HUNGARY

Overview

With over $13 billion in foreign investment since 1989, Hungary is Central and Eastern Europe's leader in attracting foreign capital. This amount is nearly double that invested in any other Central European country and over half of all Foreign Direct Investment (FDI) in Central and Eastern Europe and the CIS. Moreover, about half of all U.S. investment in the region has gone to Hungary, which has attracted $5 billion in American capital. Over 400 U.S. firms are actively doing business in Hungary and the American Chamber of Commerce in Hungary is one of the largest in Europe. As a Central European base, Hungary's advantages are location and skilled labor. Budapest is two hours away from the Austrian border while labor costs in Hungary are one-seventh of that in Austria.

Sectors such as telecommunications, energy, transport and the environment continue to grow. Over the past six years, Hungary has also developed industry strengths in the automotive field (with major investments by GM, Ford, Audi, Suzuki) and with an expanding automotive sourcing industry in plastics and electronics. Other areas, including chemicals, food processing, construction, and especially services such as banking, tourism, franchising, and information management hold very attractive business prospects.

Hungary signed a standby agreement with the International Monetary Fund (IMF) in March 1996 and became a member of the Organization for Economic Cooperation and Development (OECD) in April 1996. 1995 GDP growth was about 1.5%, following 2.9% growth in 1994 (the first year of GDP growth since 1990). In 1996, growth was in the 1% range However, 2%-2.5% GDP growth is expected for 1997. Despite government efforts, inflation continues to be troublesome. It was 28.3% in 1995 and is expected to be in the low-to-mid 20's in 1996.

Defense Industry Environment

In 1995, Hungary spent about 1.7 percent of its GDP on defense compared to 2.8 percent in 1989. This percentage (in 1995) represented 77 billion Hungarian forints ($ 626 million). In 1996 the Ministry of Defense spent approximately HUF 79 billion, up 6.8% in nominal terms, from 1995; however, because of devaluation of the forint in March 1995, this represents a real decrease to USD 531 million. Within the defense budget, HUF 790m (USD 6.4 million) is earmarked for participation in NATO's Partnership for Peace program.

Five percent of this budget is available for new equipment acquisitions. Starting in 1997, 15-20 percent of the defense budget can be spent on research and development. Modernization of the army is planned to start not later than 1998 and is expected to be finished by 2005.

It is important to note, however, that in the case of major military procurements (such as air defense radars or aircraft) money is specifically appropriated outside the defense budget.

Hungary's defense industry formerly specialized in electronic hardware for the Warsaw Pact countries. After the break up of the Warsaw Pact, the Hungarian defense industry lost its primary markets. Since 1989, defense trade between the former Warsaw Pact countries has fallen to almost zero. Within the shrinking defense budget environment, the Hungarian Home Defense Forces has not able to place enough orders to maintain pre-1989 production levels. Therefore, most of the companies that were involved in defense related production found themselves in a very difficult financial situation after 1990. Many companies went out of business; in some cases, a few branches of the original company are still in operation.

Today there are about 60 companies that are involved in defense related products and services. Nine companies are directly connected to the Ministry of Defense. These are mainly R&D companies and trading companies. The major defense firms are listed below:

Fuzfo Nitrochemical Works
Telecommunications Research Institute
Danubian Aircraft Company
Technika Foreign Trading Company
Mechanical Works
Automotive Industry Research and Development Institute
Miki Measurement Technology Development Company
Matravideki Metal Works
Feg Arms and Gas Appliances Factory
HM Arzenal Electromechanical Co.
HM ArmCom Communications Ltd.
HM Currus Combat Vehicle Technic Co.
HM Elektonic Directorate
HM Radar Radio Engineering Inc.

The Hungarian Government created a Defense Industry Office (DIO) within the Ministry of Industry and Trade to oversee the activities of the 60 companies in the defense sector. The DIO presented a program to the government to revitalize the defense industry. The plan evaluated the needs of all armed forces in Hungary (military, police, border guards, and civil defense forces) and examined how much of their needs can be filled by domestic production. In the past local contracts accounted for only 20 percent of total production; 80 percent of production was exported. This ratio has become more balanced as the domestic defense industry has downsized. The Government’s reconstruction strategy will include solutions on how to better match domestic supply and demand, and how to make the Hungarian Defense Industry more competitive in foreign markets, mainly by ensuring that products are compatible with NATO equipment.

