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TRADE POLICY REVIEW

HUNGARY

Minutes of Meeting

Chairperson: H.E. Mr. Ali Said Mchumo (Tanzania)

	<u>Page</u>
I. INTRODUCTORY REMARKS BY THE CHAIRPERSON	2
II. OPENING STATEMENT BY THE REPRESENTATIVE OF HUNGARY	3
III. STATEMENT BY THE FIRST DISCUSSANT	7
IV. STATEMENT BY THE SECOND DISCUSSANT	10
V. STATEMENTS BY MEMBERS OF THE TRADE POLICY REVIEW BODY	13
VI. REPLIES BY THE REPRESENTATIVE OF HUNGARY AND ADDITIONAL COMMENTS	19
VII. CONCLUDING REMARKS BY THE CHAIRPERSON	32

I. INTRODUCTORY REMARKS BY THE CHAIRPERSON

1. The second Trade Policy Review of Hungary was held on 7-8 July 1998.
2. The Chairman welcomed the delegation of Hungary, headed by Mr. Péter Balás, Deputy Secretary of State, Ministry of Industry, Trade and Tourism, and the discussants, Ambassador Geoffrey Raby of Australia and Mr. Asoke Mukerji of India. As usual, both discussants would be speaking in their personal capacities and not as representatives of their governments. In accordance with the established procedures, outlines of the main issues they intended to raise had been circulated in advance; these were contained in document WT/TPR/D/22.
3. He recalled the purpose of the Trade Policy Reviews and the main elements of the procedures for the meeting. The report by the Government of Hungary was contained in document WT/TPR/G/40 and that of the WTO Secretariat in document WT/TPR/S/40 and Corr.1. Copies of written questions submitted by the delegations of Hong Kong, China; New Zealand; Japan; the European Communities; Canada; Australia; Switzerland; Korea; and the United States had been transmitted to the delegation of Hungary. If full replies could not be provided during the meeting, supplementary written replies could be provided later.

II. OPENING STATEMENT BY THE REPRESENTATIVE OF HUNGARY

4. The representative of Hungary said that 1990 had brought about basic, systemic changes in Hungary's political and economic life. Parliamentary democracy had taken a firm hold, with all governments serving their full four-year terms. A new government would enter into office on 8 July 1998.

5. Induced and assisted by the change in the political system, Hungary had successfully completed the transition to a free market economy, however, the price of transition had been high, both in economic and social terms. By 1993, GDP had decreased by more than 20%, a third of enterprises were bankrupt, unemployment had risen to 13%, and almost half of Hungary's former export markets had disappeared. Economic growth had recovered somewhat by 1994, but was led largely by an increase in consumption and infrastructural investments. Thus, macroeconomic indices had steadily deteriorated: the current account reached a record deficit of almost US\$4 billion and the budget deficit approached 9% of GDP.

6. Urgent action was required to redress these macroeconomic imbalances: austerity measures were introduced to curb public expenditure, manage internal demand, and to improve external balances, and conditions for business activities. These measures included a sharp one-time devaluation of the Hungarian currency followed by continuous exchange rate adjustments and the imposition of an 8% temporary surcharge on imports. The macroeconomic situation soon started to improve and by 1997 the trade deficit had fallen to just over US\$2 billion and the current account deficit was US\$1 billion. The budget deficit remained under 5% of GDP, while economic growth accelerated to 4.4%.

7. Despite the difficult circumstances of the transition, successive Hungarian Governments had resisted protectionist pressures, not only keeping open the market, but also further liberalizing the whole economy. The positive impact of the abolition of restrictions on foreign exchange, imports and establishment, was apparent in the development of trade and investment flows. In the period 1991-97 total Hungarian exports and imports more than doubled in U.S. dollar terms. The geographical composition of foreign trade showed differing trends in imports and exports. While the share of Hungary's free-trade partners (EU, EFTA, CEFTA) increased by about 10 percentage points, their share in imports remained stable at around 70%. The commodity pattern had also considerably improved: over three fourths of exports being made up of highly processed products.

