2001 Country Reports on Economic Policy and Trade Practices
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HUNGARY

Key Economic Indicators 1/

(Billions of U.S. dollars unless otherwise indicated)

	1999	2000	2001	
Income, Production and Employment:				
Nominal GDP	48.02	46.32	50.0	2/
Real GDP Growth (pct)	4.4	5.2	3.8	
GDP by Sector: (pct)				
Agriculture	4.8	4.1	4.0	
Manufacturing	27.7	29.2	29.2	
Construction	4.7	4.6	4.8	
Services	43.0	42.6	42.7	
Government	19.8	19.5	18.8	
Per Capita GDP (US$)	4,808	4,621	4,903	
Labor Force (000s)	4,113	4,146	4,080	
Unemployment Rate (pct)	6.5	6.0	5.6	
Money and Prices (annual percentage growth):				
Money Supply Growth (M3)	16.1	12.7	15.1	3/
Average Consumer Price Inflation	10.0	9.8	7.8	
Official Exchange Rate (HUF/$ annual average)	237.29	282.27	290	
Balance of Payments and Trade:				
Total Exports FOB	25.0	28.1	29.3	
Exports to United States	.5	.6	.7	4/
Total Imports CIF	28.0	32.1	32.8	
Imports from United States	1.9	2.7	2.5	
Trade Balance	-3.0	-4.0	-3.5	
Balance with United States	-1.4	-2.1	-1.8	
Current Account Deficit/GDP (pct)	4.4	3.3	3.0	
Net External Public Debt	2.9	-0.2	2.0	5/
Fiscal Deficit/GDP (pct)	3.9	3.5	3.4	
Debt Service Payments/GDP (pct)	9.3	9	8.5	
Gold and Foreign Exchange Reserves	10.9	11.2	12.0	5/
Aid from United States (US$ millions)	9.9	4.0	0	
Aid from All Other Sources	N/A	N/A	N/A	

1/ Source: Central Statistical Office and National Bank data through October 2001, except as noted.

2/ Apparent inconsistency with growth figures due to the strengthening of the dollar against the Hungarian forint.
3/ September 2000 to September 2001.
4/ Source: U.S. Department of Commerce; 2001 figures projected from January to August data. U.S and Hungarian-source bilateral trade figures differ markedly, due to country-of-origin distinctions in exports whose final assembly occurs in Hungary.
5/ August 2001.

1. General Policy Framework

Hungary has transformed into a middle-income country with a market economy and a well elaborated but still developing Western-oriented legal and regulatory framework. The first post-communist government (1990 to 1994) began significant economic reform, but was unable to privatize many state enterprises and implement systemic fiscal reforms, which led to large imbalances in Hungary's fiscal and external accounts. A successor government (1994 to 1998) achieved economic stabilization through an IMF-coordinated austerity program adopted in March 1995, and accelerated privatization and economic reform. In 2000, Hungary continued to post solid increases in industrial output, exports, and overall output. Continued economic restructuring under the current government (elected in May 1998) is expected to allow for sustainable growth in the medium term. Regional disparities in economic growth, income and employment exist in Hungary.

A revised privatization program enacted in 1995 gave new momentum to sales of government enterprises and assets, largely on a cash basis, to Western companies. Privatization contributed to a rapid transformation of the energy, telecommunication, and banking sectors. Currently, over 80 percent of the country's GDP comes from the private sector, and Hungary has progressively lowered government expenditures as a percentage of GDP. Other significant reforms initiated in 1995 include means testing of social welfare payments (partially reversed by the current government) and pension reform (implemented in January 1998). The unfinished reform agenda includes rationalizing health care, tax reform and local government financing.

Privatization revenues helped to reduce substantially Hungary's foreign debt. The government has an unblemished debt payment record and since late 1996 all major credit rating agencies have rated its foreign currency obligations at investment grade. Foreign currency reserves stood at $12 billion through August 2001, enough for more than four months of imports.

The government has pledged to continue reducing fiscal deficits. The consolidated budget deficit in 2001 will equal about 3.4 percent of GDP, down from 3.5 percent in 2000. However, the government has dramatically increased off-budget spending for road construction and housing, bringing the real deficit to more than five percent of GDP. Hungary finances its state deficit primarily through foreign and domestic bond issues. Projections for Hungary's 2001 current account deficit vary widely, but recent monthly statistics indicate that the deficit could end up lower than the 2000 deficit of $1.5 billion. Following a cumulative decline of 17 percent

from 1995 to 1996, net real wages are expected to increase 5 to 7 percent in 2001, after an estimated 4.3 percent increase in 2000.

