

III. TRADE POLICIES AND PRACTICES BY MEASURE

(1) OVERVIEW

1. In pursuing its rapid transition to a market economy the Hungarian Government has largely resisted protectionist pressures. On the contrary, during the period under review, it has taken steps to curtail or remove border and internal measures, thereby greatly increasing the openness of the economy to international trade and investment, especially vis-à-vis the European Union and CEFTA partners. However, certain trade and trade-related policy instruments, notably investment measures, remain important features of the Government's industrial policy. These instruments may be used at Hungary's borders, as in the case of tariffs and certain non-tariff measures (NTMs), or they may be applied internally, as with regulations and standards, incentives and subsidies as well as preferential government procurement practices. All of these measures can entail elements of direct or indirect government assistance to domestic producers of goods and services, or to domestic investors.¹ Consequently, they constitute potential distortions to domestic and international competition.

2. Border measures directly affecting merchandise imports have been substantially liberalized since the previous review of Hungary's trade policies in 1991. Since then, the coverage of tariff bindings has increased to 95.7% of total tariff lines in 1997, partly as a result of Hungary's WTO commitments under the Uruguay Round (UR), although the average applied MFN tariff rate has risen from 11% in 1991 to 14.3% in 1997, mainly as a consequence of the tariffication of agricultural NTMs, the introduction of the Harmonized System (HS) in 1992, and the European Union's Combined Nomenclature (CN) in 1996. The scope of Hungary's preferential agreements with the EU and other countries is such that MFN tariffs apply in practice to less than one quarter of Hungary's imports. As a consequence, the collected rate of duty on all imports is currently only 2.5%. As regards NTMs, all trade-related charges, including a temporarily applied import surcharge, have recently been eliminated. Moreover, non-automatic import licensing, largely related to the global quota on consumer goods, now affects less than 8% of imported products compared to more than double that proportion in 1991. In addition, while Hungary does have anti-dumping and countervailing legislation based on the WTO Agreements, it has not resorted to such actions.

3. Export promotion measures are also used as instruments of trade policy, with exports being encouraged by, among other things, exemptions or drawbacks for import duties, customs-free zones, and other incentives (section (3)).

4. Considerable progress has been made in bringing Hungarian standards and regulations into line with international and particularly European norms.² Moreover, a legal and regulatory framework conducive to FDI has been established. Furthermore, Hungary offers certain tax and non-tax incentives, some directly related to improvements in export performance. These incentives are accorded equally to foreign and domestic investors. As noted in Chapter I, corporate subsidies largely offset any taxes paid by the corporate sector. Protection for patents, copyrights trade marks and other intellectual property rights has been modernized; indeed, in approximating its laws on the

¹ Tariffs and non-tariff border measures provide assistance by raising the prices of competing imports, thereby protecting domestic producers from foreign competition and enabling them to charge higher prices than they could otherwise. While some internal measures, including preferential government procurement practices, also enable domestic or other favoured suppliers to charge higher prices, many other internal measures, such as those in the form of incentives/subsidies, permit domestic producers to charge lower prices than in the absence of such measures, while maintaining profitability. Again, internal measures shelter domestic producers from foreign competition.

² To the extent that national standards and regulations pertaining to imported products differ from internationally agreed norms, they can constitute assistance to domestic producers.

protection of intellectual property to EU legislation, the Government is, in some respects, assuming obligations that exceed the minimum standards contained in the TRIPS Agreement. However, the scale of tax evasion raises doubts whether other laws (including those pertaining to intellectual property and competition) are adequately enforced.

5. Perhaps the most striking feature of Hungary's transition to a market economy has been the large scale privatization of state-owned enterprises, with high participation by foreign investors. Whereas state-owned enterprises produced as much as 90% of Hungary's GDP ten years ago, they now account for one quarter of GDP or less; companies with foreign participation now account for around 14% of GDP and for 70% of total industrial exports. Privatization has improved enterprises' competitiveness, which is reflected in export growth; and has drastically reduced the Government's role in the economy and particularly its intrusion into business decisions. Nevertheless, the Government can still exert influence on private economic behaviour, not only through remaining full or partial ownership of certain enterprises, but also through procurement practices, which tend to favour domestic-based suppliers of goods and services. At the same time, with private enterprises assuming a much greater role in the economy as a result of privatization, the Government has needed to address distortions to competition arising as a consequence of anti-competitive private practices. Accordingly, it has focused increasingly on bringing Hungarian competition policy into line with EU practices.

(2) MEASURES DIRECTLY AFFECTING IMPORTS

6. Major elements of Hungary's import regulation are customs duties and an active exchange rate policy. As a result of the Uruguay Round, all NTMs in agriculture were replaced by tariffs, industrial tariffs were reduced, and the level of tariff bindings was increased. Hungary is also party to several free-trade agreements with different schedules for phasing out tariffs.

(i) Registration of foreign trade activity

7. Any legal person or business organization, domestic or foreign, registered in Hungary is free to engage in international trading activities without any specific authorization. A licence is required only for trade involving certain products (fuels, precious metals and jewellery, radioactive and other hazardous materials, pharmaceutical products for human medicine, explosives, military engineering products and services, arms and ammunition). Such a licence is granted to firms satisfying the conditions prescribed by the Ministry of Industry, Trade and Tourism (MITT).³ In some instances other Ministries may also be involved.

(ii) Tariffs and other border levies

8. The Hungarian customs tariff contains 13,293 tariff lines at the 10-digit level. At the 8-digit level, Hungary applies the European Union's Combined Nomenclature (CN) tariff classification, consisting of 10,492 tariff lines, while retaining the national breakdown at the 9- and 10-digit level. The CN is consistent with the Harmonized System (HS 1996), with a one-to-one correspondence up to the 6-digit level. Hungary implemented the HS in 1992 and the CN in 1996. The application of technical standards and taxation, seasonal tariffs, and the need to ensure consistency with Uruguay Round commitments and comparability with previous statistics, are among the main reasons for

³ Annex 2 to Government Decree Nö 192/1996 (XII.19). For example, in the case of hydrocarbons, storage facilities must be considered sufficiently safe, while verification procedures must be in place in order to ensure that drugs imported for specific processing are used for their stated purpose.

Hungary's relatively large number of national tariff lines, which contributes to the complexity of the tariff schedule.⁴

(a) Customs valuation and clearance procedures

9. All goods not subject to explicit restriction may be imported freely by companies registered to engage in trade. Hungary is working closely with the EU with a view to acceding to the Common Transit and Single Administrative Document Conventions so that a single document, identical to that of the EU, is used for customs clearance.⁵ Customs valuation of dutiable goods is usually on the basis of their declared transactions value. However, upon receipt of a customs declaration, the customs authority may choose to check the authenticity or accuracy of the information used for the determination of customs value. The rules for the determination of customs value in the Hungarian Customs Law are in compliance with those laid down in the Agreement on Implementation of Article VII of the GATT 1994. Customs clearance time is normally the day of acceptance of the declaration of goods, but at the latest within three business days of acceptance. Simplified customs valuation procedures may apply to certain products, including fruit, vegetables and cut flowers.

10. Decisions made by customs officials may be appealed in the first instance to the customs guard who made the decision. In case of rejection, the appeal may then be lodged with the regional customs office or headquarters, depending on the nature of the decision involved, and ultimately reach the courts. In the event of the latter, there are no special courts dealing with customs matters, so that problems may arise when special expertise is required. While no data were available concerning appeals in the first instance, the ratio of appeals to decisions is thought to be roughly 1%. As regards court cases concerning customs procedures, there were 287 in 1996 and 334 in 1997.

(b) Forms of tariffs

11. Unlike many WTO Members, Hungary levies tariffs solely on an *ad valorem* basis. Seasonal tariffs apply to imports of several agricultural products, with separate tariff lines applicable to each season.

(c) Tariff levels (bindings and applied rates)

12. 95.7% of all national tariff lines are bound (Table III.1). As a result of Hungary's Uruguay Round commitments, bound rates are being reduced in equal steps from the current simple average of 11.8% to 10.2% upon full implementation. Most of the 4.3% of unbound tariff lines pertain to fish products, mineral products, footwear, precious stones, transport equipment and works of art (Chart III.1).⁶ The lack of bindings in these areas allows the authorities discretion to apply higher tariffs. Further discretion in raising applied tariffs is made possible by the fact that 4.6% of tariff lines (notably on certain agricultural and prepared food products) involve applied MFN tariff rates that are substantially below their current bound rates (Chart III.1 and Table AIII.1).

⁴ In addition to the need for distinct tariff lines for new and used cars, for example, different tariff lines are used depending on whether a car is equipped with a catalytic converter and the capacity of the engine. The latter is also the basis for excise taxation, with no such tax being levied on cars whose engine capacity is less than 1.6 litres.

⁵ WTO (1997).

⁶ More specifically, among the chapters involved are fish products, ores, mineral fuels, pharmaceuticals, fertilizers, wood pulp, apparel, footwear, nickel products, automobiles and automobile components, ships and boats.

Table III.1
Structure of applied MFN tariffs in Hungary
(Per cent)

Indicators	1991	1997 ^a	U.R.
1. Bound tariff lines	83.3	95.7	82.6
2. Duty-free tariff lines	9.0	7.9	11.1
3. Specific and mixed tariffs/all tariffs	0.0	0.0	0.0
4. Tariff quotas/all tariffs	0.0	11.0	11.4
5. Tariffs with no ad valorem equivalent	0.0	0.0	0.0
6. Simple average bound tariff rate	12.6	11.8	10.2
7. Simple average applied tariff rate	11.0	14.3	9.6
8. Import-weighted average tariff rate ^b	10.2	10.6	9.2
9. Domestic tariff "spikes" ^c	2.7	8.7	6.7
10. International tariff "spikes" ^d	11.9	20.0	10.4
11. Overall standard deviation (SD)	9.7	17.0	10.8

a Excluding import surcharge.

b Constant OECD import weights.

c Domestic tariff "spikes" are defined as those exceeding three times the overall simple average MFN rate.

d International tariff "spikes" are defined as those exceeding 15%.

Note: HS and CN were introduced in Hungary in 1992 and 1996, respectively, so that indicators from 1991 and 1997 are not fully comparable.

Source: WTO Secretariat.

13. More than 500 of the current applied MFN tariff rates are less than the final bound Uruguay Round rates. If these 500 tariffs remained at the same rates until full implementation, the overall applied MFN rate would decline from 14.3 to 9.6%.⁷

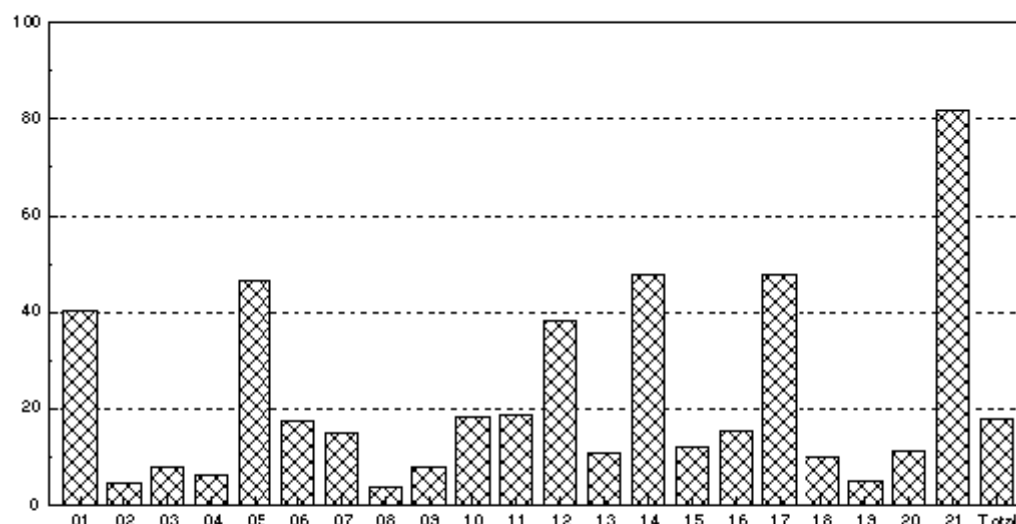
14. On the other hand, applied MFN tariffs on some other groups of products (vegetable products, articles of stone, precious stones, transport equipment and works of art) are considerably higher than the final bound average (Chart III.1). Consequently, the average applied MFN rate exceeded the overall average of bound tariffs in 1997 by 2.5 percentage points. This is partly because applied tariff rates for unbound tariff lines tend to be relatively high. It is also due to the introduction of the CN, which increased the number of tariff lines subject to high tariffs without increasing the tariff rates on individual products.

⁷ As there is no way of foreseeing what applied MFN tariff rates will be when the Uruguay Round is fully implemented, it is assumed that the applied rate for each tariff at that time will be the 1997 applied rate, if this is less than the final bound rate, and the latter otherwise. Judging from past experience, the applied rate will, in most instances, correspond to the bound rate, so that average applied rates are likely to be very close to the average bound rates. Obviously, this ignores any tariff reductions that might be negotiated in subsequent WTO agreements.