8. The stock of foreign direct investment rose from US\$2.8 billion in 1991 to US\$17.3 billion by the end of 1997, making Hungary the most attractive target for investments in the region. Germany and the United States acquired a share of about one third each; the rest came mainly from other OECD countries. Japanese investments in Hungary recently exceeded US\$500 million. Contrary to the common expectations the bulk of FDI went to capital intensive sectors, while the presence of foreign investors in labour intensive industries, such as textiles, footwear and leather had been somewhat limited. Almost half of the FDI inflows targeted the manufacturing sector, in particular machinery, food processing and chemical industries. The share of the services sector was also high, due to large-scale privatization undertaken in banking and insurance, telecommunications and public utilities.

9. Privatization of state-held assets was a key task in the process of economic transformation. Between 1990-97 almost 1,300 state-owned companies (85% of the total) were sold, mainly on a cash basis, with privatization revenue of over Ft. 1,400 billion. Thus, the share of private sector in GDP rose to 80%. Only 180 companies (mostly regional transport companies, forestry and agricultural companies, and research institutions) remained under some state control. The state retained basic ownership rights through "golden share" in only 32 of the 180 firms in partial public ownership.

Trade policy developments 1991-97

10. The systemic changes at the beginning of the 1990s led to the dissolution of COMECON and its underlying non-market-based trade regulations, thus making Hungarian trade policies uniform *vis-à-vis* all partners. Starting from this basis Hungary undertook a number of autonomous liberalization measures and entered into commitments under multilateral and regional arrangements that substantially lowered the level of protection accorded to domestic operators.

11. In the area of tariffs, the switchover to the HS-based nomenclature in 1992, and its refinement in 1996, more than doubled the number of tariff lines. While the changes in the tariff nomenclature did not increase the duties on any product, the more detailed breakdown of goods inevitably distorted time series of comparisons of nominal tariff averages.

12. Since 1972 Hungary had operated a GSP scheme in favour of developing countries, containing neither quantity limits nor, *a priori*, excluding product groups. The nominal average of GSP rates was less than half of the MFN tariffs both in agriculture and industry. Due to the open nature and wide product coverage of the scheme, around 95% of imports from developing countries received preferential tariff treatment. In 1998, a scheme of special and more favourable tariff treatment for least-developed countries had been in operation in Hungary for twenty years: all agricultural and industrial imports from LLDCs (currently 42 countries) received total, unconditional duty-free entry to the Hungarian market.

13. Besides the reduction of customs duties, between 1995 and 1997 Hungary phased out import-related charges. The import licensing fee of 1% was abolished in 1995, while the 2% customs clearance fee and 3% statistical fee were first lowered, then eliminated *vis-à-vis* all WTO partners on 1 January 1997. Non-tariff measures on agricultural imports, such as quotas and discretionary import licensing, were fully liberalized as a result of the Uruguay Round. Hungary had also made considerable progress during the review period in dismantling its residual quantitative restrictions. Imports of a number of industrial goods were liberalized, for example, furniture and undergarments. On 1 January 1998 quantitative restrictions were lifted on all textile and clothing products as well as on passenger cars with engines over 1,500 cc.

14. In addition to reducing the product coverage of the global quota on consumer goods, Hungary had increased the value ceilings (denominated in U.S. dollars) for the remaining restricted goods, by about 10% annually. These adjustments had ensured that the quota shares allocated to Hungary's free-trade partners under the respective agreements did not remove import opportunities from third-country suppliers. Hungary undertook to eliminate the global quota *vis-à-vis* its free-trade partners by the end of the year 2000; it was Hungary's intention to continue to extend this liberalization to all WTO Members.