Hungary has been a leader among Central European countries in attracting foreign direct investment, with an estimated $23 billion in cumulative inflows since 1989. The United States is a leading investor in Hungary with over $8 billion in cumulative FDI since 1989. Tax incentives and related credits are available for foreign investments, especially in underdeveloped regions. Hungary will have to transform these into regional development schemes after its EU accession. Hungarian law currently permits the establishment of companies in customs-free zones, which are exempt from indirect taxation tied to the turnover of goods. These zones, the engines of Hungarian industry and foreign trade, will face significant changes after Hungary's EU accession, but until then there are no plans to reduce the preferences guaranteed to them.

A signatory to the Uruguay Round Agreement and a founding member of the World Trade Organization, Hungary joined the Organization for Economic Cooperation and Development (OECD) in May 1996 and, as a part of that process, is further liberalizing capital account transactions. Hungary has harmonized many laws and regulations with European Union standards and has oriented economic policy towards the earliest possible accession date of January 1, 2003.

2. Exchange Rate Policy

The Government Decree on Foreign Currency (effective June 16, 2001) made the Hungarian forint fully convertible and abolished remaining restrictions on currency transactions, including permitting foreigners to buy Hungarian bonds and invest in derivatives. Foreigners and Hungarians can maintain both hard currency and forint accounts. Hungary widened the intervention band for the forint from ± 2.25 to ± 15 percent on May 4, 2001, and eliminated the crawling peg on October 1, 2001. These changes have allowed the forint to fluctuate freely within the larger band. The forint was widely considered to be undervalued prior to the changes. In the months since, the forint appreciated steadily and in recent months settled at a rate about 9 percent above the reference peg to the Euro, an appreciation of about 7 percent. The crawling peg, in place since 1995, coupled with liberalization and prudent fiscal and monetary policy helped slow average annual inflation from 28.3 percent in 1995 to 9.8 percent in 2000. The strengthening of forint in 2001 is expected to further reduce inflation in 2001 and 2002.

3. Structural Policies

The market freely sets prices for most products and services. User prices for pharmaceuticals, public transport, and utilities are set in some cases by the state. The government offers a wholesale floor price for many agricultural products. Public opposition and regulatory intervention have prevented utility prices (e.g., natural gas for heating and cooking) from reaching market levels, causing power companies to receive less than the cost-plus-eight percent return stipulated in privatization contracts. MOL has suffered significant losses since

2000 because the government fixed natural gas prices at a level substantially lower than world market prices.

Starting in 1997, successive governments have reduced income tax rates and employer social contributions in an effort to cut inflation, spur job growth, and shrink the gray economy. Corporate income tax remains low at 18 percent. A ten-year corporate tax holiday applies to investments of at least $33 million, as of October 2000, or $10 million in less developed regions, and a five-year, 50 percent tax holiday applies to investments of at least $3.3 million. Other incentive programs exist, including some offered by counties and municipalities. Consult the Country Commercial Guide for additional information.

Major structural budget reform has been implemented and further legislation is expected in this area. In January 1998, a new "three pillar" pension system was introduced in which private funds initially augment and gradually supplant more of the current state-funded, pay-as-you-go public system. The next areas of government finance reform are health care and local government financing. Health care costs are emerging as a drain on the budget and a source of fiscal indiscipline. The government continues to control pharmaceutical prices in order to limit health spending. Wholesale reforms are unlikely until after the 2002 election.

4. Debt Management

Hungary is a moderately indebted country with gross foreign debt expected to be $33.5 billion at the end of 2001. Net public domestic debt was $20.2 billion at the end of June 2001. Hungary is one of a handful of countries that has never defaulted or rescheduled its foreign debt. Moody's has upgraded the foreign currency ceilings for bonds and bank deposits in Hungary from Baa1 to A3, and other major credit rating companies to A- at the end of 2000. A standby credit arrangement with the IMF ended in February 1998 by mutual agreement. Hungary is expected to have reserves of $12 billion at the end of 2001.

5. Significant Barriers to U.S. Exports

Hungary's trade policies are shaped primarily by its World Trade Organization (WTO) commitments and its efforts to accede to the European Union (EU). Hungary's progressive implementation of its Uruguay Round agreements has generally improved U.S. access to the Hungarian market. Hungary cut its average most-favored-nation (MFN) import duties from 13.6 percent in 1991 to 8.0 percent in 1998. Hungary has not yet acceded to the WTO Information Technology Agreement (but must as a condition of EU membership) and does not belong to the WTO Plurilateral Agreement on Civil Aircraft.

Under Hungary's 1993 EU Association Agreement, Hungary completely eliminated tariffs on industrial products from the EU as of January 1, 2001. EU nonindustrial exports can also enter Hungary with reduced tariff rates on a selective basis. However, until Hungary adopts the EU common external tariff (CXT), U.S. exports to Hungary are subject to MFN tariff rates, which are often quite high. For example, Hungary's MFN rate on automobiles is 43 percent,

while automobiles of at least 60 percent EU origin enjoy duty-free access. These differentials between tariffs on EU goods and U.S. goods disadvantage U.S. exporters, and the United States is in ongoing discussions with Hungary to reduce the differentials in key areas. Duty must be paid on imports from outside the Pan European Free Trade Zone, which may then be exported duty-free to other countries within the Zone. Duty paid on inputs processed and then exported within the zone is no longer refundable, a problem that the Hungarian government has addressed on a case-by-case basis for U.S. firms exporting from Hungary to European markets.