Chart III.1

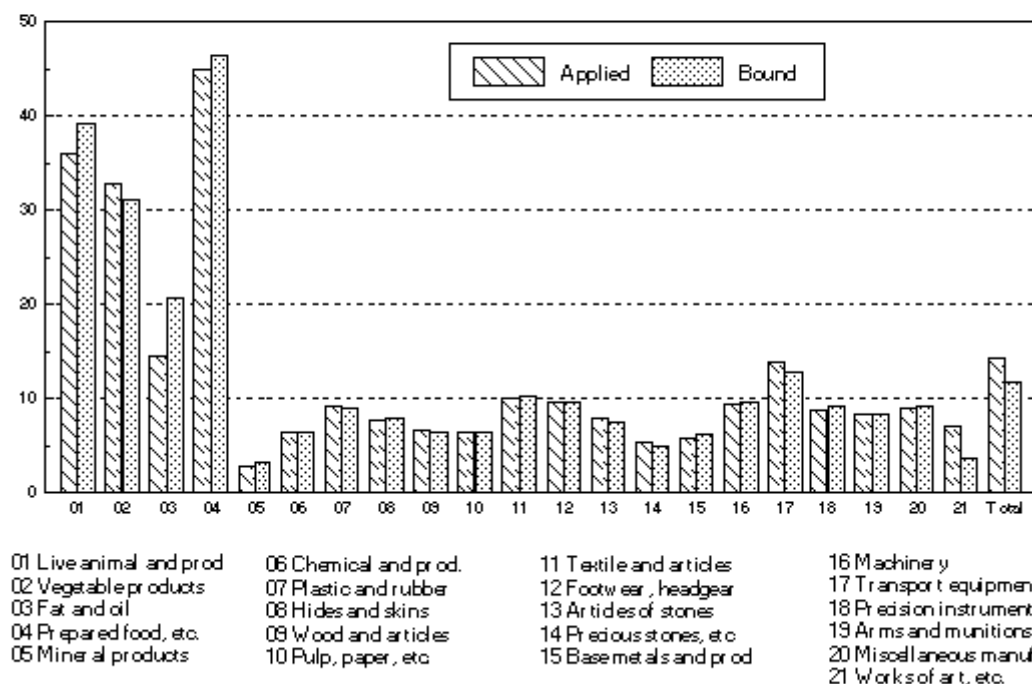
Share of unbound tariff lines by HS section, 1997

(Per cent)



Simple averages of applied MFN and bound tariff rates by HS section, 1997

(Per cent)



01 Live animal and prod
02 Vegetable products
03 Fat and oil
04 Prepared food, etc.
05 Mineral products

06 Chemical and prod.
07 Plastic and rubber
08 Hides and skins
09 Wood and articles
10 Pulp, paper, etc.

11 Textile and articles
12 Footwear, headgear
13 Articles of stones
14 Precious stones, etc.
15 Base metals and prod

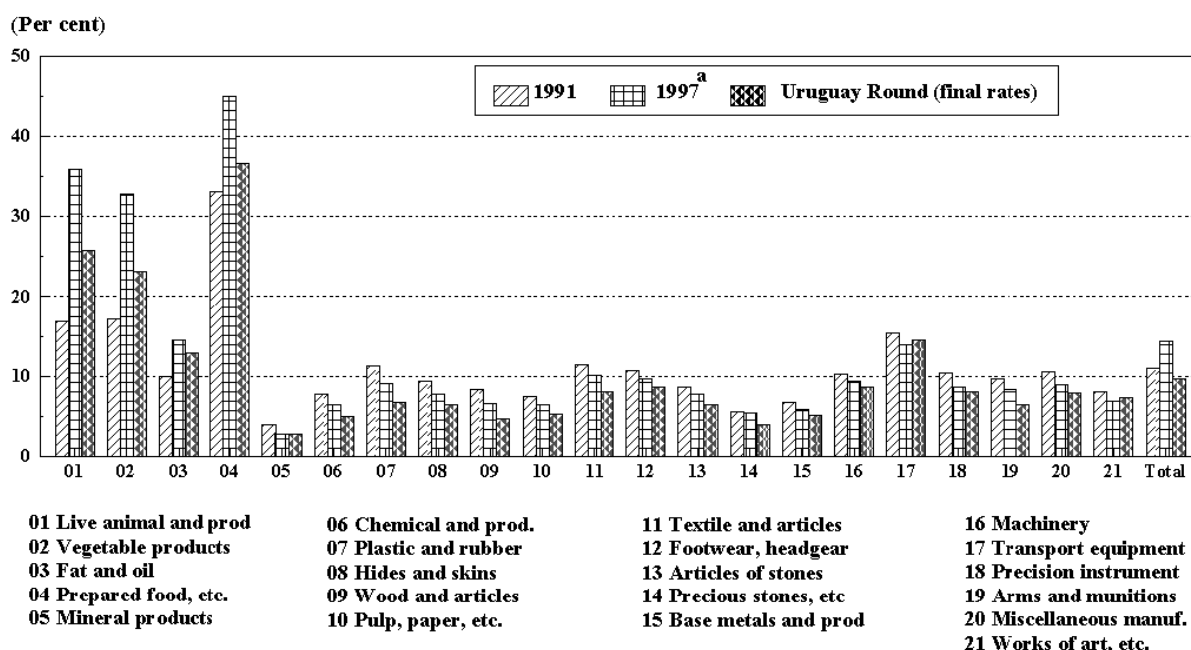
16 Machinery
17 Transport equipment
18 Precision instrument
19 Arms and munitions
20 Miscellaneous manuf.
21 Works of art, etc.

Source: WTO Secretariat calculations based on data provided by the Hungarian authorities.

15. Since 1991, the simple average of applied MFN tariff rates has risen from 11.0 to 14.3%. During the same period, the proportion of tariff lines that were duty free declined from 9.0 to 7.9%. Both of these developments are largely the consequence of tariffication of quantitative restrictions previously imposed on agricultural products and of significant changes in the tariff nomenclature caused by the introduction of the HS followed by the CN. Indeed, as a result of the Uruguay Round, average *tariff* protection (as opposed to NTMs) for agricultural products has increased substantially

from 1991 levels owing to tariffication, while tariff protection for all broad groups of industrial products has declined (Chart III.2). More detailed information on applied and bound tariff rates is found in Table AIII.1.

Chart III.2
Simple averages of applied MFN tariffs by HS section, 1991, 1997
and Uruguay Round (final rates)



Source: WTO Secretariat calculations based on data provided by the Hungarian authorities.

(d) Tariff dispersion

16. The efficiency losses associated with Hungary's tariff structure depend not just on average applied tariff rates, but also on the dispersion in these rates across products. The higher the dispersion in tariff rates, particularly within groups of similar and, thus, highly substitutable products, the greater the likelihood that consumers' and producers' decisions are distorted by the tariff structure⁸.

17. Agricultural commodities, together with prepared food, beverages, tobacco and transport equipment are the broad categories of products most protected by tariffs (Chart III.1). This will remain the case even once the Uruguay Round tariff reductions are fully implemented.

18. According to the overall standard deviation (SD), the dispersion in applied tariff rates has almost doubled since 1991. Likewise, the proportion of tariffs that constitute domestic "spikes", that is, tariffs exceeding three times the overall simple average applied MFN rate, has more than tripled. However, these rises in tariff dispersion are due to tariffication which, while converting relatively non-transparent agricultural NTMs into *ad valorem* tariffs and reducing the overall number of tariff

⁸ Strictly speaking, a uniform nominal tariff (or a uniformly restrictive NTM) minimizes the net welfare cost of such protection only if import demand elasticities are uniform across commodities and cross-price effects are negligible. Tariff uniformity may also be desirable for reasons of administrative simplicity. For a discussion of these and related matters, see Panagariya and Rodrik (1993), p. 685-703.

lines affected by NTMs, almost doubled the average applied MFN tariff on agricultural products. The SD for agricultural products alone rose from 18.6 in 1991 to 24.6 in 1997, while the SD for industrial products declined from 6.3 to 5.3 in 1997. The magnitudes of these indicators of tariff dispersion suggest the continued existence of potentially high degrees of distortion in the agricultural area caused by the tariff schedule.

(e) Tariff escalation

19. Applied tariffs are on average much higher for finished goods than for semi-manufactured goods (Table III.2). On the other hand, tariffs on raw materials (including agricultural products) are roughly the same as those for finished goods. Such tariff escalation means that the level of effective protection is likely to increase as goods undergo processing, constituting a potential obstacle to processing in exporting countries of primary commodities or of semi-finished goods, thereby potentially impeding the industrialization of developing countries exporting to Hungary.⁹ Full implementation of the Uruguay Round will not change this situation.

Table III.2
Tariff escalation^a in Hungary
(Per cent)

ISIC	Stage of processing	1991	1997	U.R.
0	Raw materials	9.5	18.2	11.2
1	Agriculture, forestry, fishing	12.9	24.9	16.4
2	Mining and quarrying	4.5	3.5	3.3
3A	Manufacturing	7.9	12.1	9.3
3B	Semi-finished manufactured goods	8.8	8.4	6.5
3C	Finished manufactured goods	12.7	16.8	11.3
Total	All products	11.0	14.3	9.6

a Based on simple applied MFN tariff averages.

Source: WTO Secretariat.

⁹ OECD (1997b), p. 19.

(f) Tariff preferences

20. As discussed in Chapter II, since the previous trade policy review, Hungary has concluded regional trade agreements with the European Union (EU) and the European Free Trade Association (EFTA). Furthermore, together with the Czech Republic, Slovakia, Poland, Slovenia and Romania, it participates in the Central European Free Trade Agreement (CEFTA). Hungary has also concluded free-trade agreements with Israel and Turkey which include, *inter alia*, reciprocal preferential tariffs. In addition, Hungary offers preferential tariff rates to developing countries and duty-free treatment to all imports from least developed countries under the Generalized System of Preferences (GSP). In combination, preferential tariffs cover 75-80% of Hungary's imports. Not surprisingly, therefore, the overall "collected" duty rate is estimated by the Hungarian authorities to be only 2.5%, much lower than the current overall simple average of applied MFN rates of 14.3%.¹⁰

21. As a result of the Europe Agreement, CEFTA, and free-trade agreements with EFTA countries, much of Hungary's bilateral trade with its European partners, other than that involving agricultural products, is already free from duties (Table AIII.2).

22. Under the GSP, preferential tariff rates are applied to products originating from those non-European developing countries (109 countries) that provide MFN treatment for Hungarian goods and do not apply any discriminatory measures against Hungary. Exemptions from customs duties are granted to all goods originating and purchased directly from least-developed countries (46 countries) listed in the Decree on Implementation of Hungary's Customs Law. The outcome is that the simple tariff average applied to imports from GSP countries was 5.2% in 1997 (Table III.3).¹¹

Table III.3
Summary of applied tariffs and tariff preferences, 1997
(Per cent)

	MFN	GSP	EU	EFTA	Poland	Czech	Slovakia	Slovenia	Romania
Simple average	14.3	5.2	9.4	9.3	4.4	4.7	4.7	8.8	6.0
Agricultural products	37.1	16.6	37.1	36.3	17.6	18.9	18.9	37.1	21.1
Industrial products	8.2	3.4	2.0	2.0	0.9	0.9	0.9	1.2	1.9

Source: WTO Secretariat calculations based on data provided by the Hungarian authorities.

23. Hungary's customs law was amended so as to enable it to join the Pan-European Cumulation System on July 1 1997.¹² The rules of origin used under its GSP scheme are simple and transparent,

¹⁰ The collected (or effective) duty rate is the total amount of duties collected as a percentage of the value of total imports.

¹¹ More detailed information on GSP tariff averages is found in Table AIII.3.

¹² This required the harmonization of Hungary's rules of origin as far as preferential trade with the EU, CEFTA and EFTA is concerned. The new system, which is aimed at increasing the volume of products traded under preferential agreements, classifies imports from within the cumulation region as domestic content. In order to obtain preferential status from other member countries, exporters must prove that the domestic content of their products reaches a certain level (100% for agricultural products and 50% for industrial goods).

being based on the criterion of 51% value added. These rules ensure full global cumulation of imports from developing countries.¹³ There are no further criteria applied for GSP eligibility.

(g) Tariff concessions and exemptions

24. The Hungarian tariff system provides for the use of tariff relief measures on an MFN basis. These measures, which are valid for one year, may include tariff quotas or tariff suspensions. A list of the products subject to such measures is published in the Hungarian Official Gazette.

25. Whereas in 1991 Hungary's use of tariff quotas was negligible¹⁴, on 1 January 1995, as a result of the WTO Agreement on Agriculture, Hungary raised many agricultural tariffs to their bound rates and introduced tariff quotas for MFN suppliers. Consequently, 11% of lines now involve tariff quotas. A list of the broad groups of products affected is contained in Table AIII.4.¹⁵ In-quota tariff rates are fixed and will not vary as MFN rates are reduced. While tariff quotas resulting from WTO Agreements are applied on an MFN basis, preferential tariff quotas on some products have also been agreed under regional and bilateral agreements with the EU, EFTA, CEFTA, Israel and Turkey.

26. While Hungarian customs regulations do not contain any special provisions for the concessional entry of imported goods, there is the possibility of duty-free entry of goods in the case of "inward processing" as specified in the Customs Law (section 73-74) when the dutiable goods are re-exported, generally within 12 months. Furthermore, under the Foreign Investment Act, duty-free status was accorded to any "means of production" imported into Hungary as an in-kind contribution by a foreign partner.¹⁶ However, this tariff concession, which discriminated in favour of firms with foreign participation, was abolished with effect from 31 December 1995.

27. Hungary also operates a duty drawback system under its Customs Law (section 137). Under this system, duty is fully refunded upon certification that, within two years from the date of customs clearance, the imported product has been either incorporated into goods for export or used up in the process of their production, and exportation has actually taken place.¹⁷

28. In addition, under sections 90-93 of the Customs Law, Hungary has established 104 customs-free zones, most of which involve the production of certain industrial goods (plastic and rubber products, textiles, non-precious metal products, machines and automotive components). Such zones accounted for roughly one quarter of Hungary's total industrial exports in 1996.

¹³ See paragraph 18 of the Hungarian Customs Law and paragraph 29 of the Decree on its implementation.

¹⁴ According to the 1992 Trade Policy Review of Hungary, only eight 'ex' items of the HS were affected by tariff quotas.

¹⁵ The latest notification in this regard was G/AG/N/HUN/8, 28 May 1997.

¹⁶ The Foreign Investment Act defines such means of production as machinery, plant, equipment, building pieces and material, sanitary installations and vehicles specifically required for the production of goods or the rendering of services.

¹⁷ Duty is also refunded if, for some reason, the imported goods are returned to the foreign supplier or in the event of overpayment of the duty.

(h) Other border levies and charges

29. Since 1973 and for most of the period under review, Hungary imposed three types of import-related fees, namely a 3% statistical fee, a 2% customs clearance fee and a 1% licensing fee. On 1 January 1996, the 3% statistical fee was reduced to 1%, the 2% customs clearance fee reduced to 1% and the 1% licensing fee abolished except for non-WTO members. A year later, the statistical fee and the customs clearance fee were abolished, again except for non-WTO members. Thus, as of 1 January 1997, Hungary does not apply any border levies or charges to WTO Members.

