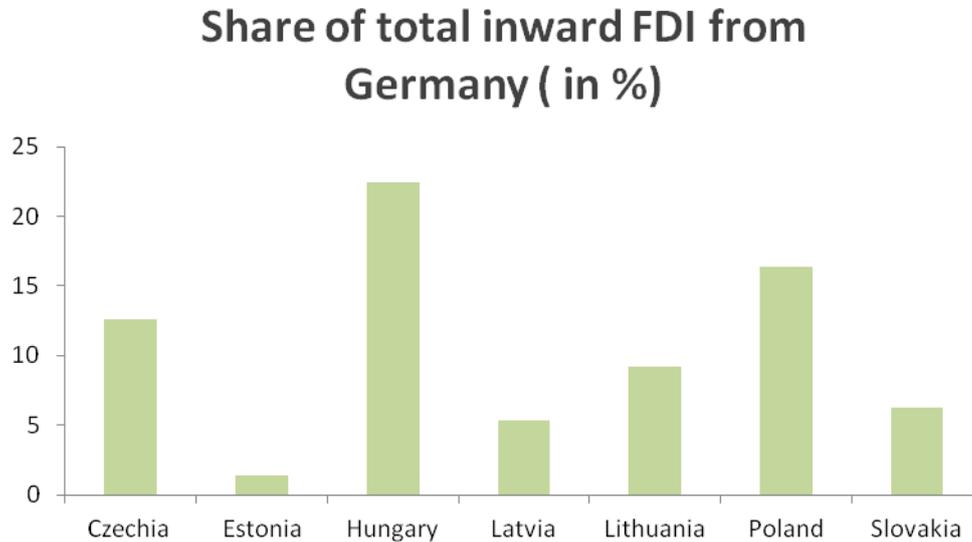
² Aleksandra Kordalska and Magdalena Olczyk (2019): Is Germany a hub of Factory Europe for CEE countries? The sink approach in GVC decomposition

³ Shigehisa Kasahara (2013): The Asian developmental state and the flying geese paradigm

the Baltics. This is represented on Figure 1, with Germany constituting the biggest share of foreign direct investment from Germany,

followed closely by Poland and the Czech Republic.

Figure 1: German inward FDI in CEE countries, 2015⁴



The very same relationship is valid for exports, Germany being the biggest export partner for the V4 countries. This is by the virtue of the international factor movement: the more foreign direct investment flows to a country, However, the relationship is not as straightforward. For instance, when looking at the Baltic countries, there is an obvious negative trade balance in relationship with Germany. The situation is a slightly more favorable in the case of the V4 countries however, in terms of value added exports do not show the same picture as in terms of export volume to Germany. This consequently can be explained by the tendency of the high value added being redirected to Germany rather than being absorbed by the host country for

the more it becomes target for exports of the investor country. The inflow of foreign direct investment has a potential to benefit the host country by technology transfer and increasing export performance. investment. The phenomenon is exceptionally visible in the case of Hungary and Poland. When applying this to the framework of global value chains, it means that CEE countries (including V4 countries, despite their slightly favorable position) have more backward linkages meaning the host countries produce intermediary goods used for Germany's production for export. Gains from trade are more tangible if a country has forward linkages which are domestic value-added exports of a

⁴ Own graph with data from Kordalska-Olczyk (2019)

country which channels into exports of the partner country.⁵

Figure 2: Gross trade, trade in value added and the difference, in USD million, 2014 (based on Kordalska-Olczyk, 2013)



This suggests that high value added processes, such as R&D, are rather staying with the domestic country as opposed to the CEE host country. (One counterexample to that is the German automotive FDI such as Opel, Audi and Mercedes-Benz in Hungary, with important R&D activities.⁶) This is commonly called as the smiling curve phenomenon.⁷ This entails that the value added is non-linear along

the global value chain: usually activities early in the phase of the production and towards the final phases of the production that are typically concerned with adding high value. The higher number of backward linkages compared to forward linkages of the V4 countries with respect to Germany suggest that V4 countries are in the “lower” part of the curve where the lowest amount of value added is absorbed.