Implementation of the WTO Agreements

15. As a result of the WTO Agreements, the level of overall bound tariffs increased from 83% to 95.7%, the increase in bindings was particularly marked for products under the Agreement on Agriculture. By the end of the Uruguay Round implementation period the nominal MFN tariff average would fall below 7% in industry and to about 27% in agricultural goods. In 1997, the nominal MFN tariff average on industrial products was 8.2%, while the trade weighted average of customs duties on MFN imports was only 4.5%.

16. Prior to the Uruguay Round, Hungary applied low tariffs on agricultural products, and quantitative restrictions served as the main protection against imports. In accordance with the WTO Agreement on Agriculture, these measures were abolished as of 1 January 1995, with a parallel increase in tariff protection. Though agricultural tariffs had not been high compared to international rates, even

after tariffication, in line with WTO rules Hungary opened preferential tariff quotas for more than 100 products to provide appropriate market access opportunities. Hungary did not apply specific or compound duties; all tariffs rates were *ad valorem*.

17. Hungary notified its support programmes in accordance with Article 29 of the Agreement on Subsidies and Countervailing Measures, including, *inter alia*, those to be eliminated by 2002. Notwithstanding this deadline, Hungary discontinued, as from 1 January 1998, the export-performance requirement that was linked to the eligibility for tax allowances on investments exceeding Ft. 1 billion. Moreover, Hungary did not apply any measures falling under the scope of the TRIMs Agreement.

18. In the framework of the General Agreement on Trade in Services, Hungary made extensive commitments in a large number of sectors to allow for the commercial presence of foreign service providers and the cross-border supply of services. Hungary also actively participated in the negotiations on, and undertook far-reaching market access and national treatment obligations, in financial and telecommunication services. As a further liberalization step, a new law entered into force on 1 January 1998, allowing establishment in the form of branches.

19. Hungarian legislation provided effective protection for intellectual property in conformity with the provisions of the TRIPS Agreement. Breach of laws to protect patents, copyright, industrial designs, topographies of integrated circuits, utility models, trade marks and geographical indications were subject to severe sanctions under civil and criminal law. Customs authorities were empowered to prevent the importation of goods infringing intellectual property rights.

Integration issues

20. Since the last review Hungary had made considerable efforts to re-establish its traditional economic and trade links with Europe through active participation in the regional integration process. Besides the Europe Agreement, Hungary had concluded a series of free-trade agreements with the EFTA, Central and Eastern European countries (the Czech Republic, Poland, Slovakia, Slovenia, Romania) in the framework of the Central European Free Trade Agreement (CEFTA), Israel, and Turkey. Hungary was currently negotiating further free-trade agreements with Estonia, Latvia and Lithuania. Negotiations with Bulgaria on its accession to CEFTA had also reached their final stage.

21. Since 1990, due to obvious political, security and economic reasons, the priority goal of successive Hungarian governments had been to seek closer ties with the EU, leading to accession. The Association Agreement between the European Communities and Hungary, signed in 1991, covered trade in goods and services and addressed areas outside the scope of the WTO, such as political dialogue and cooperation in various fields of the economy. As a general rule, the agreement provided for a ten-year transition period for the full elimination of barriers to trade. In 1994 Hungary officially submitted its application for membership of the European Union, and following the positive reaction at the 1997 EU summit meeting in Luxembourg, accession negotiations commenced in April 1998. It was Hungary's firm belief that the enlargement of the EU would be of considerable benefit not just to the participants but also to third countries, and that the process would be carried out in consistency with both the latter and the spirit of the WTO.

22. The representative of Hungary had noted with concern assertions in the Secretariat report that the integration process might have serious negative effects on third parties. He addressed three major elements of the accession process: the implementation of the trade provisions of the Europe Agreement; the legal harmonization requirement; and accession itself.