30. Among the main features of the March 1995 package of stabilization measures designed to address serious macroeconomic imbalances was a temporary import surcharge, initially levied at 8%; as described in Chapter I, this was notified to the WTO and justified by the Hungarian Government on balance-of-payments grounds.¹⁸ The surcharge applied to imports from all sources and covered all goods except primary energy products, it was refundable in the case of machinery imported for investment purposes. As the surcharge was included in the selling price upon which the VAT was levied, the overall restrictive effect of the surcharge considerably exceeded 8%. In the case of duty-free imported products subject to the standard VAT rate of 25%, the effective rate of the surcharge was 10% rather than 8%. The effective rate was even higher for products subject to import duties as well as excise taxes on top of VAT. The surcharge was reduced step by step before being eliminated as of 1 July 1997.

31. Hungary does not impose any variable import levies.

(i) Revenues from customs duties and other border charges

32. Estimates of the revenues obtained from customs duties, various licensing fees and the import surcharge during the period 1991-97 show that such levies have been a substantial source of revenue for the Hungarian government (Table III.4). After rising to a peak of 9.2% of total taxes in 1995, the total amount of customs duties and border charges has since declined to 4.4% of total taxes as a result of the reduction in customs duty rates and the elimination of other border charges. Consequently, Hungary now relies more heavily on VAT, excise taxes and personal income tax for revenue.

Table III.4
Revenues from customs duties and other border levies
(Ft billion)

	Customs duty and customs clearance fee	Statistical fee	Import licensing fee	Import surcharge	Total	% of total taxes
1991	44.3	15.6	1.8	n.a.	61.7	5.8
1992	69.1	23.5	1.6	n.a.	94.2	7.5
1993	74.7	24.7	2.4	n.a.	101.8	6.8
1994	93.3	28.6	3.3	n.a.	125.2	7.0
1995	150.2	29.7	n.a.	20.5 ^a	200.4	9.2
1996	93.4	22.7	n.a.	98.8	214.9	8.4
1997*	88.0	11.0	n.a.	31.0	130.0	4.4

n.a. Not applicable.

a In the first part of the year the surcharge was collected as part of the customs duty. Probably Ft 47.5 billion of the surcharge was collected in this way, so the total amount of the surcharge for the whole year is Ft 68 billion. It was abolished on 1 July 1997.

* Estimate.

Source: Hungarian authorities.

¹⁸ WTO document WT/BOP/N/2, 29 March 1995.

(j) Indirect taxation

33. Goods may be subject not just to tariffs and other border charges, but also to indirect taxes that are levied internally. These involve a multiple-stage consumption-based VAT, which encompasses services as well as goods, and excise taxes. These two taxes, respectively, accounted for 28% and 13% of total taxes in 1996.

34. According to revised Hungarian VAT legislation, which entered into force on 1 January 1995, entities undertaking economic activities in Hungary are liable to VAT on the taxable supply of goods and services. The VAT entails two rates: the standard rate of 25%, which applies to most goods and services; and a reduced rate of 12%, which applies to certain necessities, such as basic foodstuffs. A zero rate applies to the supply of pharmaceutical products. The VAT is levied on imports and domestically produced goods and services alike. In line with international practice, however, registered taxpayers may reclaim VAT levied on inputs and exports so that the tax base is essentially the value of goods and services consumed domestically.¹⁹

35. In addition to VAT, excise taxes are imposed on several products, notably alcoholic beverages, manufactured tobacco products, petroleum products, passenger cars and jewellery. Excises may be levied on the basis of value, quantity, or both. As regards new products, no distinction is made between domestically produced and imported goods.²⁰ However, second-hand products produced within Hungary are exempt from excise taxes; those that are imported (e.g., passenger cars and jewellery) are not. Excise taxes may be reclaimed fully or partly in some instances where the taxed products are used as inputs in the production of goods (as in the case of oil used for the production of agricultural products or electricity or as fuel for railway transportation) or are exported.

(iii) Non-tariff border measures (NTMs)

36. Hungary currently uses two principal types of "core" non-tariff border measures (NTMs), quantitative restrictions (QRs) mainly in the form of a global quota on consumer goods, and import licensing (Box III.1). Only 7.8% of all tariff lines are currently subject to these measures compared to 19.9% in 1991 (Table III.5). The global quota now covers 5.7% of all tariff lines, while other import licensing covers 2.1% of tariff lines. The broad categories of product most affected by "core" NTMs are textiles, clothing and footwear, precious stones, transport equipment, arms and ammunition, and works of art (Chart III.3).

¹⁹ Government Decree 2/1993 provides that VAT may also be reclaimed by taxpayers who have no permanent establishment in Hungary.

²⁰ As pointed out in the previous TPR of Hungary, the excise tax on cigarettes imported from convertible currency sources or produced under foreign licence used to be considerably higher than that levied on domestically produced cigarettes. Such differentiation was abolished as of 1 January 1991.

Table III.5
Extent of NTMs^a in Hungary
(Per cent)

NTM categories	Frequency ratio (F)			Import coverage ratio (IC) ^b		
	1991	1997	U.R.	1991	1997	U.R.
Core NTMs	19.9	7.8	3.8	19.5	12.8	8.9
Quantitative restrictions (QRs)	19.9	7.8	3.8	19.5	12.8	8.9
Export restraints	0.0	0.0	0.0	0.0	0.0	0.0
Non-automatic licensing	17.1	7.8	3.8	18.0	4.7	4.6
Other QRs	12.2	5.7	1.9	8.5	12.8	8.9
Technical measures and NCQRs	n.a.	3.9	3.9	..	11.4	11.4
All NTMs	19.9	10.3	6.4	19.5	22.4	18.6

.. Not available.

a NTM indicators for U.R. are calculated on the basis of those NTMs existing in 1997 and after eliminating quantitative restrictions on agricultural products subject to "tariffication" (in accordance with the WTO Agreement on Agriculture) and removing MFA quotas (in accordance with the WTO Agreement on Textiles and Clothing).

b Constant OECD import weights.

Source: UNCTAD.

Box III.1: Types of NTMs

'Core' NTMs

'Core' NTMs consist of two broad types of measures: quantitative restrictions (QRs) and price control measures (PCMs). 'Core' NTMs do not encompass automatic licensing, finance, monopolistic or technical measures. Nor do they encompass technical measures or quantitative restrictions taken for non-commercial reasons (see below).

Quantitative Restrictions

Export restraints

Arrangements between importers and exporters, whereby the latter agree to limit exports in order to avoid the imposition of mandatory restrictions by importing countries

Non-automatic licensing

The practice of requiring, as a condition for importation, a licence which is not granted automatically and which may be issued on a discretionary basis or depend on specific criteria

Other quantitative restrictions

Include various forms of quotas and prohibitions

Price-Control Measures

Variable charges

Bring the market prices of imported products close to those of corresponding domestic products

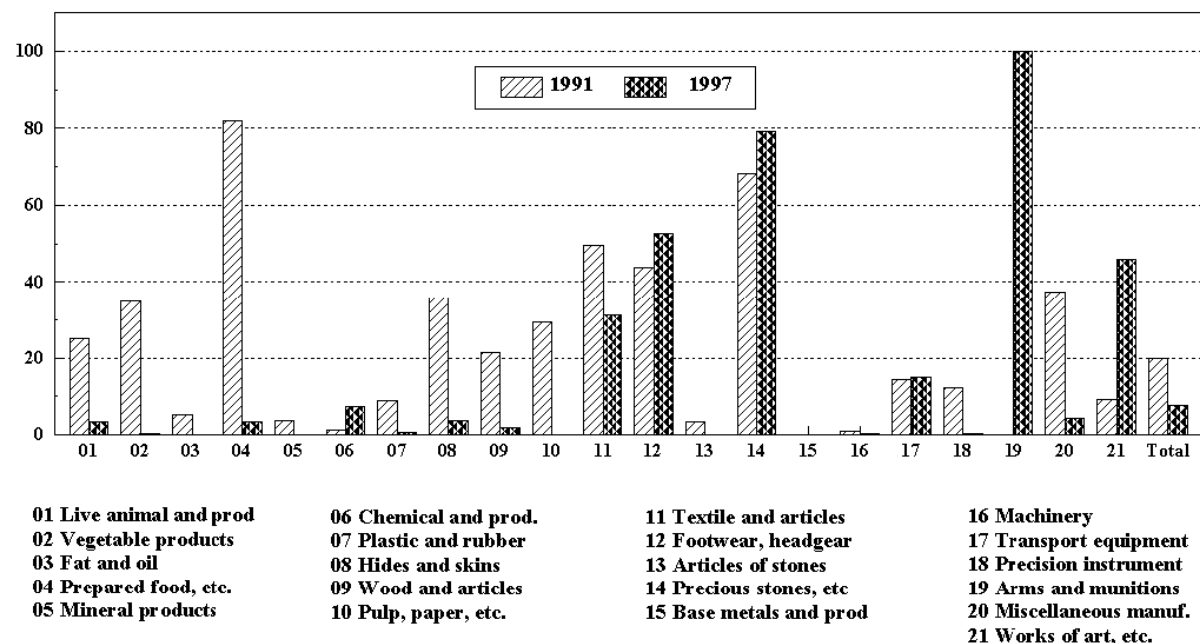
Other price-control measures

Include voluntary export-price restraints, whereby exporters agree to keep the prices of their products above certain minima.

Chart III.3

Core NTMs by HS section , 1991 and 1997

(Frequency ratios)



Source: WTO Secretariat calculations based on data provided by the Hungarian authorities.

(a) NTM escalation

37. NTMs are currently far more pervasive for finished than for semi-manufactured goods, while NTBs pertaining to the latter are more pervasive than those for raw materials (including agriculture), thus suggesting a high degree of NTM "escalation" (Table III.6). It would appear, therefore, that NTMs, like tariffs, may constitute an impediment to the industrialization of developing countries exporting to Hungary.

Table III.6
NTM escalation^a in Hungary
(Per cent)

ISIC	Stage of processing	1991	1997	U.R.
0	Raw materials	17.2	1.7	1.6
1	Agriculture, forestry, fishing	22.4	2.6	2.6
2	Mining and quarrying	4.3	0.6	0.6
3A	Manufacturing	17.5	2.3	1.9
3B	Semi-finished manufactured goods	11.9	4.5	3.4
3C	Finished manufactured goods	25.5	11.0	4.6
Total	All products	19.9	7.8	3.8

^a Based on frequency ratio for core NTMs.

Source: UNCTAD.

(b) Quantitative restrictions and prohibitions

38. Probably the most important impediment to imports during the period under review has been the global import quota on selected consumer goods (Table III.7). The Hungarian authorities plan to

phase out the quota by 2001. While the value of the quota has been gradually increased, and several categories of products (furniture, underwear and some other textiles and clothing, non-fish food and tobacco products) have been freed from the quota, it remains restrictive. Judging from the nature of the products affected (notably textiles, clothing and footwear together with new and used cars and caravans), industrial policy considerations play an important role. For most of the products covered, the quota is expressed in value terms. For cars, however, the quota is expressed in quantitative terms. In 1997, the total value of the quota was US\$629 million for non-automotive products, 89,720 for new cars, 200 for new caravans, and 58,600 for used cars and caravans. Goods produced in customs-free zones are also subject to the quota. No licence fees are levied in connection with this quota. As of 1 January 1998, several more items have been removed from the list of products subject to quantitative restrictions, on an MFN basis.²¹

39. The available quotas, which are published twice annually in the Official Gazette, are allocated to importers by the Ministry of Industry, Trade and Tourism. Four fifths of the quota licences are automatically allocated to "traditional" importers, on the basis of their actual imports in the previous year. The remaining one fifth is allocated to new importers and, in the event of excess applications, the quota is distributed among them on a *pro rata* basis. Not only does such an allocation system restrict competition among importers, but the quota rents accrue to importers who may then re-sell the products to domestic distributors.²²

Table III.7
Global import quota on consumer goods, 1994-97
(US\$ million, unless otherwise specified)

Product groups	Abolished	1994	1995	1996	1997
Household detergent		18	25	35	45
Footwear made of leather and leather substitutes		46.5	65	70	77
Furniture	1.1.92	n.a.	n.a.	n.a.	n.a.
Underwear	1.1.95	40	n.a.	n.a.	n.a.
Overwear		66	94	104	114.4
Second-hand clothing		19.5	27	28.8	31.6
Other clothing and ready-made clothing		46.5	65	71	78
Haberdashery products		12	16.6	17.2	22.6
Textile piece-goods		30	43	47.2	52
Other industrial products		90	126	133.1	146.4
Jewellery, precious metal objects		24	33	34.2	37.6
New cars ('000 units)		51	80.6	83.8	89.72
New caravans ('000 units)		1.5 ^a	0.2	0.2	0.2
Used cars and caravans ('000 units)		45 ^b	52.8	54.8	58.6
Canned products	1.1.95	16	n.a.	n.a.	n.a.
Bakery products	1.1.95	4.5	n.a.	n.a.	n.a.
Confectionery products	1.1.95	25	n.a.	n.a.	n.a.
Beverages	1.1.95	33	n.a.	n.a.	n.a.
Dairy products	1.1.95	37.5	n.a.	n.a.	n.a.
Citrus fruit	1.1.95	48	n.a.	n.a.	n.a.
Tobacco products	1.1.95	4	n.a.	n.a.	n.a.
Fish, tinned fish		17	22.6	22.6	24.8
Total		467.0	517.2	563.1	629.4

n.a. Not applicable.

a Used and new caravans together.

b Used cars only.

²¹ WTO document G/LIC/N/1/HUN/2, 19 February 1998. The products include a significant list of textiles and clothing products, as well as certain other items.

²² OECD (1997a), p. 71.

Source: Hungarian authorities.