About 25 percent of the Hungarian Armed Forces' needs are satisfied by local producers. These products are mostly small arms, electronic parts, ammunition and clothing. Germany has supplied arms and spare parts to Hungary from the stocks of the former East German Army. Germany provided the equipment free of charge in recognition of Hungary's role in the fall of the Iron Curtain in 1989. In 1993, Hungary received 28 MIG-29 Fighters from Russia as half of the

settlement of Russia's outstanding $1.6 billion debt to Hungary. As further debt settlement of USD 150 million, Russia delivered 97 BTR-80 armored vehicles and 20 armor-piercing rocket launchers, engines for MIG-29 fighters and runway equipment. U.S. companies supplied the IFF systems for the upgrade program of the Air Defense Forces through the FMS program. In April 1996, MOD bought one hundred T-72 tanks from Belarus to replace outdated T-55 tanks. With the 100 new tanks, Hungary will temporarily exceed the limits stipulated by Mutual Balanced Force Reduction Treaty, thus Hungary has undertaken to destroy 100 T-55 tanks. No decision can be expected before the end of 1996 on the modernization of the remaining T-55 tanks.

Defense Opportunities

Regarding specific programs, air defense systems remain a high priority. The main focus of development will be upgrades in the following areas:

- avionics
- air traffic control (ATC)
- radar systems
- command and control
- short-range missiles
- communication and information systems

In addition to the list above, another priority area is the upgrade of tactical units and command and control, especially NATO compatible radios.

Hungary is a participant in the Regional Airspace Management Initiative Program proposed by President Clinton in 1994. The creation of an Air Sovereignty Operations Center (ASOC) will provide the Hungarian military with a modern, centralized command and control center for air sovereignty and air defense purposes. The U.S. funded program is being led by the USAF Electronic Systems Center, Hanscom AB, MA. The ASOC is programmed to be established first in Hungary in late 1996 or early 1997. The RAI Program is a high priority for the Hungarian Government and military in their effort to upgrade their air defense and air sovereignty systems. In order to support these modernization efforts, the Hungarian military is in the process of preparing a tender for two 3-D long range surveillance radar systems.

The GOH has available approximately USD 1.7 million from the Partnership for Peace Initiative for the purchase of new communication equipment for the Hungarian Home Defense.

The Ministry of Defense (MOD) intends to purchase HUF 30 billion (USD 100 million) worth of ground-to-air missiles and tracking systems through a long-term credit arrangement. The first round of the tender was declared unsuccessful as none of the seven bidders met all the requirements. MOD is continuing talks with four of the bidders including Hughes Aircraft. The procurement is urgent as the new equipment is planned to be put into operation in 1998-1999. The tender invitation for the new tracking system has been drafted but will not be published until the question of financing is settled. As stipulated by Parliament, financing must include at least a 2-3 year moratorium on payments, an 8-12 year payment schedule, and full consideration

provided to offsets and industrial cooperation opportunities.

The same financing conditions would apply to the procurement of about 30 fighter aircraft to replace aging MIG-21, MIG-23 and SU-22. The Saab (JAS 39 Gripen), Dassault (Mirage), Lockheed Martin (F-16), and McDonnell-Douglas (F/A-18) have all submitted proposals. The Hungarian government has postponed the tender until the second part of 1997. The reason behind the delay is to wait for NATO's decision concerning Hungary's admission. If Hungary does not buy new planes, its three air-divisions will shrink to just one MIG 29 division by the year 2000. Lockheed Martin and McDonnell Douglas have offered very generous lease plans in coordination with the U.S. Air Force F-16, U.S. Navy F/A-18 and the Defense Security Assistance Agency. Both Lockheed and McDonnell Douglas have pledged approximately one billion dollars worth of industrial cooperation in conjunction with a new plane purchase agreement and some industrial cooperation in conjunction with a used plane lease.