23. The main concern in connection with the implementation of the trade provisions of the Europe Agreement was that it had resulted in trade diversion: third parties were believed to have lost market shares. He did not wish to prejudge the outcome of the examination of the Agreement currently being carried out, both for goods and services, in the Committee on Regional Trade Agreements, however he drew attention to trade statistics reflecting the dynamics of Hungarian imports from the EU and other non-preferential trading partners between 1991 and 1997. Imports from the EU had grown by 206%, while those from the United States had increased by 266%, from Canada by 410%, from Japan by 220%, and from Korea by 193%. These figures clearly proved that the dynamics of imports from non-EU countries exceeded the growth rate of imports from the European Union. Thus, fears of trade distortion at the expense of third countries were unfounded. Trade with most Asian economies was heavily unbalanced: Hungary's exports to Japan and Korea were only one seventh of imports. Many of Hungary's overseas trading partners had greatly benefited from the opening of the Hungarian market. In addition, liberalization of all non-tariffs measures had been carried out strictly on an MFN basis, thus all Members of the WTO had profited therefrom.

24. Legal harmonization was an obligation arising from the Association Agreement and a precondition of accession. The general consequence of harmonization was replacement of the regulatory system by the *acquis communautaire*. The overall result of this process was the introduction of more liberal and transparent rules in Hungary. Thus, third parties also benefit from the streamlined, uniform and Euro-conform Hungarian regulatory system; the non-discriminatory application of the European regulations improved establishment and market access possibilities also for non-European suppliers. Telecom and financial services were excellent examples of how third-country suppliers benefited from the legal harmonization in Hungary; the result had also been bound in Hungary's GATS schedules *vis-à-vis* all WTO members. The harmonization process had helped Hungary to become the main target for investors from countries such as the United States, Canada, Japan, Australia, and South Africa. Other reforms rooted in the legal harmonization process, particularly in the areas of intellectual property and competition policy, would go beyond Hungary's WTO obligations.

25. Hungary's ultimate goal was accession to the European Union, which would result in, *inter alia*, the EU Common Commercial Policy (CCP) becoming applicable to Hungary. Hungary would implement the Community Common Customs Tariffs upon accession, and reduce its tariff level to that of the EU. In 1997, the simple average for industrial products (HS 25-97) was 4.9% in the EU and 8.7% in Hungary. In services, the EU's GATS commitments would apply to Hungary. In Hungary's view, this would further improve the trading environment for third parties.

26. Hungary was convinced that Members would find its participation in the European integration process was also beneficial for the trade interests of non-European countries. Details of the accession would be elaborated in the coming years and he believed that it was premature to debate the hypothetical consequences at this stage.

27. Finally, the representative of Hungary called attention to what were, in Hungary's view, a number of erroneous statements or judgements in the Secretariat report, as well as a number of areas that Hungary did not consider relevant for discussion in this forum.

28. Hungary believed that its achievements in advancing trade and economic liberalization in the period under examination, would be recognized by Members. He assured Members of the TPRB that Hungary would faithfully observe its WTO commitments and fully support further multilateral negotiations under the auspices of the WTO in traditional and new areas.

III. STATEMENT BY THE FIRST DISCUSSANT

29. The first discussant noted that Hungary was a post-transition economy, with the peculiarities of a country that had emerged from a system of pervasive state direction and economic planning. Remarkable change had been achieved in a comparatively short period. While this review might emphasize in a constructive way areas where more needed to be done, this should not diminish the importance of what had been achieved over the last five years.

30. Nothing underlined the extent of the transition more than the change in property rights. This was the most fundamental of all institutional arrangements and one that gave character and shape to an economic system. According to the Secretariat report, in the past ten years the private sector share in DP had increased from 10% to around 75-80%. Although lower than for long-standing market economies, this nevertheless represented an historic transformation in how the economy was organized and run.

31. The process, however, was not complete. Having one quarter to one fifth of economic activity in state hands still represented a loss of economy, efficiency and potential welfare. The Secretariat report noted continuing state ownership of varying degrees for some 290 enterprises at the end of 1997. He believed that Hungary may have gone further in privatization than other transition economies. Presumably, this was because the Hungarian Government recognized the benefits of privatization in terms of greater efficiency and hence welfare.