40. Sub-quotas of the global quota are maintained for preferential trading partners, namely the EU, EFTA and CEFTA countries (Table III.8). In accordance with the Europe Agreement, however, the quota was removed from textiles and clothing and some other products on 31 December 1997. This liberalization measure was extended to all WTO Members on an MFN basis.

41. Under the Customs Duty Law of 1995, imports of cars more than four years old are prohibited, on environmental and safety grounds. An exception involves specialized older vehicles, which may be imported, provided they pass a special technical test. Unfortunately, such a prohibition combined with high tariffs on imports of new cars (with large engines) from non-preferential sources and the global quota on new and relatively new cars tends to curtail competition. The resulting increase in the prices of such cars is likely to reduce the pace of replacement of old cars, which are usually more polluting and embody lower safety standards than new or relatively new cars.²³ Consequently, this prohibition in combination with other tariff and non-tariff border measures may be counterproductive from the standpoints of environmental protection and safety. Such goals might be achieved more effectively by applying national environmental and safety standards to all used vehicles on a non-discriminatory basis. The authorities claim that such standards would be difficult to enforce, however.

Table III.8

Share of selected trading partners in global import quota on consumer goods (2nd half 1997)
(US\$ million, unless otherwise specified)

Product groups	Total value ceiling	EU	Czech Rep	Slovakia	Poland	Iceland	Norway	Share of individual value limits	
								%	US\$
Household detergent	22.5	8.0	3.3	0.22	0.27				22,500
Footwear, leather	38.5	22.0	1.04	0.6	1.1				38,500
Overwear	57.2	40.0	0.8	1.1	1.9				57,200
Secondhand clothing	15.8	11.3					5		10,000
Other clothing & ready-made clothing products	39.0	25.3					5		10,000
Haberdashery	11.3	6.05					5		
Textile piece goods	26.0	20.5	1.2	1.2	1.2		5		
of which carpets									10,000
Other industrial products	73.2	40.2	1.4	0.8	2.2		5		
Jewellery, precious metal objects	18.8	7.9			0.2		5		
New cars ('000 units)	44.86	25.81	1.4	0.2	1.6				44 pieces
New caravans ('000 units)	0.1								
Used cars and caravans ('000 units)	29.3	16.5							29 pieces
Fish, tinned	12.4				1.0	0.55	0.55	5	

Source: Hungarian authorities.

42. No quantitative restrictions other than the global quota and the prohibition on imports of second-hand cars apply to WTO Members.

²³ The Hungarian authorities estimate the average age of cars in Hungary to be roughly ten years, which suggests that a large proportion of cars are over ten years old.

(c) Import licensing and permits

43. Import licences are required either for goods subject to import quotas (listed in Annex 1/b of Government Decree No. 192/1996 (XII. 19)) or for items that are typically controlled in most countries, that is, products (listed in Annex 1/c of the Decree) used for military purposes, hazardous materials, endangered species, and substances used for the illegal making of narcotics. In some instances, import or export licences can be granted only to firms satisfying certain technical and other conditions prescribed by the MITT.²⁴ The products (listed in Annex 2) subject to import and export permits include fuel products, precious metals, materials particularly hazardous to the environment and health, pharmaceutical products for human medicine, industrial explosive and firework products, military engineering products and services, small arms and ammunition for civil use (Table AIII.5). In the event of refusal of a licence or permit, applicants have the right of appeal to the Ministry of Industry, Trade and Tourism. Appeals are relatively infrequent, however, roughly ten per year.

(d) Anti-dumping, countervailing and safeguard actions

44. Although Hungary does have its own legislation concerning anti-dumping and countervailing (AD/CV) measures (Government Decree No. 69/1994.(V4)), which has been notified²⁵, hitherto it has not been used. So far, only two requests were made for AD investigations, both of which were refused by the authorities. No request has been made for CV investigation. Domestic producers may consider the procedures required for the initiation of AD/CV actions too sophisticated and costly, preferring instead to seek protection by means of import licensing or quotas²⁶, and it is not the practice of the Hungarian authorities to take AD/CV actions *ex officio*. In any event, the authorities indicated that they would not consider such actions where goods are subject to quantitative restrictions. According to the authorities, existing legislation on contingency measures does not conflict with the relevant WTO rules.

45. Hungary's safeguards legislation is contained in Decree Ný 113/1990, which is based on paragraph 5 of its Protocol of Accession to the GATT. No safeguard measures have been applied to WTO Members since the entry into force of the Uruguay Round Agreements. However, safeguard measures, usually in the form of quantitative restrictions, have been applied to certain non-members, notably some CIS countries.

(e) Balance-of-payments measures

46. During the period under review, balance-of-payments measures consisted of a temporary import surcharge that was notified to the WTO. The surcharge, which was introduced at a rate of 8% as one of the main features of the March 1995 stabilization package, was gradually reduced to 6% from 1 October 1996, 4% from 10 March 1997 and 3% from 15 May 1997 before being eliminated on 1 July 1997.

(f) Barter contracts

47. According to the authorities, no barter agreements have been concluded since the disintegration of the COMECON and the switch to payments in convertible currencies in 1991.

²⁴ Section (2)(i).

²⁵ GATT documents ADP/1/Add.14/Rev.1 and SCM/181/Add.2.

²⁶ European Bank for Reconstruction and Development (1994), p. 115. Import quotas are, in fact, applied to certain steel products from some non-WTO members, including the Ukraine.

(3) MEASURES DIRECTLY AFFECTING EXPORTS**(i) Export duties and other charges**

48. Hungary did not levy any duties or other charges on exports during the period under review. Government Decree Ný 61/1990 (X.1) nevertheless provides for the possibility of applying administrative controls for certain dual-use technologies.

(ii) Minimum export prices

49. Hungary does not set minimum export prices for any products.

(iii) Export restraints and licensing requirements

50. Less than 2% (224) of Hungary's national tariff lines are currently subject to export licensing, many fewer than in 1991. Licences may be required to fulfil Hungary's obligations under international treaties regarding trade in endangered species, hazardous substances or other environmentally sensitive products. Or, in the case of goose liver, licensing may be used for the purpose of monitoring in relation to animal rights. A monitoring system is applied in connection with Hungary's bilateral export limitations, particularly with regard to its exports of agricultural products and textiles.²⁷ In August 1996, Hungary introduced temporary restrictions, in the form of discretionary licensing, on exports of some grains, cereal products and animal feeds, to prevent serious domestic shortages of these products and avoid disruption of the domestic animal feed market.

(iv) Export assistance

51. The Hungarian Government accords direct assistance to exports through export subsidies, export credits and insurance together with export promotion and marketing assistance. Since the previous Review, the Government's role in providing export assistance has been significantly reduced and streamlined.

(a) Export subsidies

52. Export subsidies are granted for several agricultural and fishery products (Chapter IV(2)).²⁸ In accordance with its obligations under the Agreement on Agriculture, however, Hungary is committed to reducing these subsidies by 36% between 1995 and 2000. This commitment initially involved a base amount set at Ft 22 billion, implying a cut in the total amount of such subsidies to Ft 14 billion by 2000. Shortly after entry into force of the Uruguay Round Agreements, it became evident that export subsidies in both 1995 and 1996 were actually about twice the level of Hungary's commitment of Ft 22 billion in nominal terms and covered 149 products instead of the 16 specified in the WTO Schedule. This situation was due to a considerable discrepancy between the value of total export subsidization in the period 1986-1990, which constituted the base level for the reduction of

²⁷ For example, such licences are issued in connection with import quotas imposed by the United States and Canada on textiles and clothing.

²⁸ The stated objectives of the relevant programmes (the Export Enhancement Programme for Agricultural and Fishery Products, the Programme for Promoting Export-oriented Product Development, and the Programme of Investment-related Tax Concessions), and the list of products benefiting from and the corresponding per unit amount of export subsidies for 1995 are contained in Annexes to Joint Decree 38/1994 (XII.30) PM-IKM of the Minister of Finance and the Minister of Industry, Trade and Tourism (G/SCM/N/9/HUN).

export subsidies, and the way it was reflected in Section II of Part IV of the Schedule.²⁹ The outcome was a dispute with several WTO Members. The dispute was resolved in October 1997, with Hungary being granted a waiver from its obligations until 31 December 2001. Under the waiver, the base amount was set at Ft 51 billion, with Hungary agreeing to cut the amount to Ft 42 billion in 1997, and then in stages so as to reach Ft 22 billion as of 1 January 2001.³⁰

(b) Export credits and insurance

53. The Hungarian Export-Import Bank (EXIMBANK) and the Hungarian Export Insurance Corporation (MEHIB) were established simultaneously in 1994, pursuant to Act XLII. Their primary purpose is to facilitate exports considered important to the national economy.

54. In the case of exports, EXIMBANK focuses mainly, but not exclusively, on the renewal of former contacts with the former socialist countries and increasing exports to the developing world, which are regarded as high risk countries.³¹ It provides financial services related to export transactions, namely credits and loans, and guarantees, and services related to credit rating.³² EXIMBANK is fully owned by the Government, which is ultimately liable for obligations arising from loans taken out and bonds issued by EXIMBANK in connection with the provision of these financial services.

55. A non-profit oriented institution, MEHIB insures export credits against commercial and political risk.³³ Whereas insurance against commercial risk is backed by leading West European re-insurers, MEHIB's provision of insurance against political risk is guaranteed by the central government budget, thereby possibly entailing an element of financial assistance. In addition, it provides tendering insurance, reimbursing 70% of the costs of tendering if the tender is not awarded to the insured for reasons beyond its control.³⁴ Direct investment abroad by Hungarian companies can also be insured against losses due to political events or various acts of the Government of the host country.

(c) Export promotion and marketing assistance

56. Assistance to exports was previously also provided by the Economic Development Fund, established in 1992, whose total budget in 1995 was Ft 5.6 billion. This assistance was in the form of a repayable or non-repayable contribution to economic operators established in Hungary. It was awarded through open tender procedures or upon the initiative of the Fund Management. Among the trade promotion activities benefiting from such assistance were: the introduction of goods, services and intellectual products into new foreign markets; dissemination of knowledge and information concerning foreign trading activity; the organization of international exhibitions and trade fairs; missions of business people; and organizations involved in trade promotion.

²⁹ WTO document G/L/183.

³⁰ WTO document WT/L/238, 29 October 1997. See also Chapter IV of this report.

³¹ Ministry of Industry, Trade and Tourism (1996a), p. 19.

³² EXIMBANK may also finance imports, if it considers them important to the national economy, and important Hungarian investments abroad.

³³ Ministry of Industry, Trade and Tourism (1996a), p. 18.

³⁴ Ministry of Industry, Trade and Tourism (1997).

57. In 1996, some previously decentralized Funds, including the Economic Development Fund, were unified into a programme known as the Targeted Allocation for the Development of the Economy, with a total budget of Ft 15 billion.³⁵ Again, support from the Targeted Allocation is available for trade promotion (as well as for the encouragement of investment and economic restructuring). More specifically, under the Trade Promotion Tendering System, assistance in various forms is provided for, *inter alia*: participation in foreign fairs with Hungarian-brand products; production of product information leaflets, technical description, informational films, publication of advertisements; rent of company representational offices, exhibitions or showrooms abroad; and development, implementation and attestation of quality assurance systems meeting EU standards.³⁶

(v) Anti-dumping and countervailing actions

58. Hungarian exports are currently the target of anti-dumping duties from the United States, the EU, Canada, Argentina, Australia and Turkey (Table AIII.6). As a consequence of the Europe Agreement, Hungary benefits from a preferential framework in respect of anti-dumping actions by the EU. This consists of improved information, possibilities of requesting consultation in an investigation and a preference for price undertakings rather than anti-dumping duties upon conclusion of an investigation.³⁷

(4) INTERNAL MEASURES

(i) Technical regulations and standards

59. Products imported into Hungary must conform to technical regulations established by the Government to protect health and safety or to preserve the environment. Likewise, agricultural imports must comply with national sanitary and phytosanitary regulations, which are aimed at protecting human, animal or plant health from pests and diseases. Although Hungary is moving towards large-scale adoption of international or EU standards, 72% of national standards still differ from international norms.

(a) Standards and quality control

60. Aside from fulfilling its obligations under the WTO Agreement on Technical Barriers to Trade, Hungary's main objective with regard to the setting of technical regulations and standards is to harmonize them in accordance with EU provisions. Under the Europe Agreement, Hungary is committed to achieving full conformity with EU technical regulations and with European standardization and conformity assessment procedures. Whereas the process of harmonization with EU regulations has largely been accomplished in the case of foodstuffs, harmonization has been slower for pharmaceutical and chemical products. In the case of the automotive sector, Hungary plans to implement fully European standards by the time it accedes to the EU. It is envisaged that Hungary's implementation of European standards will reach the levels similar to those of EU Member States by the end of 2001. Insofar as European standards are established on the basis of international

³⁵ Ministry of Industry, Trade and Tourism (1996 & 1997).

³⁶ The forms of assistance include non-repayable grants, interest-free loans, interest subsidies, interest-free payment in instalments for the customs duty payable on import leasing, repayable interest-free subsidy from the funds of the Central Technical Development Core Programme, bank loans refinanced by the National Bank of Hungary, and equity participation by the State. The non-repayable grant may extend to 50% of the costs eligible for support.

³⁷ WTO (1997), p. 54, paragraph 36.

standards, harmonization with European standards also involves the introduction of international standards in Hungary.

61. While the Ministry of Industry, Trade and Tourism (MITT) has general responsibility for the implementation of the Agreement on Technical Barriers to Trade, according to the Law XXVIII of 1995 on National Standardization, the Hungarian Standards Institution (*Magyar Szabványügyi Testület*) is the national standards body with overall responsibility for the national standards system. The responsibilities of the Hungarian Standards Institution (HSI) include the exclusive right to set national standards and publication of these standards.³⁸ Furthermore, it operates an information service, which involves, *inter alia*, publication of its official journal, the Standardization Gazette (*Szabványügyi Közlöny*), in which draft national standards are announced and national standards published, and responding to comments and enquiries regarding national standards.³⁹ The National Accreditation Body is responsible for the accreditation of testing laboratories, of which there are more than 300. The HSI is the enquiry point for the purposes of the WTO Agreement on Technical Barriers to Trade.