Conclusion

Germany plays an important role in CEE value chains, as an investor and as a trade partner. However, CEE countries have a less favorable

position in these international value chains. There can be multiple explanations to this. One of that is FDI from Germany focuses rather on

⁵ Rashmi Banga(2013): Measuring Value in Global Value Chains

⁶ Éltető – Magasházi – Szalavetz(2015): Global Value Chains and Upgrading: The Experience of

Hungarian Firms in the Heavy Engineering and Automotive Industries

⁷ Armando Rungiy -Davide Del Prete(2017): The Smile Curve: where Value is Added along Supply Chains

low value added activities (e.g. assembly) and less on high-value added (e.g.: R&D), with a handful of exceptions to this rule. Other could be that German exported goods and services are further redirected meaning they are not consumed in Germany, but somewhere outside of the region. This serve as a proof of the nature of the global value chains which are

rather an intertwined system of hubs and spokes rather just the sum of a linear trade and investment relationships. For CEE and especially Hungary, Germany is a hub or an intermediary connecting CEE with countries outside Europe as China while dominating or taking a key position in their value chains.

International trends

Changes in the production, consumption and employment situation in certain major international economies compared with peer expectations and the previous period.

		Period in review	Actual data	Expectations	Previous period
	Unemployment Rate	(Oct)	5.0%	5.0%	5.0%
Germany	Manufacturing Purchasing Managers Index	(Oct)	42.1	41.9	41.7
	IFO Business Climate Index ¹	(Oct)	94.6	91.5	94.6
France	INSEE Business Climate Index ²	(Oct)	105.4		106.2
	Unemployment Rate	(Oct)	3.6%	3.6%	3.5%
USA	CB Consumer Confidence Index	(Oct)	125.9	128.0	126.3
	Manufacturing Purchasing Managers Index	(Oct)	51.5	50.7	51.1
China	Manufacturing Purchasing Managers Index	(Oct)	49.3	49.9	49.8

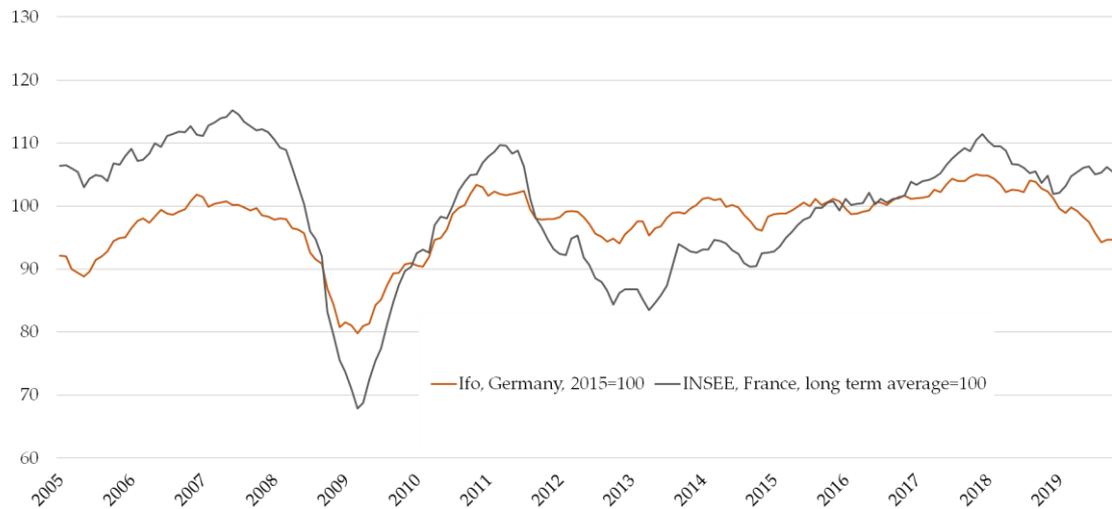
¹<https://www.cesifo-group.de/ifoHome/facts/Survey-Results/Business-Climate/>

²<http://www.insee.fr/en/themes/indicateur.asp?id=105>

The rest of the data source: <http://worldeconomiccalendar.com>

In Germany, the IFO business climate index remains unchanged. The manufacturing purchasing manager index (PMI) shows a slight increase, a bit better than expected, while the unemployment rate stagnates at the same level. The French INSEE business climate index deteriorated compared to the month prior. In the United States, the CB consumer confidence index dropped significantly in comparison to last month and is far below than expected. The manufacturing PMI showed a slight increase. The unemployment rate slightly increased. The Chinese manufacturing PMI remains virtually unchanged- only with a slight drop.

Business confidence in Germany and France,
based on the Ifo and INSEE business climate survey,
January 2005 - October 2019



Sources: www.ifo.de, www.insee.fr

Contact

Address: MKIK GVI
1054 Budapest, Szabadság tér 7.
Tel: 235-05-84
E-mail: gvi@gvi.hu
Internet: <http://www.gvi.hu>

Prepared by:

Veronika Csányi, analyst, MKIK GVI

Research manager:

Ágnes Makó, PhD
Managing director, MKIK GVI

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