HUNGARY

TRADE SUMMARY

The U.S. trade deficit with Hungary was $2.0 billion in 2002, an increase of $328 million from $2.3 billion in 2001. U.S. goods exports in 2002 were $688 million, up 0.4 percent from the previous year. Corresponding U.S. imports from Hungary were $2.6 billion, down 11.0 percent. Hungary is currently the 60th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Hungary in 2001 was $1.3 billion, down $29 million in 2000.

IMPORT POLICIES

Tariffs

Hungary's trade policies are shaped primarily by its World Trade Organization (WTO) commitments and its European Union (EU) accession plans. Hungary's average most-favored-nation (MFN) import duties have fallen from over 13 percent in 1991 to 7 percent in 2002. Customs duties on textile products range from 0 percent to 13 percent. Hungary has a preferential trade agreement with the EU (the Europe Agreement) and free trade agreements with the European Free Trade Area (EFTA) countries, its Central European neighbors (CEFTA), Turkey, and Israel.

Hungary's progressive implementation of Uruguay Round agreements has generally improved U.S. market access to Hungary. Hungary has not yet acceded to the WTO Information Technology Agreement, but will have to implement its tariff-cutting provisions upon accession to the EU, projected for 2004. Hungary is not a signatory to the WTO Plurilateral Agreement on Civil Aircraft either, but renewed for 2002 a waiver of import duties on the leasing or purchase of non-EU aircraft, parts and engines by state-owned Malév Hungarian Airlines.

Under its Europe Agreement, Hungary eliminated tariffs on industrial products from the EU on January 1, 2001. Many U.S. products are still subject to Hungary's MFN rates, and often encounter significant tariff differentials when competing against EU products. Moreover, in 2000, Hungary and the EU reached agreement to further liberalize agricultural trade. These "zero-for-zero agreements" end EU agricultural subsidies for goods exported to Hungary. In return, Hungary eliminated tariffs on most EU agricultural products. As a result of these agreements, U.S. industrial and agricultural products are disadvantaged relative to EU products. For the most part, these differentials will diminish when Hungary adopts the EU's common external tariff (CXT) upon EU accession in 2004, but until then U.S. exporters may face significant disadvantages.

To address the tariff differential issue, on January 30, 2002, the United States and Hungary signed a trade package that reduced tariffs on approximately $180 million of annual U.S. exports to Hungary as of April 1, 2002. The products include the following: steam and gas turbines, large engine autos, auto and tractor parts, automatic data processing machines, office machine parts, beauty products, various chemicals, plastics, medical instruments and equipment, laser disks, telephone equipment, almonds, pecans, grapefruit and bovine semen. In most cases, Hungary agreed to reduce the tariff to the EU's CXT.

Nontariff Barriers

About 96 percent of imports (by value) no longer require import licenses and the number of product categories under quota constraints is decreasing yearly. For consumer goods, import licenses are required only from non-WTO countries for footwear, apparel, dry goods and fish. Under WTO rules, Hungary must phase out quotas on textiles and apparel by 2004. As a result of the WTO Agricultural Agreement, Hungary has progressively replaced quotas on agricultural products and processed foods with tariff-rate quotas.

In October 2000, Hungary resolved a long-standing trade dispute with the United States over Hungary's Uruguay Round commitments on beef imports. As a result, Hungary increased its annual quota on high quality North American beef to 200 metric tons per year in 2001. However, public and official concerns over bovine spongiform encephalopathy (BSE) and foot and mouth disease outbreaks, and a weak distribution system for this kind of beef, mean that U.S. beef exports have yet to fill the quota.

U.S. firms producing in Hungary, especially auto parts manufacturers, complain that

Hungarian tax authorities refund the customs duties and fees paid on these “imports for re-export” too slowly, tying up of large sums of money. Furthermore, the Pan-European Cumulation system hampers the exports of items such as lumber and veneer products to Hungary. Under this recently introduced system, Hungary no longer refunds customs duties on U.S.-origin inputs used in the production of goods subsequently exported under preferential trade agreements involving the EU, Hungary and other countries.