62. The HSI is a member of the International Organization for Standardization (ISO) and the International Electrotechnical Commission (IEC). In addition, it is an affiliate member of the European Committee for Standardization (CEN) as well as the European Electrotechnical Committee for Standardisation (CENELEC), a member of the European Telecommunication Standard Institute (ETSI) and has applied for admission to the International Network of Quality System Certifiers (IQNet). It also cooperates on a bilateral basis with several countries' national organizations for standardization and quality certification. For example, upon request, it carries out joint certification in accordance with ISO 9000 standards. Such cooperation does not involve mutual recognition of certification, however, although negotiations in this regard concerning agricultural and industrial products have been initiated with CEFTA countries⁴⁰. Negotiations between Hungary and the EU on the mutual recognition of technical regulations pertaining to processed agricultural products and pharmaceuticals are expected to begin in the near future.

63. At the end of 1997, 14,521 Hungarian national standards were in force, many relating to regulations adopted prior to the 1990s. The majority of these regulations are being revised, however, and others are liable to amendment in the next year or two. During the review period, over 2,000 European standards were introduced in Hungary (Table III.9), in addition to 1,344 ISO and IEC standards adopted during the same period. As a consequence, the proportion of Hungarian standards either similar or identical to international or European standards rose from 3% to roughly 27% between 1990 and 1997. According to the law, all technical regulations, standards and conformity assessment procedures apply to domestically produced and imported goods and services alike.

64. Marking, labelling and packaging of products are covered by Hungarian standards, which are, by and large, identical to those of ISO and CEN.

³⁸ Technical requirements together with the different forms of conformity assessment procedures, such as preliminary control, testing and inspection, are laid down in technical regulations and standards.

³⁹ Two months is usually allowed for presentation in writing of comments on national standards. WTO document G/TBT/2/Add.41.

⁴⁰ The CEFTA already includes a procedure for the exchange of notifications on draft technical regulations.

Table III.9
Relation of Hungarian standards to international and European standards

	1990	1991	1992	1993	1994	1995	1996	1997
Total number of Hungarian standards	19,585	19,609	19,779	19,136	18,258	14,380	14,349	14,521
Identical to ISO standards	9	150	511	689	1,007	1,084	1,092	1,108
Identical to IEC standards	2	34	115	159	221	242	242	247
Identical to European standards	-	24	129	224	580	883	1,051	1,967
Deviate only slightly from ISO standards	618	594	358	590	813	1,076	618	671
CMEA standards	1,288	1,186	1,086	1,010	918	-	-	-

Note: In case of applying European standards, no deviation is allowed.

Source: Hungarian Standards Institution.

(b) Sanitary and phytosanitary measures

65. While the regulation and certification of food and SPS standards in Hungary lies primarily within the jurisdiction of the Ministry of Agriculture, other bodies or ministries may have responsibilities in these areas too.⁴¹ A new law on food control entered into force at the beginning of 1996 and new regulations concerning the execution of these controls are being formulated.

66. Ministry of Agriculture and Food Decree 5/1988 (IV.26) stipulates phytosanitary import regulations. These regulations, which the Hungarian authorities consider to be in accordance with international standards, are based on the recommendations of European Plant Protection Organization and the UN/FAO regional plant protection organization as well as the Office Internationale des Epizooties (OIE). The regulations do not discriminate against imported products. Approximately 60% of Hungarian phytopathological inspections are in harmony with the pertinent EU regulations. A new plant protection law together with its executory decree is currently being drafted in accordance with EU Directive EEC 77/93. This law is expected to enter into force in 1998-99. There is no difference between the fees for export or import inspections.

(c) Environmental standards and regulations

67. Hungary applies environmental and safety standards to domestic and foreign products alike, however, as observed above, importation of used cars over four years old is prohibited, ostensibly on environmental and safety grounds. This is tantamount to applying more stringent, prohibitive, standards to imported used cars over four years old than to domestic used cars of the same age. Environmental standards may also figure in government procurement practices and privatization tendering (sections (iv) and (v) below).

(ii) Direct taxation

68. Prior to 1988, taxes were used not so much to collect revenues but rather as instruments to orient the economy and influence consumption, with a large number of tax preferences being granted on a highly discretionary basis.⁴² This was particularly true in the case of enterprises, which were

⁴¹ The supervision of production of foods is the responsibility of the 20 County and Metropolitan Veterinary and Food Control Stations over which the Ministry of Agriculture exercises control. The control of sanitary conditions in the processing of foodstuffs and marketing falls within the competence of the State Public Health and Medical Officers' Service (Ministry of Public Works) while the control of products placed on the market is the responsibility of the General Inspectorate for Consumer Protection attached to the MITT and of 19 county-based inspectorates.

⁴² International Bureau of Fiscal Documentation (1996).

subject to a complicated system of nominal taxes and variable contributions to special funds. The outcome was a system of business taxation that was neither transparent nor neutral, giving rise to bargaining over the granting of tax concessions.⁴³

69. A major development that undoubtedly helped to pave the way for Hungary's transition to a market economy was the 1988 tax reform, which abolished several existing taxes and established a comprehensive tax system, involving a value-added tax, a personal income tax and a business profits tax. Tax reform coincided with the entire rebuilding of the legal environment in Hungary with, among other things, the enactment of the Commercial Code and Foreign Investment Law. Since the 1988 reform, the Hungarian tax system has been in a steady process of evolution and change.

70. Two main outcomes of the 1988 tax reform in addition to the establishment of a VAT were the introduction of both a graduated personal income tax (PIT) and a classical corporate income tax (CIT), which replaced the business profits tax in 1990. Personal tax rates currently range from 20% (on incomes of up to Ft 250 000) to 42% (on incomes of up to Ft 1 100 000), although individual entrepreneurs who pursue the specific activities as listed in the Law (i.e. industrial production, agricultural production, construction services, rental services, taxi transportation, hairdressing) can opt for a flat rate tax of 12.5%, 25%, 30% or 35% of their revenues less assumed costs if income is below a certain threshold. Personal income taxes accounted for 23.6% of total taxes in 1996. Expatriate employees who do not maintain a "permanent residence" and are employed by a foreign company or by a Hungarian company with foreign participation were taxed on 70% of their taxable salary in 1995 and 75% in 1996. This preferential provision ceased in 1997. All private persons currently pay taxes on the same basis.

71. Since it was introduced in 1990, the CIT system has undergone several modifications, the latest including the repeal of the split-rate tax (involving an 18% basic tax rate and a 23% supplementary tax) and its replacement in 1997 by an 18% corporate income tax and a 20% withholding tax on dividends. Perhaps the most striking and enduring feature of Hungary's corporate income tax system, however, has been the wide array of (relatively non-transparent) tax deductions, exemptions and credits that it allows (Box III.2). These have been designed to encourage the retention of profits for the financing of new investment, to attract foreign investment, promote exports and other activities, as well as to develop certain sectors of the economy and regions. The scope and generosity of these concessions is such that the corporate income tax contribution to total tax revenues was very small, only 5.3%, or 1.9% of GDP in 1996.

72. In the initial phase of transition, the CIT, like its predecessor, was characterized by high statutory tax rates and a wide range of tax preferences granted to selected activities, mostly in the form of special tax exemptions or relief, particularly in the case of foreign investors, the purpose being to attract foreign direct investment. A significant aspect of the tax system in this early phase was that foreign investors were treated more favourably than domestic entrepreneurs. Such "positive discrimination" was thought necessary to compensate foreign investors for what they perceived to be the relatively high risk of investing in an economy in the early stages of transition. Most of these preferences were abolished at the end of 1993, however, and any incentives are now largely accorded to domestic and foreign investors alike. Two notable exceptions involve the special deduction granted to companies with at least 30% foreign participation and the tax allowance for fully foreign-owned offshore companies. Although the last date for qualifying for this special deduction was the end of 1993, existing enterprises continue to enjoy the incentive for which they originally qualified until 2003. Fully foreign-owned offshore companies can still qualify for the tax allowance.

⁴³ According to a representative of a prominent auditing company, this may still be the case to some extent. *The Budapest Sun*, "Tax system praised: Business practice still lagged behind western Europe", page 9, 6-12 November 1997.

Box III.2: Tax incentives for investment, 1996

(Ft million)

Incentive	Description	Amount
Special deduction for business organizations with foreign participation	Prior to 1989 companies with foreign participation of at least 30% were granted numerous tax holidays for the first year after the company was established or for a certain number of years, depending on certain conditions (tax exemption or tax rebate), including different (lower) tax rates from those applied to domestic companies. Even though the incentives were withdrawn after 31 December 1993, companies with foreign participation remained eligible for the benefits if they met the conditions by December 1993. The incentive will be terminated in 2003.	29,706
Incentive for offshore companies	This incentive, which was introduced on 1 January 1994, is available for offshore trading or service companies. A tax credit of 85% of the tax due, granted to offshore companies, was withdrawn and replaced beginning 1 January 1997 with a low rate of corporate income tax, i.e. 3%. Offshore companies are not entitled to any other tax incentives.	397
Tax exemption for dividends reinvested by foreign members of a business organization	No tax is levied on dividends reinvested in Hungary by foreign investors.	57
Temporary incentive for large-scale investment	Instead of the major investment incentives, which were abolished from 1 January 1995, a new type of temporary investment incentive was introduced with effect from 1 January 1996. Under this incentive a company may reduce its tax liability by 50%, provided that: <ul style="list-style-type: none"> - it invests at least Ft 1 billion after 31.12.95 to expand manufacturing facilities; - it invests at least Ft 1 billion after 31.12.96 to establish commercial accommodation; and - the investment results in an increase in export revenue or turnover from commercial accommodations, respectively, by at least 25% and Ft 600 million in comparison to the previous year, or on average calculated during the 5-year period. 	5,723
Tax concession to promote export-oriented product development	The objective of this programme is to stimulate development projects that increase the range and volume of goods competitive on external markets.	1,351
Tax concession to promote investments in production of exportable goods	Tax deduction granted for interest on bank loans used to finance export-oriented investment.	1,351
Regional incentives:		
Investment tax credits	Until the end of 2002, tax credits equal to 6% of the investment value are available to taxpayers in qualifying zones for infrastructural investments, investments in machines and equipment in high priority zones; and investments in machines, equipment and building in industrialized zones.	507,712
Special write-offs	An investment allowance in the form of an immediate 100% write-off of the acquisition price is granted to companies having their seat or registered branch in an industrial zone, provided they put into use fixed assets (i.e. machines and equipment, buildings and construction, except passenger cars) for the first time in the zone. Accelerated depreciation is also granted at a rate of 10% for buildings.	
Tax exemption	Taxpayers are granted a 100% reduction in the corporate income tax, provided the investments in manufacturing activities were made after 31 December 1995. The tax allowance, available until the end of 2002, applies in the tax years during a 5-year period from the date that manufacturing commenced, provided the revenues from export or agricultural production have increased: for a taxpayer in an industrial zone, by 1% in comparison to the previous year; for a taxpayer in a high-priority region by an amount equal to at least 5% of the invested value; and in the case of establishing commercial accommodation (e.g., hotels), within a 5-year period from the commencement of operations.	..
R&D incentive	A reduction of the tax-base equivalent to 20% of direct research and development costs.	..
Accelerated depreciation	Taxpayers are allowed to depreciate machinery and equipment put into use for the first time after 31 December 1995 at the maximum rate of 30% (instead of 14.5%). Taxpayers may also depreciate immovable capital assets (buildings) put into use in qualifying regions for the first time in Hungary at the rate of 10%.	..
Tax benefit on compensation allocation and coupon, respectively	Tax benefit is granted to cooperatives in case of land sales on certain conditions.	7
Other tax benefits		1,555

.. Not available.
Source: Hungarian authorities.

73. Certain corporate tax incentives stipulate export requirements. In the case of the tax incentive for large-scale investment, which has been available since 1 January 1996, companies may reduce their tax liability by one half provided they invest at least Ft 1 billion in the expansion of manufacturing facilities and the investment results in an increase in export revenue of at least 25% or Ft 600 million compared to the previous year. Other tax incentives are designed to promote investments in the production of exportable goods and export-oriented product development. Hungary has invoked Article 29.3 of the Agreement on Subsidies and Countervailing Measures to justify these incentives.⁴⁴

74. Corporate tax concessions are also used to promote certain sectors. For example, among the additional eligibility criteria attached to the special deduction granted to companies with at least 30% foreign participation was the requirement that more than half of the company's annual sales originated from manufacturing or other "activities of particular importance". Other tax incentives, including accelerated and special depreciation schemes, are offered to companies investing in high priority industrial zones or regions; that is, where unemployment is 50% higher than the national level.

75. While estimates of the total annual costs of various tax incentives in terms of revenue forgone were not available, according to information provided by the Hungarian authorities, nearly Ft 30 billion of tax revenue was forgone in 1996 alone as a consequence of the special tax deduction for companies with foreign participation. The cost associated with the tax incentive for large-scale investment was around Ft 5.7 billion in the same year.

76. The Hungarian authorities have not evaluated the effectiveness of tax or other incentives for investment in accomplishing their stated objectives. In the absence of convincing evidence to the contrary, their effectiveness remains in doubt.⁴⁵ Indeed, there are grounds for believing that incentives may not be merely ineffective, but possibly counterproductive (Box III.3).⁴⁶

⁴⁴ Documents G/SCM/N/3/HUN/Suppl.1 and G/SCM/N/39/HUN.

⁴⁵ OECD (1995b), p. 31.

⁴⁶ As pointed out in the WTO Annual Report, "it is difficult not to conclude that the world economy - and the vast majority of individual countries - would be better off with ... limitations on the use of investment incentives." WTO (1996), Volume I, p. 61.