Although 96 percent of imports (in value terms) no longer require an import license, quota constraints apply to some 20 product groups, including cars, textiles, and precious metals (the quotas, however, are not actually reached in most of these areas). Under WTO rules, Hungary will phase out quotas on textiles and apparel by 2004. As a result of the WTO Agricultural Agreement, quotas on agricultural products and processed foods have been progressively replaced by tariff-rate quotas. In 1997, Hungary eliminated an import surcharge imposed as part of the March 1995 austerity package.

For domestic political reasons, Hungary has not yet implemented an amendment to the 1996 Media Law which would harmonize Hungary's broadcast regime with EU directives on content and quotas. Current draft legislation would require that over 50 percent of both public and private TV broadcasting be European programming, where practicable. In the meantime, the more restrictive original law still governs, which requires 70 percent European content. The Media Act revision would also limit any single cable provider to one-sixth of the household market. The Unified Communications Act passed in 2001 will eliminate the monopoly of the formerly state-owned telecommunications company at the end of 2001. Smaller local telephone operators have monopoly rights for local services until the end of 2002.

On February 26, 2001, Hungary and the EU signed a Protocol to the Europe Agreement on Conformity Assessment and Acceptance of Industrial Products (PECA), under which the EU and Hungary agreed to recognize the results of each other's designated conformity assessment bodies, thus eliminating the need for further product testing of EU products imported into Hungary. However, it appears these benefits will only apply to products that are both of EU country origin and bear the "CE" mark denoting compliance with EU standards. As such, products of U.S. origin that bear the CE mark may not receive testing-free entry into Hungary. The United States government has, and will continue to, discuss its concerns over PECA with Hungary and the EU in bilateral and multilateral settings.

Foreign investment is allowed in every sector open to private investment. Foreign ownership is restricted to varying degrees in civil aviation, defense, and broadcasting. Only Hungarian citizens may own farmland. Hungary has requested a seven-year transition period after EU accession to eliminate this restriction.

Under the November 1995 Law on Government Procurement, public tenders must be invited for purchases of goods with a value over $33,000. As of October 2000, the same is true of construction projects worth $66,000 or designs and services worth over $16,500. Bids that contain more than 50 percent Hungarian content receive a 10 percent price preference. This process does not apply to military purchases affecting national security, or to gas, oil, and

electricity contracts. Hungary is not a party to the WTO Government Procurement Code, and some U.S. firms have taken legal action against non-transparency and procedural irregularities involving government tenders.

Importers must file a customs document (VAM 91 form) with a product declaration and code number, obtained from the Central Statistical Office. Upon importation, the importer must present Commercial Quality Control Institute (KERMI) certified documentation to clear customs. This permit may be replaced by other national certification and testing agency documents, such as those of the National Institute for Drugs. Hungary participates in the International Organization for Standardization (ISC) and the International Electro-Technical Commission (IEC).

6. Export Subsidies Policies

The Hungarian Export-Import Bank and Export Credit Guarantee Agency, both founded in 1994, provide credit and/or credit insurance for less than ten percent of total exports. Hungary offers no direct export subsidies on industrial products, but does give export subsidies to some agricultural products. After 1993, agricultural export subsidies exceeded Hungary's Uruguay Round commitments in the range and value of products subsidized; in October 1997, the WTO approved an agreement in which Hungary committed to phase out excess subsidies and not to expand exports of subsidized products to new markets. Hungary is abiding by the terms of that agreement in phasing out subsidies, despite continued political pressure from domestic constituencies.

7. Protection of U.S. Intellectual Property

Intellectual property rights laws in Hungary are generally good, but insufficient resources, court delays, and relatively light penalties hamper enforcement. In 1993, the United States and Hungary signed a comprehensive Bilateral Intellectual Property Rights Treaty. Hungary belongs to the World Intellectual Property Organization; Paris Convention on Industrial Property; Hague Agreement on Industrial Designs; Nice Agreement on Classification and Registration of Trademarks; Madrid Agreement Concerning Registration and Classification of Trademarks; Patent Cooperation Treaty; and Berne and Universal Copyright Conventions. In 1998 Hungary ratified the new WIPO Copyright Treaty and Performances and Phonograms Treaty. In compliance with its TRIPS obligations, Hungary enacted a new copyright law that went into effect on September 1, 1999, that introduced modern copyright legislation. Some question exists of whether sufficient legal authority exists for civil ex parte search procedures.