STANDARDS, TESTING, LABELING AND CERTIFICATION

On February 26, 2001, Hungary and the EU signed a Protocol to the Europe Agreement on Conformity Assessment and Acceptance of Industrial Products (PECA). The agreement took effect on June 1, 2001. The agreement eliminates the need for further product testing and certification of EU-origin products covered by the PECA. Products originating in non-EU countries - even if tested and certified to EU requirements - may not benefit from these agreements. For example, U.S. medical device exports often face additional testing upon entry into Hungary. The United States has repeatedly raised its concern - bilaterally, with the EU and in the WTO - that the rule of origin provision in these agreements unjustifiably discriminates against non-EU origin products and is inconsistent with WTO obligations. The European Commission and Hungary are now negotiating to remove the problematic origin provision from Hungary’s PECA, and may finish this process in early 2003.

Hungarian import regulations limit and delay imports of breeding animals, livestock semen, planting seeds, and new plant varieties. These regulations include requirements that all bovine semen that enters Hungary be purchased through domestic animal inspection centers and submit to a 30-day in-country quarantine. According to U.S. industry estimates, potential sales without these restrictions could be worth up to $10 million. In January 2001, Hungary suspended import licenses for U.S. beef, bovine genetics, and pet food products in response to the BSE outbreak in Europe. Hungary called this action a precautionary suspension while it consulted with the EU, and took this step to prevent problems for Hungary's exports to the EU. Hungary reopened imports of bovine semen and non-ruminant protein pet food in February 2001.

In January 2002 Hungary introduced new “EU harmonized” certificate requirements for meat, bovine semen, and pet food, without notifying the affected foreign countries and the WTO Sanitary and Phytosanitary Committee. The United States and Hungary have not yet completed equivalency negotiations on the new requirements. As a result, unclear certification may hamper the exports of some animal products to Hungary.

In 1998, Hungary adopted legislation governing genetically modified organisms (GMOs) in agriculture. These laws, designed to bring Hungary into harmony with EU law, impose import restrictions that primarily affect new plant varieties. The Ministry of Agriculture requires a multiyear registration procedure. Final approval for field trials rests with a mixed committee that includes scientists and environmentalists. The market for seed imports is relatively small (estimated at $18 million in 1998), but U.S. firms in Hungary also produce seed and plant stock for other markets. U.S. industry estimates that elimination of the current restrictions on imports and field trials would lead to additional U.S. exports of $10 to $25 million.

GOVERNMENT PROCUREMENT

Hungary is an observer but not a signatory to the WTO Agreement on Government Procurement (GPA), however it must accede to the GPA upon becoming an EU member. Hungary has been a strong supporter of the negotiations of a WTO Agreement on Transparency in Government Procurement and in1999 co-sponsored, with the United States and Korea, a proposed agreement on Transparency in Government Procurement .

The total value of public procurement in the first three-quarters of 2002 was 541.7 billion Hungarian forints (HUF) ($2.3 billion), an almost 10 percent increase over the same period in 2001. Of these, 73.9 percent were open tenders, up from 72.2 percent in 2001. Eight hundred thirty complaints came before the Public Procurement Arbitration Court in 2001; of these, 325 were found to have merit.

The 1995 Public Procurement Act regulates foreign access to government-funded construction, service and supply contracts. Tenders must be invited for the purchase of goods in excess of HUF 10 million ($43,000) and for the purchase of services in excess of HUF five million ($21,500). Three provisions of the current law allow preferential treatment of Hungarian companies. The first allows governmental institutions to issue tenders that explicitly exclude foreign firms, but it is rarely invoked. The second provision allows these institutions to award contracts to bids with at least 50 percent Hungarian content even if the price is 10 percent higher than majority-foreign bids. A third provision allows tenders to require the participation of local subcontractors or local labor. These provisions are expected to remain in place until EU accession. The Hungarian government has not begun electronic online procurement yet, having postponed its launch several times.