Box III.3: Evaluation of the effectiveness of incentives

Incentives for investment are widespread in Hungary, as in many other developing and developed economies. According to the OECD among the countries of Central Europe, Hungary has probably accorded foreign investors the most favourable tax treatment. The main aim of these incentives is to attract foreign direct investment (FDI) and thereby develop local industry. While Hungary's share of the total FDI in the region is around 40%, it is difficult to judge the extent to which incentives have actually contributed to this success. Nonetheless, there are grounds for doubting the effectiveness of such incentives, based on evidence from other economies. Moreover, in some instances the use of incentives may even be counterproductive.

In the first place, incentives are seldom among the main determinants of business decisions. Proximity to markets, the availability of sufficiently skilled labour at relatively low cost, and a stable economic and legal environment are usually much more important. Other countries' experience with evaluation of tax and non-tax incentives suggests that the cost of such measures to the Government (in terms of expenditure or tax revenue forgone) may exceed the investment generated. Their high cost is related to the difficulty in identifying incremental investment; that is, investment that would not have been undertaken without the incentive. Tax cuts for foreign multinational enterprises (MNEs) that are taxed in their home countries purely on a residence basis (that is, they receive a full credit for taxes paid abroad) may have little or no effect on the incentive for those firms to invest in the country offering such relief. Such cuts would provide an effective incentive only insofar as MNEs are in an excess foreign credit position, taxes on repatriated income can be deferred, the MNE's home country exempts foreign-source income from domestic taxes, or "tax sparing" is allowed.

Secondly, insofar as incentives do stimulate particular types of investment, they may result in a less efficient allocation of national resources than would be the case if the Government remained neutral and refrained from influencing private decisions. Any adverse effect of incentives on resource allocation would manifest itself as lower total factor productivity. In the case of investments, such as those in R&D, which are thought to yield social benefits (externalities) that are not adequately taken into account by private investors, it is usually extremely difficult to measure such externalities accurately, with the result that incentives may turn out to be excessive.

Thirdly, incentives are usually expensive for the Government, involving large losses in tax revenues. A tax system involving many special incentives is also much more susceptible to tax avoidance, and tax evasion, which further contribute to the loss in tax revenues. Incentives tend to worsen the fiscal balance, thus reducing national savings and showing up as a deterioration in the current account balance.

Lastly, use of incentives may provoke countermeasures by trading partners. Even where they do not contravene the WTO Agreement on Subsidies and Countervailing Measures, they may be used by other countries as a justification for countermeasures. Alternatively, countries may react by adopting incentives of their own, thus resulting in a beggar-thy-neighbour situation. Such an "incentives race" is harmful to all countries concerned.

77. In view of the large amounts of tax revenues forgone as a result of investment incentives, the authorities indicated that they were reviewing their widespread use in order to make them more selective. Curtailment of other income tax incentives would not only contribute to more efficient allocation of resources, but also simplify the income tax system and reduce the scope for tax avoidance and evasion.⁴⁷

⁴⁷ For example, an earlier tax reduction for enterprises with foreign participation was thought to have been abused through the formation of "puppet" foreign companies. The customs duty exemption for imported means of production was also felt to have been abused as there were suspicions that goods were being imported duty free under this provision and then resold in Hungary (OECD, 1995b, p. 99).

(iii) Non-tax measures affecting investment**(a) Regulations concerning registration of commercial presence and protection of investment**

78. The Hungarian Government's desire to attract foreign investment is reflected not just in its domestic tax laws, but also in the legal and regulatory framework pertaining to companies and the protection of investments, including intellectual property. As discussed in Chapter II, this framework includes two basic laws that regulate the establishment and operation in Hungary of companies with foreign participation (joint ventures or wholly foreign-owned companies), the Company Act (Act VI of 1988) and the Act XXIV of 1988 on Investments by Foreigners in Hungary (Foreign Investment Act). Hungary has also developed an extensive network of bilateral agreements concerning investment protection and relief for double taxation. In addition, it provides legal protection of intellectual property rights.

(b) Protection of intellectual property rights

79. Protection of intellectual property rights is essential in order, *inter alia*, to enable investors to obtain competitive returns on their investment in intellectual capital. Lack of protection constitutes a disincentive to the undertaking of such investment, tending to result in insufficient investment in intellectual property or even discouraging foreign direct investment. Protection also helps to "internalize" the externalities often associated with R&D and related investments in intellectual property, thereby reducing the disincentive to undertake such investment. It also obviates the need for government subsidies to bridge the gap between the social and private returns from investments in intellectual capital. On the other hand, as recognized by Article 40 of the TRIPS Agreement, some aspects of intellectual property protection may impede the transfer and dissemination of new ideas and technology, thereby restraining competition and adversely affecting trade. It follows that in Hungary, as in other countries, policy aimed at providing adequate protection of intellectual property rights involves establishing an appropriate balance between private investors' need to earn a reasonable profit on their investment in intellectual capital and the social benefits from allowing the public to exploit new knowledge to the greatest extent (Table III.10).

80. Hungary is a party to most of the major multilateral agreements in the field of protection of intellectual property (Table AIII.7). Hungarian legislation on the protection of industrial property did not require any major changes to comply with its obligations under the TRIPS Agreement. No temporary exemption was required for pharmaceuticals, because the protection of pharmaceutical products *per se* by patents was established before the entry into force of the TRIPS Agreement.

Table III.10

Summary of intellectual property protection in Hungary corresponding to TRIPS obligations

Form	Main legislation	Coverage	Selected exclusions	Duration	Sanctions
Copyrights and related rights	Copyright Law III (1969) as amended by law No. LXXII (1994) Amending Industrial Property and Copyright Legislation, Articles 1-6 repealed by Law XXXIII (1995), Articles 20-28 concerning patents still in force	Authors' rights in the artistic, literary and scientific domains. To enjoy copyright protection a work must be an original creation	Statutes, public resolutions, official notifications, document standards, or other obligatory regulations	Life of author plus 70 years	Imprisonment up to 5 years (Infringement of Author's and Adjacent Rights)
Geographical indications	Protection of Trademarks and Geographical Indications (TMA), Law XI (1997)	Protection for geographical signs and appellations of origin. Geographical indications of agricultural products and foodstuffs are granted protection if the products bearing the geographical indication also comply with the conditions specified in the product specification provided for by special legislation	The indication has become generic; earlier rights to a geographical indication or to a trade mark; trade marks having a reputation even with respect to unsimilar goods	Unlimited	Imprisonment up to three years; false indication of goods
Industrial designs	Industrial Designs Law 28 (1978) as amended by Articles 9,10 and 11 of Law VII (1994)	The external shape of an industrial product is entitled to the protection afforded to designs, if it is new and if protection is not excluded by the decree	Public interest; humanitarian principles; morality	5 years; renewable for further 5 years	Imprisonment up to 3 years
Patents	Protection of Inventions by Patents (PA), Law XXXIII (1995)	Any inventions that are new, involve an inventive activity and are susceptible to industrial application	Public interest	20 years from filing date	Imprisonment up to 3 years
Topography of integrated circuits	Protection of the Topographies of Microelectronic Semiconductor Products; Law XXXIX (1991)	Protection is granted to the topography of microelectronic semiconductor products provided it is original. A topography is original if it is the result of its creator's own intellectual effort and is not commonplace in the industry at the time of its creation		10 years from filing date (or, if earlier, from first use)	Imprisonment up to 3 years
Trade marks	Protection of Trademarks and Geographical Indications (TMA), Law XI (1997)	Any sign capable of being represented graphically, provided these are capable of distinguishing goods or services from those of other undertakings	Public interest (public policy, morality or law, deception of the public); application in bad faith, State emblems and like (PUE 6ter), religious symbols	10 years from filing date; may be renewed for 10-year period	Imprisonment up to 3 years; false indication of goods
Utility models	Protection of Utility Models (UMA); Law XXXVIII (1991); this law has been amended by Article 12 of Law VII (1994) and Article 117 (B) and (c) of Law XXXIII (1995) (see above under patents)	Any solution relating to the configuration or construction of an article or to the arrangement of parts thereof, which is new, involves an inventive step and is susceptible of industrial application	Aesthetic shape of products; plant varieties	10 years from filing date; two 3-year extensions possible	Imprisonment up to 3 years

Form	Main legislation	Coverage	Selected exclusions	Duration	Sanctions
New plant varieties	Protection of Inventions by Patents, Law XXXIII (1995)	A plant variety shall be patentable if it is distinguishable, uniform, stable and new and has been given a denomination apt for registration	May not consist solely of figures (except where it is a practise for designating varieties; it must not be liable to mislead; it must be different from the denomination of an existing variety of the same or closely related plant species; its use must not be contrary to public order or morality	Plants 15 years, vines and trees 18 years from grant, animal breeds 20 years from filing date	Imprisonment up to 3 years
Computer software	Copyright Act, Law III (1969)	The Act provides protection for computer software		70 years after the death of author of software	Imprisonment up to 5 years

Source: World Intellectual Property Organisation; Government of Hungary; WTO Agreement on Trade-Related Intellectual Property Rights.

81. The major changes in intellectual property rights legislation in connection with Hungary's accession to the EU have already been put into effect. More specifically, patent and trade mark laws have been harmonized with Community legislation. As a result of this harmonization Hungary's legislation is, by and large, now more stringent than the minimum standards laid down by the TRIPS Agreement. In the case of duration of copyright protection, for example, whereas the TRIPS Agreement stipulates the life of the author plus 50 years, Hungary's current copyright law provides protection for the author's life plus 70 years. Another example is that Article 51 of the TRIPS Agreement covers only importation of counterfeit trade mark or pirated copyright products. However, in accordance with Decree 128/1997 on Customs procedures in Hungary, this provision is applied to all counterfeit trade marks, counterfeit geographical indications and infringement of copyrights and related rights. Data on applications and registrations of intellectual property are presented in Table AIII.8.

82. Parallel imports of goods and services containing any category of intellectual property mentioned above are not allowed under Hungarian law. For the importation of these goods by a third party, the consent of the right holder is required.

83. If a patent has not been used within a specified period of time after being filed, under Article 31 of the law concerning Protection of Inventions by Patents (PA), a compulsory licence may be granted, unless the patentee justifies the lack of exploitation. Furthermore, under Article 32 of the PA, if a patented invention cannot be exploited without infringing another patent ("the dominant patent"), a compulsory licence may be granted to the extent necessary for the exploitation of the dominant patent. Under Article 33, the scope and duration of a compulsory licence are determined by the court, which, failing agreement between the parties, also decides the amount of compensation. Similar provision applies to utility models (Article 16 of the Utility Models Act (UMA)). Compulsory licensing is not possible with respect to trade marks, industrial design and topographies; nor can it be a remedy for the anti-competitive use of intellectual property rights.⁴⁸ No compulsory licence has been granted since 1 January 1993.

⁴⁸ Common provisions on compulsory licences are regulated by Article 33 of the PA.

84. The legislation on intellectual property, civil law, the law on civil procedure and criminal law may be used to combat infringement. The Metropolitan Court has jurisdiction and exclusive competence in all cases involving infringement of intellectual property rights. The second instance is the Supreme Court. As regards civil remedies, Article 35 of the PA provides, among other things, for: the declaration of infringement by the court, injunction in order to stop the infringement, restitution, and seizure or destruction of the means used for infringement and of the infringing products. The patentee may also claim damages under the rules of civil liability. Similar remedies are provided for by the law in case of trade mark infringement and infringement of industrial design, utility model and topography protection. Provisional measures may be applied under the Code of Civil Procedure. Provisional measures may also be taken under the Trademarks Act (TMA) to protect the proprietor of a trade mark. Similar provisions are included in the PA, the UMA and in the Decree on the protection of industrial designs. As regards criminal sanctions, violation of authors' rights and neighbouring rights also constitutes a criminal offence under Article 329 of the Criminal Code, punishable by up to five years imprisonment. Under Articles 296 and 329 of the Criminal Code, an infringement of intellectual property involving false indication of goods also qualifies as a crime, punishable by up to three years imprisonment.

85. Government Decree 128/1997 (VII.24) Korm. provides for measures by the customs authorities to prevent the importation of goods infringing trade marks, the protection of geographic indications, and copyright or neighbouring rights. The rightholder may file an application for measures with respect to goods of a certain producer or of a certain country for a certain period (general application) which cannot be longer than six months, or file an application with respect to a certain transport of goods (special application). The rightholder is required to provide adequate evidence about the counterfeit goods and to deposit security. In addition, the customs authorities are entitled to initiate procedure *ex officio* preventing *prima facie* infringing goods from entering the country. Since the above Decree came into force on 1 August 1997, four applications have been submitted to the competent customs authority and one procedure initiated *ex officio*. The authorities consider that this Decree is in accord with the relevant provisions of the TRIPS Agreement. Foreign and Hungarian intellectual property rightholders equally can avail themselves of legal procedures and remedies applied in Hungary.

86. The scale of the unofficial economy, noted in Chapter I makes the sale of counterfeit and pirated goods a continuing problem, although the trade losses associated with piracy have been declining. Losses in 1996 were estimated by the International Intellectual Property Alliance (IIPA) to be around \$70 million for motion pictures, sound recordings, computer software and books, notwithstanding stepped up enforcement in 1996 with, among other things, several convictions of distributors and users of pirated software.⁴⁹ Clearly, it is too early to assess the effectiveness of the new measures in preventing the sale of counterfeit and pirated goods.

(c) Investment incentives

87. Hungary attempts to encourage investment, particularly FDI, not only by establishing a conducive regulatory framework, protecting intellectual property rights and providing tax

⁴⁹ According to figures recently released by the Business Software Alliance (BSA), nearly 70% of personal computers in Hungary operate using some form of pirated software (compared to around 50% in western Europe), with a loss in sales amounting to Ft 10 billion (\$50 million) as well as VAT payments. Illegal use of software in Hungary can result in a prison sentence of two to five years. More than 100 prosecutions are currently under way as a result of violations of information technology regulations. Three court decisions have been handed down so far, each of which resulted in a prison sentence. BSA has reportedly signed a cooperation agreement with the Hungarian National Police (ORFK) and a similar arrangement with the Customs and Excise Office is envisaged in the near future (Budapest Sun, 22-28 January 1998, p. 10.).

concessions, but also by offering non-tax forms of direct financial assistance to domestic and foreign investors alike (Box III.4).