32. He requested clarification of the reasons, in terms of efficiency and welfare gains, for continuing direct State ownership and involvement in enterprises. He was interested to know whether the Government planned to remove itself further from direct participation in the economy by selling off these holdings, and if so, what process it envisaged and what its priorities were in this area.

33. With a not insignificant share of the Hungarian economy still in State hands, price controls and administered prices still operated in some areas. The Secretariat report contained an estimate that some 16% of prices (weighted by their share in the consumer price index) were subject to central or local government control. Somewhat surprisingly, however, the share of administered prices in all prices had been rising, which was surely contrary to expectations. He requested the views of the Hungarian delegation on this matter.

34. There could be no doubt that Hungary had entered a post-transition phase in moving towards a more market-oriented economy. The critical issue was how much further the Government believed the reforms must go. He wondered whether reform fatigue might now be setting in, especially following the recent, difficult macro-stabilization period; and whether there was concern or discussion of the possibility of getting stuck in a post-transition phase, where new, powerful interest groups formed to maintain the new status quo.

35. With regard to macroeconomic management, a great deal had been achieved since the stabilization package of 1995. A key challenge in managing both the economics and politics of transition was the extent to which macroeconomic balances were maintained at the time the market was allowed to play a greater role. At times of domestic imbalances, reflected in increasing current account deficits, pressures built up for greater government intervention in trade and even investment flows.

36. The 1995 stabilization package was introduced to cut inflation, stem a rising current account deficit, and slow growth in foreign debt. The package was intended to restore balance between aggregate savings and investment, and thus cut the current account deficit. More direct measures aimed at imports were also taken. These included an import surcharge (removed in July 1997) and a 9% devaluation of the forint, accompanied by adoption of a crawling-peg mechanism for determining subsequent exchange rate

movements. The immediate impact of these measures resulted in actual falls in the components of domestic demand: GDP growth slowed, but remained positive; importantly, the budget deficit as a share of GDP fell, but this was achieved largely as a result of the proceeds of an accelerated privatization programme. This would represent a one-off windfall to government revenues unless increased productivity from private ownership of the assets resulted in a permanent stream of higher taxation revenues. Nevertheless, the structural budget deficit was also halved between 1995 and 1996.

37. Although the inflation rate fell in 1996 and 1997, it remained high compared with inflation in most of Hungary's competitors. Moreover, it was not compensated for adequately under the exchange rate adjustment mechanism, leading to an effective, real appreciation of the currency. All of this made the task of restoring external balance more difficult.

38. Domestic demand pressures also seemed to be building up again. Growth in wages and earnings had picked up in 1998, investment demand was once more growing very strongly, and the budget deficit as a share of GDP was returning to levels not seen since the austerity package was introduced. Similarly, the current account deficit seemed to be returning to pre-1995 levels. He believed that the new Government was committed to ensuring stable macroeconomic conditions, but welcomed advice on what measures might be taken. He wondered whether, for example, direct measures might be introduced again to control imports and boost exports or whether it was likely that the current expansion would again become unsustainable, leading to another set of sharply contractionary policy measures.

39. He questioned whether, in the transition and post-transition periods, a succession of boom-bust cycles was inevitable. In this connection, the experience of the Asian economic crisis seemed to be relevant: it showed, for example, how difficult it was to manage economies as they opened to greater external capital flows; presumably, this was more so for smaller than for larger economies. He enquired whether the Government had drawn any lessons from the East Asian experience for managing its own liberalization endeavours.

40. Both the composition and direction of exports had changed markedly during the period of transition. The EU's share of Hungary's exports, for example, had increased from 45% in 1990 to almost 63% in 1996; import shares showed similar change. The structure of production had also changed: the combined share of agriculture and mining fell by almost half during the 1990s; manufacturing remained roughly constant; and services increased, but from an already high base. Such a change in an economy's structure was dramatic. Part of the change no doubt reflected the impact of more rational economic signals coming from the greater role of prices in allocating resources. Nevertheless, it would be interesting to know to what extent industrial policies were playing a role and how the Government viewed the future structural composition of the economy.