Existing sub-contractors and companies wishing to do business in this area should contact both companies for opportunities.

At Lockheed please contact:
Mr. Douglas Miller, Program Director Hungary
POB 748 Fort Worth, TX 76101 Mail Zone 1611
Tel: (817) 777-7657

At McDonnell Douglas:
Mr. Thomas E. Williams, Vice President Communications and Special Events
Mail: 0011312 POB 516, St. Louis, MO 63166-0516
Tel: (314) 232-5229

There are also possible future defense opportunities in upgrading existing weaponry. This includes upgrades to existing equipment, technology transfer, joint ventures, and US purchases of Hungarian-manufactured products. One example is the replacement of the existing Russian-produced engines in Hungary’s MIG-29 fleet. These engines have a very short life span, high maintenance costs, high replacement costs, and very high fuel consumption rates.

Defense Procurement Process

Defense procurement in Hungary is typically subject to a tendering process. Presently, normal commercial tendering procedures apply. A new law on government procurement specifying tendering and purchasing procedures for government contracts was passed in November 1995. Although the Ministry of Defense has a license to negotiate and buy directly, most of the procurement and tenders are conducted by the Tender Office of the Ministry of Defense.

Decisions on contract awards are made by the Minister of Defense with the consent of the

Ministry of Industry and Trade, as well as the Ministry of Finance and approved by the Parliament. In addition, Parliament can authorize additional funds for defense purchases which cannot be covered from the MOD budget.

Diversification/Commercial Opportunities

Despite the painful adjustment from a command to free-market economy, many commercial opportunities exist for U.S. firms.

Privatization

The state privatized a major portion of the gas, electricity and telecommunication sectors in the latter part of 1995. Major privatization also took place in banking, pharmaceuticals and elsewhere. Hungary is the only country in the region to have privatized large parts of its telecommunications and energy sectors. By the end of 1996, 70-75% of GDP will be in private hands. In 1995 alone, the GOH earned $4.5 billion in privatization proceeds.

The defense industry, however, is handled as a special group within this privatization program. In 1995, there were about 60 companies in the defense related industry. In most cases, the government retains partial ownership, with share holdings ranging from 25 percent to 50 percent plus one vote.

Listed below are government contacts related to privatization:

APVRT Hungarian Privatization and
State Holding Co.
Pozsonyi u. 56.
H-1133 Budapest
1399 Budapest, POB 708
Tel: 011-36-1-269 8600
Fax: 011-36-1-149 5745

Ministry of Industry and Trade
Defense Industry Department
Mr. Gyorgy Szatmary
Head of Department
Vigado u. 6.
H-1051 Budapest
P.O. Box 111, H-1880 Budapest
Tel: 011-36-1-266 8476 or 118 5044/ext 395
Fax: 011-36-1-118 5421

Several industry sectors have been identified by the Foreign Commercial Service as "best prospects" for U.S. industry and are briefly described below.

Aerospace

Hungary does not have an indigenous aircraft manufacturing capability. All civilian and military aircraft are imported. Although some Hungarian companies are involved in the development of avionics upgrades and electronic systems for aircraft, most of the installed systems are imported. The Hungarian Home Defense Forces (HHDF) presently have two Fighter Wings consisting of MIG-21, MIG-23, SU-22, and MIG-29 Aircraft. The MIG-21 and SU-22 Aircraft are approaching the end of their useful life within the next five years. A total of twenty-eight MIG-29 Aircraft were obtained from Russia in late 1993 as part of a government-to-government debt resettlement arrangement.

Hungary's transport fleet consists of eight AN-26 aircraft which were purchased in used condition. HHDF helicopters are MI-24, MI-17. MI-8, and MI-2 aircraft. All Hungarian military aircraft are of Soviet design and most will require replacement in the next ten years. Exceptions are the two Czech designed L-39 "Albatros" training aircraft.