Some U.S. firms have expressed concern about the lack of transparency and an apparent EU bias in government tenders, particularly in the defense sector. In more than one case the government has postponed making a decision on a large or sensitive procurement without explanation, or transferred decision-making authority from the relevant ministry directly to the Prime Minister's office. Purchases related to state security, as well as purchases of gas, oil, and electricity, are subject to several exemptions from public procurement regulations. All defense-related procurement over HUF 1 billion ($4.2 million) must also be combined with an offset package of at least 100 percent of the offset basis. Thirty percent of the undertaken offset value should be investment in Hungary. These offset requirements are mandatory and inflexible and represent a significant barrier to U.S. defense exports to Hungary. The current government is attempting to install more transparency into public procurement, including by requiring greater accountability and financial reporting by sub-contractors in an effort to minimize conflicts of interest.

EXPORT SUBSIDIES

Hungary provided export subsidies only for a few marginal commodities in 2002 (e.g., live hogs to destinations outside the EU or the Central European Free Trade Agreement area). In accordance with a 1997 agreement with the United States and other petitioning members of the WTO, Hungary's WTO waiver concerning support for agricultural exports expired on January 1, 2002. As a result, Hungary's legal export subsidy opportunities dropped to $106 million for sixteen designated groups of products. The expected value of such subsidies in 2003 is about $10 million. The United States has encouraged Hungary to take advantage of less trade-distorting agricultural support opportunities offered under WTO rules.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

With one major exception (the protection of confidential pharmaceutical test data), Hungary's intellectual property rights (IPR) laws are adequate, though insufficient resources, court delays and relatively light penalties hamper enforcement. Copyright industries report that piracy of audiovisual works and computer software remains at unacceptably high levels.

Data Exclusivity

In April 2002 the Office of the United States Trade Representative announced that it would keep Hungary on the Special 301 Priority Watch List for a second year because Hungary does not adequately protect the confidential test data submitted by pharmaceutical companies seeking marketing approval. This deficiency appears contrary to Hungary's obligations under Article 39.3 of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which required such protection by January 1, 2000. On January 1, 2003, a Hungarian government decree to provide this data exclusivity protection took effect, but offers retroactive protection only for test data submitted on products granted marketing authorization on or after April 12, 2001, rather than back to January 1, 2000 as required by TRIPS.

Hungary claims that its unfair competition legislation adequately prevents 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 U.S. pharmaceutical industry estimates it would increase sales by up to $100 million annually if Hungary rectified the data exclusivity problem and other weaknesses in its patent protection regime. The United States has taken every opportunity to urge Hungary to remedy this situation.

Patent Protection

Despite having strengthened its patent protection following the conclusion of the U.S.-Hungary bilateral agreement on IPR protection in 1993, the Hungarian patent protection system needs improvement. Specifically, persistent problems in the judicial system hinder protection of patent rights. U.S. interests have tried unsuccessfully to get the judicial system to reverse the burden of proof in patent infringement cases, and to obtain injunctive relief prohibiting the marketing of products that the courts have ruled as infringing on patent rights. The lack of relevant technical expertise in the courts can result in such cases taking three or more years to reach conclusion. Penalties awarded in such cases are considered to be too low to act as effective deterrents.

Copyright Protection

In 2002 Hungary became a contracting party to two World Intellectual Property Organization (WIPO) treaties: 1) the WIPO Copyrights Treaty; and 2) the WIPO Performances and Phonograms Treaty. Hungarian copyright laws generally conform to international standards, but weak enforcement means piracy is still widespread. Video and cable television piracy abounds; local television and cable companies regularly transmit programs without authorization. U.S. industry estimates total losses due to piracy at $91.1 million in 2001, up 34 percent since 2000. Most recent U.S. industry statistics indicate that 35 percent of videotapes and 60 percent of optical disks sold in Hungary are pirated copies. However, the estimated level of unauthorized cable programming has dropped from 60 percent to 30 percent in the last year. The estimated public performance piracy rate is 50 percent.