88. One of the principal sources of direct financial assistance to businesses is the Targeted Allocation for the Development of the Economy, established under Decree Ný4/1996 (II.6) and managed by the Ministry of Industry, Trade and Tourism (MITT).⁵⁰ In 1996, the programme had Ft 15 billion at its disposal. The Targeted Allocation fund provides assistance not just for the promotion of trade, as discussed above, but also for direct investment and economic restructuring. Assistance may involve repayable loans or non-repayable grants⁵¹, which are awarded by MITT on the basis of a competitive tendering process, the Economy Development Tendering System. The amount of the subsidy cannot normally exceed one third of the combined costs of the investment in manufacturing facilities and infrastructure and may not be greater than Ft 200 million (with the exception of individual manufacturing investments exceeding Ft 1 billion).

89. Among the other main forms of assistance for investment is the Targeted Allocation for Regional Development. This fund provides assistance to companies that create new jobs and hire the unemployed in regions where unemployment exceeds 15%. All business organizations registered in Hungary, upon submission of economically viable proposals, are eligible for assistance amounting to Ft 700,000 per new job created. One half of the funds is allocated in a decentralized manner, based on the decisions of the regional development councils of the individual counties concerned.

Box III.4: Investment and other subsidies, 1996

Name of subsidy	Form of subsidy	Amount (Ft million)
1. Export enhancement programme for agricultural and fishery products	The subsidies are granted in the form of a bounty.	42,102 ^a
2. Price support programmes for certain agricultural products	Buying-in of certain products at guaranteed prices by State intervention agency.	7,500 ^b
3. Agricultural funds	* <u>Stock-Breeding Fund</u> : Subsidies from the Fund are in the form of repayable or non-repayable financial contributions. These subsidies are awarded through open tenders.	776 ^a
	* <u>Fishery Fund</u> : Subsidies from the Fishery Fund are in the form of grants that may be awarded through open tenders.	91 ^c
	* <u>Agricultural and Forestry Fund</u> : Subsidies provided for the purchase of equipment and auxiliary appliances are repayable contributions.	12,778 ^c
	* <u>Game Husbandry Fund</u> : Subsidies from the Game Husbandry are in the form of grants that may be awarded through open tender.	105 ^c
	* <u>Land Protection Fund</u> : Subsidies from the Fund are in the form of grants that may be awarded through open tenders.	684 ^c
4. Central Fund for Technical Development	Subsidies from the Fund are usually in the form of a repayable interest-free loan for up to 50% of research and technical development costs up to the stage of creating a prototype. Subsidies are awarded through tender procedures or upon the initiative of the Management of the Fund.	4,160 ^{cd}
5. Targeted Allocation for Territorial Development	Subsidies aimed at areas where unemployment is 50% above the national average and in the form of: non-repayable capital transfer, interest subsidy for bank loans financing development projects, repayable financial contributions, government guarantee on bank loans.	5,000

⁵⁰ Details of other forms of assistance are found in Hungary's notification to the WTO (document G/SCM/N/3/HUN/Suppl.1, 14 June 1996).

⁵¹ The specific forms of subsidy include interest-free loans, interest subsidies, interest-free payment in instalments for the customs duty payable on import leasing, repayable interest-free subsidies from the funds of the Central Technical Development Core Programme, bank loans refinanced by the National Bank of Hungary and equity participation by the State.

	Name of subsidy	Form of subsidy	Amount (Ft million)
6.	Targeted Allocation for Development	Subsidies from the Economic Development Fund are in the form of repayable or non-repayable contributions that may be awarded through open tender procedures or upon individual request	15,000 ^e
7.	Environment Protection Fund	Subsidies are in the form of non-repayable financial contributions; repayable contribution (loan) free of interest or at preferential rates; credit guarantees	8,608
8.	Mining Conversion Programme	These subsidies are in the form of grants or government guarantees on bank loans.	3,600
9.	Metalurgy Conversion Programme	These subsidies are in the form of grants or government guarantees on bank loans.	10,840
10.	Assistance to the public railways	These subsidies are in the form of grants.	29,800

a Figure for 1997 (according to WTO document WT/L/238, 29 October 1997)

b Amount budgeted in 1995, but not spent.

c Data for 1995 (according to WTO document G/SCM/N/3/HUN/Suppl.1, 14 June 1996.

d This amount is included in the figure of 15,000 indicated for the Targetted Allocation for Development.

e This figure includes the amount of 7,160 budgeted for the Central Fund for Technical Development.

Source: WTO Secretariat, based on information provided by the Government of Hungary.

90. In addition, there are many industrial parks either in operation or under construction and another 36 are in planning and design stage. These parks offer several advantages to domestic and foreign investors, notably: full infrastructure (water supply, electricity, drainage, telephone and fax lines, etc.), which may be tailored to the needs of investors; road connections; a broad range of services, and local tax preferences. Furthermore, in 1996, the Government also launched a targeted programme of incentives for the creation and the development of industrial parks. While details of the programme are still being decided, it may include interest-free loans as well as non-repayable grants to cover some of the costs of the feasibility studies and investments. Various eligibility criteria must be fulfilled; e.g. the area where the industrial park is to be established should be classified as a socially and economically underdeveloped region, a region undergoing industrial restructuring or hit by permanent unemployment, or covered by the rural development programme.

(d) Performance and local-content requirements

91. While Hungary has not notified any trade-related investment measure (TRIM) as defined in the TRIMs Agreement, as noted above, the granting of incentives is sometimes conditional upon performance or local-content requirements. These requirements may involve not just export performance, as in the case of the tax incentive for large-scale investment (described above), but employment conditions. For example, among the conditions attached to the tax allowance for fully foreign-owned offshore companies is that, in their domestic administrative and court proceedings, they employ only domestic lawyers and that a majority of their senior officers, supervisory board members and employees, taken separately, are Hungarians. As a transition economy, Hungary is obliged under the TRIMs Agreement to phase out such requirements by 2002.

(iv) Government procurement

92. During the latest period for which data are available, the 14 months from November 1995 to December 1996 inclusive, total (central and local) government procurement amounted to approximately Ft 150 billion, or 14% of GDP. Of this amount, 43%, 41% and 16%, respectively, involved goods, services and construction contracts. During the same period, central and local government accounted for 20% and 52%, respectively, of the total value of government procurement, with public undertakings accounting for 24%. Insofar as these undertakings are privatized in the future, government procurement will constitute a smaller share of GDP.

93. The basic legal instrument of government procurement is Act XL of 1995 on Public Procurements, which was designed in accordance with the existing international instruments (World Bank Guidelines, UNCITRAL Model Law) and the relevant EU directives. It entered into force on 1 January 1996⁵². The Act applies to central and local government and to public undertakings, including utilities. The rules of the Act apply to procurements exceeding the following thresholds: Ft 15 million for goods; Ft 7.5 million for services; Ft 30 million for building and construction projects; Ft 7.5 million for technical planning for building and construction projects; and Ft 240 million for pre-qualification requirement (as defined in Section 42:3 of the Law on Public Procurement). The Act is enforced by the Public Procurement Council, an independent agency under the supervision of Parliament.

94. Government procurement procedures may be open, by invitation or by direct negotiation.⁵³ The general procedure for government procurements is open tendering. A "by invitation" procedure can be applied only if, owing to the particular nature of the procurement, a limited number of bidders is suitable for fulfilling the contract and there are at least five qualified bidders. A direct negotiation procedure may be applied only if, *inter alia*, either of the other two procedures was unsuccessful, or if the technical peculiarities, artistic considerations, etc. are such that the contract can be carried out only by a single contractor. Of the 3,240 procedures initiated during the period November 1995 to December 1996 inclusive, 2,252 involved open tender, 194 invitational tender and 795 direct negotiation.

95. Intended procurements are published initially in the Public Procurement Bulletin and subsequently, in some cases, in domestic newspapers. To the extent that foreign-based bidders are allowed to participate in the procedure, the announcement may also be published in foreign newspapers, in which case the foreign language summary of the announcement may also be published in the Bulletin.

96. The criteria used to judge bids apply to domestic-based bidders, irrespective of whether they are foreign-owned or Hungarian-owned. The Hungarian authorities estimate that 5-10% of the value of contracts is awarded to foreign-based bidders. No information is available on the share of domestic-based, foreign-owned suppliers in total public procurement.

97. Evaluation criteria must be published in the invitation for tenders. Bids complying with the conditions specified in the invitation for bids are judged on the basis of: (a) consideration of the lowest amount, or (b) the most favourable bid as a whole. In the case of the latter, the order of importance of the criteria used as a basis for judging the bids must be specified and published. Where the price difference in bids does not exceed 10%, the higher-priced bid may be considered of equal value, if half of the higher-priced contract is produced by domestic employees. Where the price difference does not exceed 10%, preference is given to the bid for which the value produced by domestic employees is the highest. In the event that the winning bid cannot be established on the basis of the foregoing price and domestic employee criteria, preference is given: (a) to the bid which contains products embodying environmentally friendly trade marks; and (b) when the quality assurance system of the bidder is certified by an accredited certifier in any national system.

98. The entity inviting the bid must publish information on the outcome of the procedure within 15 days of its announcement. If they so request, unsuccessful bidders must be informed of the reasons for their exclusion within 15 days. Appeals by unsuccessful bidders should be lodged with the Public

⁵² WTO document S/WPGR/W/11/Add.17.

⁵³ WTO document WT/WGTGP/W/9, 16 December 1997.

Procurement Committee, comprising a chairman and three commissioners. Of the 165 cases appealed during the period (November 1995 to December 1996 inclusive), 73 were upheld.

99. Hungary is not a party to the Plurilateral Agreement on Government Procurement, nor does it envisage acceding to the Agreement in the near future. On the other hand, Hungarian legislation is, by and large, compatible with the EU directives in this field, with the requirements of the EU directives regarding utilities (energy, water, telecommunications and transport) being among the notable exceptions. Complete harmonization with EU legislation is expected to be accomplished no later than the date of accession.

(v) State-owned enterprises, privatization and corporate governance

100. Privatization, which began in 1990, has been a key aspect of Hungary's transition towards a market economy. This reflects the Government's recognition that private ownership, and therefore privatization of state-owned enterprises, plays a crucial role in improving enterprise performance and corporate governance. Of the 1,857 state-owned enterprises existing on 1 January 1990 (with a book value of approximately Ft 2,000 billion), 297 were still held by the State at the end of 1997. Of these, the State fully owns or holds a majority stake in 151 enterprises and minority holdings in 146. Consequently, whereas a decade ago the private sector produced only 10% of GDP, its share is currently 75-80%. Unlike in several other economies in transition, privatization in Hungary has been largely based on a cash-based method with direct sale of enterprises to investors by competitive tendering on a case-by-case basis. Active use has been made of global placements in the privatization not just of major manufacturing firms, but the country's largest banks and particularly public utilities.

101. Privatization has greatly contributed to growth in productivity, which has improved much faster in privatized firms than in state-owned enterprises.⁵⁴ Among striking features of the Hungarian privatization process, apart from its fast pace, are the high participation of foreign investors and the wide range of sectors covered, notably all major banks and many public utilities including several so-called natural monopolies, such as telecommunications, electricity and gas distribution.⁵⁵ The sale of enterprises to foreign investors was considered essential for the re-capitalization of privatized enterprises whose existing capital tended to be obsolete, the adoption and use of modern management practices and technologies, and the re-training of employee in new production methods.

102. One of the main developments during the period under review was the implementation of a new privatization law (Act XXXIX) passed in May 1995. This law constituted a landmark in the privatization process. It restored credibility to the privatization programme, which had been threatened by a lack of transparency in its implementation⁵⁶, and thereby accelerated privatization of state-owned enterprises. It provided for the merger of the two State holding companies that had previously been responsible for the privatization and management of such enterprises (SPA and HSHC) into a new entity, the State Privatization and Holding Company (ÁPV Rt.). The latter was assigned sole responsibility for the management and sale of state-owned enterprises as well as for the liquidation of those that were unprofitable.

⁵⁴ According to Pohl *et al.* (1997), gains in labour productivity in Hungarian state-owned enterprises (SOEs) were half those achieved by privatized firms. Evidence in the same study also suggests that growth in total factor productivity (TFP) increases substantially after privatization - by 4.5 percentage points per year over a period of at least four years.

⁵⁵ Foreign investors participated in the privatization of nearly 500 companies, accounting for much of the inflow of FDI into Hungary. In general, privatization has not been accompanied by restrictions on the re-sale of shares to foreigners.

⁵⁶ OECD (1997a), p. 8.

103. The round of privatization of utilities towards the end of 1995, attracting record levels of foreign direct investment, involved, among other things, the sale of an additional 40% stake in MATAV, the main Hungarian telecommunications company, to a joint venture consisting of Ameritech and Deutsche Telekom, thus raising the total stake of this joint venture in MATAV to 67%.⁵⁷ It also involved the sale to foreign investors of large stakes (either majority or large minority stakes with options to expand the ownership share) in two non-nuclear power generators, in all six regional electricity distribution companies and in five regional gas distribution companies (shares in these companies were purchased mainly by German, Italian, Austrian and French utilities). Privatization of utilities has proceeded at such a pace that the electricity and gas distribution framework now in place will require little, if any, change to comply with EU regulations regarding competition in these sectors. Other major privatization transactions completed during 1995 include the sale of a majority stake in MOL (the national oil and gas conglomerate and largest of all Hungarian firms) to domestic and foreign investors and a 60% stake in Budapest Bank to the European Bank for Reconstruction and Development and General Electric Capital (of the United States).⁵⁸

104. One outcome of this surge in privatization was that total revenues in 1995 amounted to Ft 481 billion, roughly three times the amounts realized in each of the two previous years. A large part of these revenues was used to redeem outstanding foreign debt, with significant fiscal benefits. After the record sales in 1995, privatization revenues dropped considerably in 1996 and 1997 to Ft 176 billion and Ft 350 billion, respectively. Nevertheless, a number of important transactions have been completed or initiated, including the sale of MHB, the Hungar Hotel hotel chain, Kereskedelmi & Hitel Bank, the last of Hungary's five big previously state-owned banks, stakes in MOL, and Richter (a large pharmaceutical firm). There was also a public offering of 19% of the government's remaining 33% stake in MATAV. Opportunities for further quick sales are limited, however, as a number of the remaining state-owned enterprises will probably be difficult to privatize without further considerable restructuring. Others will probably remain in state hands until liquidated.⁵⁹

105. Notwithstanding the improved transparency of the privatization process since the establishment of ÁPV Rt., the decision-making process in the field of privatization appears to have been sometimes opaque. According to the OECD, the authorities' inability to provide objective and quantitative explanations for the choice of one proposal over another, or for the rejection of all choices, inevitably left the decision and the process open to charges of arbitrariness and compromised the credibility and legitimacy of the process in the eyes of both the general public and of potential investors.⁶⁰

106. These problems were partly addressed by a subsequent amendment to the 1995 law. Under the provisions of Act LXXVI of 1997 passed by Parliament in July 1997, the ÁPV Rt. now has to accept any reasonable offer, even if there is only one bidder and to re-tender unsold companies within 90 days if the first tender does not succeed. Sales can only be blocked by the ÁPV Rt. board of directors with a two-thirds majority and tender conditions cannot be changed after the tendering process begins. Moreover, a written memorandum of all important privatization decisions must be

⁵⁷ In 1997, MATAV was also listed on the New York Stock Exchange.