The government has expressed a desire to obtain Western aircraft and systems in order to replace the aging MIG-21's and SU-22's and to increase NATO inter-operability. A decision on issuing a tender for aircraft procurement has been put off until the second half of 1997. Industrial offsets and long-term advantageous financing are key to Hungary’s consideration of an aircraft purchase.

The availability of spare parts to maintain aircraft in operational condition is a major concern of the military. The HHDF has two major aircraft maintenance facilities: Kecskemet Aircraft Maintenance Facility (Kecskemet Airbase) which conducts intermediate maintenance of fixed-wing aircraft; and the Danubian Aircraft Maintenance Company which performs depot level overhauls on helicopters, MIG-21 and L-39 fixed-wing aircraft. At present, engine overhauls can only be performed in the former Soviet Union and must be paid for in hard currency.

The Hungarian military has expressed great interest in the upgrade of aircraft avionics Systems to NATO and Western compatibility standards. In 1992, the first FMS case among former Warsaw Pact countries was signed for the installation of U.S./NATO-compatible IFF Transponders and ground interrogation radars in the Hungarian Air Forces. This FMS sale was part of an overall Hungarian effort to improve the air defense capabilities of the military. Hungarian military airfields do not have Western technology precision approach and landing systems (except Taszar temporarily used by the IFOR troops), the non-precision NDB provides the only Western compatible approach system. The only civilian airfield with Western precision approach and landing systems is Ferihegy International Airport in Budapest.

The military is not able to generate a sufficient amount of contracts for Danubian Aircraft Maintenance Company. Therefore the company would like to extend its services to the civilian sector as well as to neighboring countries. Danubian Aircraft Company has some production capabilities as well. The company produces parts for the Gripen Aircraft (components to the tail section) manufactured by Saab of Sweden. Duna Aircraft is open to discussion with other possible joint venture partners on local production of parts.

Telecommunications

The Hungarian telecommunications sector went through major changes during the last two years. The Telecommunications Law, which came into force in July 1993, created the framework in which to initiate privatization and introduce competition·

The Hungarian Telecommunications Company (MATAV) is the owner of the National Digital Overlay Network. MATAV is the largest service provider with national monopoly rights for long distance and international services until the year 2002. The Ministry of Transport, Telecommunications and Water Management is considering the possibility of shortening MATAV's monopoly by one to two years. MATAV also is responsible for providing local services in 39 of Hungary's 54 rural telephone districts. Because of its size and importance, MATAV is in a position to influence decisions on national technical specifications and standards. In 1993, MATAV was "privatized," 30.2 percent of the company's shares were sold to a consortium consisting of Ameritech and Deutsche Telekom. In 1995 the same consortium increased its stake in MATAV to 67%.

Besides MATAV, a number of new companies will service local areas. Seven partly foreign-owned consortia received concession rights in 1994 for local telecommunications services in 14 rural telephone districts. Three of these local telephone operators include U.S. investors. Hungary has four sizable private networks, which are all under reconstruction (MAV Hungarian Railways, MOL Hungarian Oil Company, MVM Hungarian Electricity Company, State Flood and Waterways Management Service). These networks have only restricted telephone service rights but they might become competition to MATAV in a couple of years in the fields of data communications, leased lines and dedicated lines services. Besides these private networks, government agencies also maintain proprietary networks (Ministry of Interior, Ministry of Defense), which are planned to be upgraded and extended. Antenna Hungaria, formerly called the Hungarian Broadcasting Company, is another emerging competitor to MATAV. Antenna Hungaria is the second largest telecommunications company, holding operation rights for certain specialized areas.