The 1999 Copyright Act strengthened Hungary's copyright laws and has helped to drive piracy of audiovisual works and transmissions underground. The Copyright Act, however, does not expressly provide for civil *ex parte* searches, although the Hungarian government asserts that such measures are available under the Civil Procedure Act. The U.S. software industry is now testing whether these alternative procedures provide an adequate means for obtaining civil *ex parte* searches. In 2000, the Criminal Code was amended to impose more severe penalties, including eight years imprisonment for video piracy and two years for signal theft. In 2001, the Budapest Police Economic Crime Unit initiated almost 7,500 criminal investigations involving piracy (slightly up over year 2000), and closed some long-pending cases.

SERVICES BARRIERS

Hungary does not have an Open Skies civil aviation agreement with the United States. Under the terms of the current U.S.-Hungary aviation agreement (signed in 1989), U.S. airlines wishing to operate direct flights to Hungary or make code sharing arrangements must gain approval of Hungary's Civil Aviation Directorate (CAD) for each route. The CAD must renew approval of the flight schedule periodically. Although one U.S. carrier now provides direct air cargo services to Hungary, Hungary's difficult and nontransparent documentation and customs procedures further hinder the provision of air courier services. There is no prearrival processing or regular review of the *de minimis* value regime for packages. Customs procedures often create unnecessary delays, which increase costs and decrease efficiency for express courier operators.

To finalize its EU accession negotiation chapter on audiovisual services, Hungary passed an amendment to the 1996 Media Law in July 2001. The new law requires that over 50 percent of public and private TV broadcasting be of European origin and over one-third be Hungarian. The law gives broadcasters until EU accession to implement the provisions, but makes no exceptions for programming broadcast to other countries or thematic channels, and does not include the "where practicable" language of the EU's Television without Frontiers Directive that might allow such activities. The Media Act revision also limits any single cable provider to one-sixth of the household market.

Foreign lawyers wishing to practice in Hungary are required to work with Hungarian lawyers. This has led to the conclusion of so-called "cooperative agreements" between Hungarian and U.S. firms to provide clients both Hungarian and international legal advice. Foreign lawyers cannot provide legal advice on foreign or international law without being licensed in the practice of Hungarian law.

Only a Hungarian-certified accountant may conduct audits, but this individual may work for a foreign-owned firm. Foreign nationals may be licensed as architects and engineers, but they must first have their degrees examined for equivalence by Hungarian authorities, and may be required to sit for qualifying exams in some cases. They must then be registered locally and join the local chamber of architects and engineers.

A 1998 decree that the government has never enacted would restrict the distribution of products by direct marketing. This decree prohibits the direct sale of certain products, such as therapeutic substances not classified as pharmaceutical products and foodstuffs. It also imposes a requirement that distributors obtain a vocational training degree. Direct marketers are currently operating in Hungary, but under the threat that the government may enact the restrictions.

INVESTMENT BARRIERS

Hungary's early commitment to privatization of large state enterprises made it a leading recipient of foreign direct investment in Central Europe. Hungary progressively reduced state ownership in "strategic" enterprises but has sometimes retained a single golden share, with veto rights retained in some cases. With EU accession in May 2004, Hungary will have to relinquish its remaining golden shares. The government has announced plans to sell some or all of its remaining stake in some key infrastructure monopolies, including in the telecommunications, energy, transportation and banking sectors. Currently, Hungary restricts ownership in varying degrees in civil aviation, defense and broadcasting. Only Hungarian citizens may own farmland; this will gradually change after EU accession.

Hungary plans to liberalize its gas sector in 2004 which should spur investment. Under the current system, the government controls the domestic price at artificially low levels and rarely approves exports at world market prices. Gas liberalization may help make oil exploration profitable by raising the price, but would require a more complex corporate structure from the participants. In order to improve transparency, companies will have to separate production, storage, transportation, trade, and distribution. An exploration company would thus have to create a separate company to sell its gas.

U.S. petroleum firms involved in exploration activities in Hungary indicate that though the draft law is an improvement, it still has significant flaws. They point out two major disincentives to investment in the current draft: 1) the partially state-owned monopoly MOL retains exclusive rights as the public utility wholesaler; and 2) no provision exists for cross-border swaps. These mean that gas producers would still only be able to sell to MOL domestically, and could not participate in international swaps. (Swaps, which trade gas in one country for that in another, are the easiest way to expand participation in the international gas market.) The draft law instead speaks of regulating the "cross-border physical flow" of gas. It is also unclear as to whether the law will treat the EU as a single market without internal borders for the purpose of energy trading, or as individual markets.