In May 2001, the United States Trade Representative announced that it had upgraded Hungary to the Special 301 Priority Watch List because Hungary does not adequately protect confidential test data submitted by pharmaceutical companies seeking marketing approval, contrary to its obligations under Article 39.3 of TRIPS. On April 12, 2001, the Hungarian government issued a ministerial decree to provide this so-called data exclusivity protection, but the decree does not take effect until January 1, 2003, and would not provide protection for test

data submitted prior to that date. The Hungarian government claims that its unfair competition legislation is adequate to prevent generic drug manufacturers from using data submitted by multinational research pharmaceutical firms, but examples exist where generics have actually come to market prior to or very soon after the original product. The United States has urged Hungary to rectify this situation at every possible opportunity. Hungary did not provide product patents (only process patents) for pharmaceuticals before 1994, and examples exist of domestic generic drugs coming to market before process patents expire.

Pharmaceutical manufacturers have also tried unsuccessfully to get the Hungarian government to reverse the burden of proof in patent infringement court cases. The industry has also reported a lack of transparency in the Hungarian government's drug pricing and reimbursement policies, claiming the government discriminates against imported drugs in favor of domestically produced generics.

Trademark infringement is a problem in Hungary, with various counterfeit goods (e.g., perfumes, clothing) available on the local market. These goods appear to be entering Hungary from other countries rather than being manufactured here. The number of civil actions brought before the Budapest Metropolitan Court (the exclusive court of competence for these cases) is up dramatically since 1997, but the enforcement of sanctions against the sale of pirated goods is still lacking. There are no available estimates of the losses incurred by the various industries due to either black or gray market activities. This area of IPR infringement is receiving increased attention from Hungarian and international law enforcement, however, due to the involvement of organized crime and connections with money laundering schemes.

Copyright protection is weak in Hungary, with pirated CDs, tapes, videos, and software available on the local market. Many of these products are produced in Hungary. Video and cable television piracy is widespread, and local television and cable companies regularly transmit programs without authorization. U.S. industry estimates that 40 percent of the videotapes available in Hungary in 2000 were pirated copies. Local groups such as the Business Software Alliance and the Hungarian Anti-Piracy Association are funded in part by manufacturers associations (e.g., Motion Picture Association) and are working to reduce the level of piracy, in cooperation with Hungarian law enforcement. There are about 1,000 software copyright court cases tried each year. Government cooperation has been good, but not enough resources are available to effectively stop copyright infringement.

The Pharmaceutical Research and Manufacturers Association estimates it loses between $50 and $100 million annually due to the data exclusivity problem and other weaknesses in Hungary's patent protection regime. The International Intellectual Property Alliance estimated losses to U.S. trade in 2000 due to copyright piracy at $55.6 million.

8. Worker Rights

a. The Right of Association: The 1992 Labor Code, as amended in 1999, recognizes the right of unions to organize and bargain collectively and permits trade union pluralism. Workers have the right to associate freely, choose representatives, publish journals, and openly promote

members' interests and views. With the exception of military personnel and the police, they also have the right to strike.

b. The Right to Organize and Bargain Collectively: Labor laws permit collective bargaining at the enterprise and industry levels. The Economic Council (formerly the Interest Reconciliation Council), a forum of representatives from employers, employees, and the government, sets the minimum and recommended wage levels in the private sector. Special labor courts enforce labor laws. Affected parties may appeal labor court decisions in civil court. The 1992 legislation prohibits employers from discriminating against unions and their organizers.

c. Prohibition of Forced or Compulsory Labor: The government enforces the legal prohibition of compulsory labor.

d. Minimum Age for Employment of Children: The Labor Code forbids work by minors under the age of 14, and regulates labor conditions for minors age 14 to 16 (e.g., in apprenticeship programs).

e. Acceptable Conditions of Work: The Labor Code specifies conditions of employment, including: working time, termination procedures, severance pay, maternity leave, trade union consultation rights in management decisions, annual and sick leave entitlement, and conflict resolution procedures.

f. Rights in Sectors with U.S. Investment: Conditions in specific goods-producing sectors in which U.S. capital is invested do not differ from those in other sectors of the economy.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 2000

(Millions of U.S. Dollars)

Category		Amount
Petroleum		-47
Total Manufacturing		834
Food & Kindred Products	(D)	
Chemicals & Allied Products	62	
Primary & Fabricated Metals	(D)	
Industrial Machinery and Equipment	399	
Electric & Electronic Equipment	79	
Transportation Equipment	107	
Other Manufacturing	66	
Wholesale Trade		151
Banking		(D)
Finance/Insurance/Real Estate		(D)

Services	-55
Other Industries	76
TOTAL ALL INDUSTRIES	1,040

(D) Suppressed to avoid disclosing data of individual companies.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.