A number of private companies are active in the wireless field. Three mobile systems are in operation in Hungary. Joint ventures of U.S. West and MATAV operate a 450 MHZ analog (Westel 450) and a 900 MHZ digital GSM (Westel 900) mobile system. Hungary has two licenses for GSM Services, the second license is held by Pannon GSM, a Scandinavian consortium. Five companies received licenses in 1992 to build and operate VSAT Systems. Four of them (Hungaro Digitel, Sat-Net GTS Hungary and Banknet) have already set up their earth stations in Hungary and started building networks for banks and government offices·

In 1995, MATAV installed 330,000 new subscriber's lines (equivalent to 24 lines per 100 persons), 1,389 public coin phone booths and 1,054 public card phones, spending a total of $400 million (HUF 64 billion) on investments. The target is to increase the penetration rate to 35-40 lines per 100 persons by the year 2000. In 1996, MATAV will install 300,000 new telephone lines. Under the terms of a 1993 concession contract, MATAV has promised to end waiting lists for telephone service by the end of 1996.

MATAV has made a priority of replacing analog lines with digital. Currently, 60% of its exchanges are digital. The Hungarian Digital Backbone Network was successfully constructed during 1992-1995. Within this project an optical fiber network of approx. 3,000 km. and a digital microwave network of approx. 1,800 km were deployed. Opportunities are emerging on the subscriber network field at MATAV as well as at the new local telephone operators. The development of these subscriber networks is expected to feed the demand for new transmission technologies.

The equipment market is completely liberalized. Procurement for the major projects are financed from international financial sources (IBRD, EBRD, IFC, etc.). These procurement require a tendering process. In other cases buyers are free to select vendors themselves. American equipment vendors have to compete with very aggressive European vendors for contracts. Major vendors present in the market are: Ericsson, Siemens, Alcatel, Northern Telecom, and AT&T.

Communication Equipment and Computers

A demand for integrated computer and telecom systems is emerging. A number of banks and governmental agencies are in the process of installing IT systems. These projects require not only hardware, but systems integration as well. A yearly growth rate of 10% is predicted for the IT market during 1995-1999. With the stabilization of the economy, postponed IT procurements will be conducted. The stagnation of PC sales in 1995 (about 120,000 pieces sold) was due to the 9% devaluation of the Forint in March, 1995, and the introduction of the 8% import surcharge, both part of the austerity package. The import surcharge will be phased out by June, 1997. The Hungarian ALBACOMP assembles 17-18,000 PCS a year. With this figure it leads the list of the PC suppliers with a market share of about 14% followed by Compaq, IBM and DEC. Dynamic growth sectors are:

- systems and servers
- workstations
- active networking elements (routers, bridges, modems)
- professional services

Market opportunities are especially good in the banking field where USD 100 million IT procurements are expected within 2 years. Further major market sectors are: government, education, telecom and industry.

Environment

Environmental issues are becoming more and more of a concern in Hungary. Environment related programs are progressing slowly due to the lack of funding. One of the most important environmental programs is the clean-up of the former Soviet military bases. The rehabilitation program covers 171 bases, 340 localities and about 6,000 buildings and also the soil belonging to and neighboring these bases. To date, the clean-up of only 12 bases has been completed which provides ample opportunities for U.S. firms in this area.

A portion of the clean-up is sponsored by the government. Local governments and private enterprises are also seeking ways to exploit the former bases. Without adequate resources for clean-up, the projects are going forward very slowly and in most cases are focusing on pollution containment only.

Safety and Security Equipment

One manifestation of the economic changes has been increased crime. Governmental statistics indicate that about 80 percent of crime in Hungary is directed towards property (car theft, residential, burglaries, shoplifting, vandalism etc.). There are an estimated 1,200 businesses and individuals engaged in the safety and security market (manufacturers, importers, installation). Approximately 85 percent of the domestic market is supplied by imports. The largest foreign suppliers are: 1) Germany 2) U.S.A., 3) Austria, 4) Italy, 5) Israel.

The government is the prime purchaser of safety and security equipment. While many agencies of the government are suffering from budgetary constraints, there are numerous planned procurement over the next few years. The objective is to increase the protective services offered by the government agencies, such as the police, the fire brigades, the border guards, and other armed forces.

Transportation/Health Care

Procurement in the sectors of transportation and Health care is decentralized. Major Hungarian vehicle producers are Ikarus (buses) and Raba (trucks). General Motors and Suzuki have assembly plants and Ford, Loranger, Audi and ITT have parts manufacturing facilities in Hungary. Other companies playing major roles in the Hungarian market are Volkswagen, Lada, Fiat and Toyota.