Government delays in approving energy price increases have repeatedly prevented U.S. and other foreign firms from realizing the eight-percent returns guaranteed in energy privatization contracts. The Hungarian government has limited energy prices to consumers in line with predicted inflation levels of six percent per year, despite actual inflation in 2000 of almost 10 percent. However, this situation will begin to change as the electricity market began opening on January 1, 2003, allowing large industrial users to choose their energy suppliers.

ELECTRONIC COMMERCE

Hungary has only recently begun to deal with electronic commerce issues and liberalize its market to make doing e-business in Hungary a more attractive prospect. A new telecommunications act which seeks to eliminate the local and long distance monopoly of the formerly state-owned telecommunications company (Matáv) took effect on December 23, 2002. No real challenger has emerged to Matáv due to disagreements over interconnection fees between Matáv and alternative service providers, as well as the lack of serious interest from foreign investors due to the global slump in the telecommunications sector. The government plans to introduce further assymetrical legislation in 2003 to encourage a second market player.

All firms face structural obstacles in entering the Hungarian e-commerce market. According to OECD estimates in 2000, Hungary has the highest Internet access costs of any OECD member in purchasing power terms ($4.30/hour, compared to the lowest, the United States, at $0.58/hour). Users pay both per-minute telephone and Internet service provider fees. Matáv canceled a popular flat-rate telephone charge Internet access package in spring 2002 because the package did not significantly boost usage; however, the announcement still caused a public uproar. Telecomm liberalization did not significantly reduce the cost of Internet access. Without real decline in local telephone prices, Internet use (currently 17 percent) will remain below the EU average, although broadband access is a growing alternative. PC penetration stands at only 22 percent, and many of those machines have 386 processors, which are incompatible with much newer software.

Businesses that hope to market their products online in Hungary face low (but rapidly rising) credit card use rates, a lack of good delivery companies, and a general public distrust of purchasing products online or through the mail. An electronic signature law took effect on September 1, 2001, and the Hungarian parliament passed electronic commerce legislation governing information disclosure for online sales in December 2001, including provisions banning unsolicited e-mail.

Sales via the Internet are unrestricted, but subject to taxation. Internet purchases delivered from abroad are subject to customs duties as well as value-added tax (VAT), and VAT is also collected on purchases if delivered from within Hungary. The Customs Office assesses and collects VAT on software imported on physical media and/or installed on hardware. No customs duty payment is required in case of software purchased and delivered via the Internet; however, the VAT is to be paid after the purchase on a self-assessment basis.

Hungary has agreed in principle with the U.S. goal of an indefinite extension of the current moratorium on customs duties on electronic transmissions. The ease, and potential for abuse, inherent in software sales via the Internet may make this a target of scrutiny in the future, since this is a potential source of unlicensed software in Hungary.

OTHER BARRIERS

Hungary has a national healthcare system, under which the government decrees which pharmaceutical products it will subsidize. For cost reasons, the program tends to favor domestically-produced generics over imported products still under patent protection. Shortly after taking office in May 2002, the new Socialist government decided not to implement a three-year agreement with 128 domestic and foreign pharmaceutical manufacturers on drug subsidies, citing budgetary pressures. The March 2001 agreement would have raised subsidized drug prices by five percent on July 1, 2002, and allowed for the addition of about six hundred new products to the subsidy list, including many new innovative drugs. The government made the announcement in early June without prior notification to industry. The drug companies have protested what they see as the government's abrogation of a legal contract, and are currently negotiating a new framework with the government.

In a surprising move, the Hungarian government issued a decree in late December 2001 which discontinued the rights of a foreign partner who held a minority share in the management of Budapest Ferihegy airport. The government claimed the move was necessary as part of a reorganization plan for airport operations, and announced in December 2002 that it has no plans to reprivatize the airport. The airport corporation, privatization agency and foreign partner have begun talks on compensation.