⁵⁸ At the same time, some inefficient companies were simply allowed to go under.

⁵⁹ The pace of liquidation activity slowed in recent years, largely because the bulk of liquidations took place in 1992-93. Since the beginning of the transition effort, 650 have been liquidated. Liquidation tends to be a lengthy process, taking about three years to complete. Bankruptcy is usually a more efficient way of disposing of unprofitable companies.

⁶⁰ OECD (1997a), p. 58.

made available to the public. While these changes have increased the transparency of ÁPV Rt. operations and decisions, some ambiguity remains as to the criteria used by ÁPV Rt. to deem an offer "reasonable".⁶¹

107. In addition to the matter of performance requirements, several other important issues remain to be addressed in respect of the ÁPV Rt.: the divestment of minority stakes in companies where the law does not require the ÁPV Rt. to maintain shareholdings; the corporate governance of those enterprises where the ÁPV Rt. either holds the majority of shares or retains a "golden share"; and assistance provided by ÁPV Rt. to privatized firms. Furthermore, as the privatization process enters its final stages, the future role of the ÁPV Rt. needs to be re-appraised.

108. The ÁPV Rt. is committed to divesting its minority shareholdings, amounting to about Ft 130 billion, as rapidly as possible. It was originally envisaged that the rest of privatizable enterprises would be sold by the end of 1997, but this proved to be a rather ambitious target, given that many of these enterprises still require extensive restructuring. For example, no suitable buyers have been found for the three remaining state-owned conventional power generators (Pecs, Vertes, and Bakonyi), although the ÁPV Rt. continues its efforts to sell these enterprises either through bilateral negotiations with potential investors or by inviting bids again. The privatization process is now scheduled to end in 1998, with the ÁPV Rt. retaining shares in 109 enterprises (with a book value of about Ft 500 billion), 50 of which, including Hungarian Railways (MAV Rt.), Hungarian Post, EXIMBANK and the Hungarian Export Insurance Corporation (MEHIB), will remain fully state-owned. MAHART Rt. (a shipping company), Ikarus (a bus manufacturer) and MVM Rt. (an electricity company) are among the major privatizations remaining.

109. Rationalization of the number of, and the rights attached to, golden shares is also necessary. The Government, through the ÁPV Rt., has maintained a golden share (combined in some cases with sizeable participation) in 32 companies, including 20 of the largest. The rationale for holding such shares, together with the rights attached to them, is wide-ranging, including the maintenance of traditional brand names (as in the case of the Herend and Zsolnay China and Hungarian paprika manufacturers) and the desire to ensure that the company's strategy is agreed upon with the state. While retention of golden shares by the Government in privatized companies is not uncommon in other WTO member countries, this normally involves so-called "natural" monopolies, such as the energy and telecommunications sectors.⁶² Significant in Hungary's case is the large number of golden shares retained by the Government and their wide sectoral dispersion, including not just energy and telecommunications, but also firms in the manufacturing and food-processing.

110. Another important issue relates to the use of ÁPV Rt. resources to assist privatized enterprises facing difficulties. While the most important long-term objective of a privatization programme is to increase the productivity of privatized enterprises, such gains may not fully materialize if the discipline provided by the market to increase efficiency is vitiated by the ÁPV Rt. More specifically, recent events raise some doubts concerning the enforcement of a genuinely hard budget constraint.⁶³ While many enterprises have been liquidated, or declared bankrupt, there still seems to be a case-by-case approach when enterprises encounter problems. ÁPV Rt. can legally take responsibility for restructuring companies on the brink of liquidation and has already intervened to avoid the initiation

⁶¹ OECD (1997a), p. 59.

⁶² Although claims about the existence of natural monopoly continue to influence public policy in Hungary and elsewhere, the concept is becoming increasingly irrelevant as new technologies emerge that are efficient at much lower levels of production than previously. Consequently, the characterization of "natural monopoly" has given way to the notion of "workable competition" (Rose, 1997, p.2).

⁶³ OECD (1997a), p. 62.

of bankruptcy procedures for two privatized companies by re-nationalizing them. Furthermore, despite the progress made in privatization, there still appears to be some resistance to carrying out the restructuring necessary in the case of some large companies. ÁPV Rt. bought back a company that had been previously privatized and was on the verge of liquidation, and also played a role in rescuing two companies that were involved in the debt-reconciliation programme, apparently motivated by the desire to avoid large-scale layoffs.⁶⁴

111. There is also the broader issue of the appropriate role of the ÁPV Rt. as far as its majority shareholdings are concerned, once the privatization process is completed. Two options are apparently being considered: either maintaining the agency as a sort of investment fund (the "treasury" model) or transforming it into a conglomerate, with representatives of ÁPV Rt. being fully involved in the management of the companies (the "holding" model). Whichever model is chosen, it will be important to avoid a situation developing where its resources are used to subsidise inefficient enterprises or it becomes a vehicle for attracting government subsidies. Irrespective of the model adopted, effective post-privatization corporate governance is essential if privatized firms are to improve their productivity performance.

(vi) Monopolies and concessions

112. The beneficial effects of privatization on productivity may be mitigated if it fails to foster effective corporate governance of privatized enterprises, or if privatized firms are granted monopoly power. The concession of monopoly power or delayed liberalization may be part of the terms of privatization. For example, such a concession with respect to basic telecommunications services was granted to MATAV in 1993 for an eight-year period in order to provide an incentive to Ameritech and Deutsche Telekom both to purchase their initial 30% stake in the enterprise and for the privatized company to undertake further investment in telecommunications infrastructure. According to the authorities, the Competition Act (section (viii) below) adequately addresses the question of monopolies in Hungary.⁶⁵

113. The 1991 Concession Act designated some activities (including drugs, postal services, telecommunications, management of broadcasting frequencies, railways, mining, gas supply, and the generation, transmission and supply of electricity) to be performed by the State or local authorities (either directly or through companies established for that purpose) or by private operators through concession tenders. The Act expressly allows for foreign investors to participate in such tenders on a national treatment basis, by way of a concession contract awarded on the basis of a public tender. All enterprises incorporated under Hungarian law can thus obtain these concessions irrespective of whether they are controlled by domestic or foreign interests. Concessions may be awarded for terms of at least five, and not more than 35 years. These rules apply to concessions granted by central government or sub-national authorities. Concessions are also subject to specific price setting provisions.

(vii) Bankruptcy

114. Another important aspect of Hungary's transition to a market economy was the establishment of a new bankruptcy law in 1992. Whereas previously, firms could obtain assistance in the form of

⁶⁴ OECD (1997a), p. 62.

⁶⁵ In the case of goods and services subject to monopoly power, firms may charge higher prices than those prevailing under competitive conditions; the excess profits derived from the exercise of such monopoly power may also be used to cross-subsidise other goods and services sold in competitive markets, thereby enabling firms with a monopoly in one market to use predatory pricing in another in order to drive out its competitors.

soft loans from state-owned banks or by the Government deferring tax or other payments, the new law contained a strict bankruptcy provision, including a trigger mechanism that automatically activated bankruptcy or liquidation procedures in cases where the period of arrears was as short as 90 days.⁶⁶ The outcome was a large number of liquidations, including some economically viable firms that were facing only temporary liquidity problems. At the same time, many large state-owned enterprises were able to circumvent the law either because of their close links to state-owned banks, which continued to extend credit, or through special debt-resolution channels entailing a large element of debt forgiveness. Notwithstanding these and other problems, including the overloading of the courts handling the cases, the new law marked a major step in the development and enforcement of the rules necessary for a smooth-functioning market economy.⁶⁷ In addition to the law's enactment, the process of implementation fostered the emergence of professionals, institutions and specialized knowledge necessary to support a functioning bankruptcy law. This process also pushed forward privatization of state-owned enterprises and thereby the establishment of market-based incentives.

(viii) Competition

115. As a result of privatization, and the demonopolization associated with it, the vast majority of enterprises, including public utilities, across key sectors of the economy are now operating in the private sector under competitive conditions. While the opening of the Hungarian economy to international trade and foreign investment has provided a relatively simple and effective form of competition policy, a coherent (and stable) regulatory framework is also needed if the market is to function efficiently and the associated productivity gains are to be shared fairly with consumers. This does not always seem to be the case in Hungary, at least for administered prices (see below).⁶⁸

116. Only 16% of prices (weighted by their share in the consumer price index) are subject to central or local government control (Table AIII.9). The price controls are primarily the result of privatization of basic utilities and energy supply, for which concession contracts contain pre-agreed price arrangements in order to avoid a one-time sharp increase in energy and utility prices. Price controls on foodstuffs and other basic products were eliminated in 1992. (See Table AIII.9.)

117. The importance attached by the Hungarian Government to competition policy, and thus the interests of consumers, is illustrated by the fact that the Constitution recognizes and supports the right to entrepreneurship and the freedom of economic competition.⁶⁹ Since the previous trade policy review, the 1990 Competition Law was amended before being replaced, as of 1 January 1997, by the 1996 Competition Act.⁷⁰ This Act represents a significant step towards the achievement of the necessary approximation to EU anti-trust legislation.

118. Among the most notable new elements of the Act is the change in the focus of the law from protection against "unfair" market behaviour to a stronger emphasis on non-competitive ("restrictive") market practices. The new law contains a general prohibition not only of horizontal cartels, but on all kinds of vertical restraints (instead of only resale price maintenance) that prevent, restrict or (as a new

⁶⁶ The automatic trigger was repealed at the end of 1992.

⁶⁷ OECD (1997a), p. 81.

⁶⁸ OECD (1997a), p. 62.

⁶⁹ Moreover, the Civil Code declared the ban on unfair economic activity as one of its fundamental principles.

⁷⁰ Act LXXXVI of 1990 on the Prohibition of Unfair Market Practices. Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices.

element) distort competition, or may do so. On the other hand, agreements concluded between undertakings that are not independent of each other are no longer prohibited as such. The new law also contains a system of exemptions from the prohibition, which resembles those specified by EC competition law, including some block exemptions. In addition, the dominance concept is no longer based on market share thresholds; it is instead based on the ability of firms in a dominant position to act independently to a great extent from other market participants. Likewise, the obligation of participants in a merger to apply for authorization is no longer linked to market share thresholds. The new elements of the definition of concentration together with the criteria for assessing mergers are in close harmony with those of the EU Mergers Regulation. As a consequence of this new law, Hungary's legislative framework on competition policy is now largely compatible with EU standards.

119. As the new law entered into force only in January 1997, no information was available regarding enforcement. Under the previous Competition Act, decisions were reached in 756 cases by the Office of Economic Competition during the period 1 January 1991 to 30 June 1997 (Table III.11), and in a further 98 cases between 30 June and 20 October 1997. Violations were found in only one third of these cases, however, and of the total of Ft 1.8 billion in fines imposed, little more than Ft 100 million has been collected.⁷¹ This suggests that the Act may not have been strictly enforced. Inadequate enforcement of competition laws can constitute an important additional form of assistance to some domestic producers, sheltering them from domestic and foreign competitors alike. The outcome may be a situation in which trade and domestic resource allocation are distorted not so much by government action, but rather its failure to take adequate action against anti-competitive private practices. As in the case of specific border and internal measures, such protection is obtained at the expense both of other domestic producers who, as a consequence, face higher prices for their inputs, and of consumers. It remains to be seen whether enforcement is improved under the new Competition Act.

120. With the privatization of several major public utilities, the Government is also now expected to play an important role in regulating the activities of private suppliers of electricity, gas and telecommunications, which the authorities regard as natural monopolies. Hungary's regulatory policy has sometimes lacked consistency, however. In the case of telephone tariffs, for example, although the formulae used for determining some tariffs contain efficiency provisions, these were not invoked, and firms were allowed to increase prices by the full amount of inflation. By contrast, a wide range of costs were excluded from the calculation used to determine the amount of permissible increases in electricity and gas prices.⁷² Such inconsistency in the application of laws and regulations is detrimental to the development and long-term planning of entrepreneurial activities, and to competition.

⁷¹ See European Bank for Reconstruction and Development (1997), p.174.

⁷² The laws on electricity and gas envisaged full cost-recovery pricing regime for electricity and gas. This was a crucial pre-condition for attracting domestic and foreign investors in the privatization in December 1995 of state-owned power generating companies as well as electricity and gas distributors.

Table III.11

Decisions reached by the Office of Economic Competition (1 January 1991 to 30 June 1997)

Subject-matter	Number of decisions	Number of negative ^a decisions
Restrictive agreements	43	16
Abuse of dominant position	229	56
Control of concentrations	74	1
Cases with other subject matter	410	197
Total	756	170

a Decisions ascertaining an infringement of the law and/or prohibiting certain conduct.

Source: WTO Secretariat.