There is a great need for health care/hospital technology in Hungary. The equipment currently in use is outdated and requires continual maintenance. However, the lack of funds postpones almost all the projects in this area. There is some small scale interest arising from private clinics, the number of which is increasing.

The following is a list of contacts for the commercial product areas described above.

Ministry of Transport, Communications and Water Management
International Department
Mr. Andras Hardy, Director General
Dob utca 75-81
1077 Budapest
Tel: 011-36-1-351 7522
Fax: 011-36-1-322 3480

Ministry of Industry and Trade

Mr. Erik Szarvas, U.S. Desk Officer
Hoved u. 13-15.
1880 Budapest V.
Tel: 011-36-1-112 2842, or 331 4149
Fax: 011-36-1-332 9750

Ministry of Environment and Regional Policy
Ms· Eszter Szovenyi, U.S. Desk Officer
Fo utca 44-50
1011 Budapest
Tel: 011-36-1-201-2846
Fax: 011-36-1-201-4133

Please note that in the telecommunications field the market is decentralized, the Ministry of Transport, Communications and Water Management is only responsible for regulatory issues. Companies operating in the telecommunications field make their own decisions regarding procurement. The same rule applies for the security equipment and the health care equipment fields.

Doing Business in Hungary

Western business standards apply in Hungary. The largest drawback may be the language barrier. English is becoming more and more commonly spoken in the business community; however in defense circles only a few people speak English. MOD usually provides its own interpreters for the meetings; for meetings with other agencies and companies it is advisable to take an interpreter. Correspondence can be in English. However, in most cases, tender offers must be submitted in Hungarian. It is also advisable to translate product documentation into Hungarian.

Trade Regulations

Imports are subject to customs duty and the rate depends on the type of the product. The Custom Authorities release the product only after customs duty, 1% of statistical fee and 15% of handling fee was paid. Hungary has a value added tax (VAT) system. The VAT is 25 percent for almost all goods, except pharmaceuticals and some basic foodstuffs.

Exports, imports, transit and trading of defense related products are controlled by the Export Control Office of the Ministry of Industry and Trade. There are about 60 companies that have licenses to conduct business in this area. The Ministry of Defense and the Home Defense Forces and the Ministry of Interior have their own licenses for imports; therefore, they can negotiate directly with foreign suppliers. The U.S. Embassy advises that U.S. companies check if the Hungarian company has a license before they enter into any serious negotiations. For further information contact:

Ministry of Industry and Trade
Export Control Office

Col. Jozsef Bode, Director General
Vigado U. 6
1051 Budapest

Tel: (36-1) 118-0655
Fax: (36-1) 118-3742

Almost all the products that are to be sold in Hungary must go through a type approval or certification process. The type approvals/certificates are provided by the Research Institutes of the relevant industry, or by the Quality Control Institute (KERMI). Hungary does not accept certificates of foreign countries, testing by the relevant Hungarian institution is necessary for the certificate.

U.S. Government Points of Contact

The following is a list of useful contacts for U.S. firms interested in the Hungarian market.

U.S. Embassy

Foreign Commercial Service
John J. Fogarasi
Commercial Attaché
Szabadsag ter 7.
Bank Center, Granite Tower
H-1054 Budapest
Tel: (36-1) 302 6100
Fax: (36-1) 302 0089

Col. Arpad Szurgyi, Defense/Army Attache
Col. Jon L. Martinson, Air Attache
U.S. Embassy,
Szabadsag ter 12.
Tel: (36 1) 267 4400
Fax: (36 1) 269 9326

LTC Michael J. Strang,
Chief of Office Of Defense Cooperation
U.S. Embassy,
Szabadsag ter. 12.
Tel: (36 1) 267 4400
Fax: (36 1) 269 9338

Trade Association

Peter Fath, Executive Director
American Chamber of Commerce
Deak F. u. 10.
H-1052 Budapest
Tel/Fax: (36 1) 266 9888