41. He noted that subsidies had fallen during the period under review, but a range of subsidies or taxation incentives continued to be used to attract investment into particular areas. Hungary also seemed to continue to seek to attract foreign investment through a range of investment incentives with apparent high costs in terms of taxation revenues forgone. He asked to what extent the use of subsidies or taxation incentives was tied into industry policy or whether these were still transitional measures that would be phased out.

42. A major structural impediment for many transition economies seemed to be the difficulty of introducing and enforcing an efficient and equitable system of taxation. This was usually attributable to many factors, privatization being not the least of them. It had been reported that in some places the undeclared economy in Hungary could be as much as one third of declared GDP. The question of taxation seemed to be particularly important in view of the efforts of successive governments to restore domestic balance through tighter fiscal policy. With a large part of the privatization programme

completed, the task of fiscal consolidation was likely to be harder. He sought the views of the Hungarian delegation on this, and information on taxation reform issues.

43. After a period of phenomenal economic change and adjustment, Hungary's main focus of economic and trade policies seemed to be towards a single, historic objective: membership of the European Union. The political objective was understandable. Hungary's trade had already become heavily oriented towards the EU and it could be expected to become even more so over the next few years before membership. He requested an assessment of the expected impact of membership on the composition of trade. In particular, Hungary was capable of producing and exporting agricultural products efficiently: he asked whether future membership of the EU would lessen the importance of pursuing difficult policies to maintain an efficient agricultural sector.

44. In conclusion, he noted the major changes that had occurred in every aspect of the Hungarian economy. It had been a truly remarkable and historic transformation and one that deserved the highest praise. The members of the Hungarian delegation deserved to be proud of these achievements.

IV. STATEMENT BY THE SECOND DISCUSSANT

45. The second discussant, believed that the documentation provided indicated that Hungary had successfully continued its internal economic restructuring towards a market economy, and integrating its economy in regional terms with Europe, while maintaining its multilateral commitments under the WTO Agreement. He was interest to hear the Hungarian experience in managing this transition, given the inevitable pressures generated by any transition process, especially pressures to create protectionist policies.

46. Addressing the first major area of trade policies and practices, he noted that Hungary had removed border levies and charges for WTO Members from 1 January 1997. Hungary levied MFN tariffs for 25% of all tariff lines, with the remaining 75% of lines attracting preferential tariffs. This difference in tariff treatment would have an obvious impact on Hungary's trade relations, and it would be useful to know how the Hungarian authorities saw this situation in terms of their commitment to the multilateral trading system.

47. The authorities had established a single-document customs clearance system. He was interested in hearing an assessment of the consequences of tariffication of quantitative restrictions, and whether there had been any efficiency losses due to the 'complex tariff structure'. He also requested the views of Hungarian delegation on the observation that protection through tariffs for agriculture, and the existence of tariff quotas for agricultural products, could lead to distortions.

48. Regarding non-tariff border measures, although the necessary enabling legislation was in place, during the period under review Hungary had not used anti-dumping, countervailing, or safeguard measures. Even the balance-of-payments import surcharge, levied during a portion of the period under review, had been phased out; there was no longer any barter trade; and import licensing powers were used with discretion and subject to appeal. Hungary still maintained some quantitative restrictions, though these were limited to 5.7% of all its tariff lines. He believed that a discussion of the operation of the global quota on consumer goods would be useful, including possible reasons for its reported under-utilization, as well as of the existence of sub-quotas for preferential trading partners. He was interested to know whether the Government intended to continue to use import licensing, which affected 2.1% of its tariff lines.

49. Hungary did not levy export duties or charges, nor did it maintain any minimum export prices. Export licensing existed essentially for environmental reasons and to prevent domestic shortages. There had been a reduction in export subsidies granted for several agricultural products. Further, government institutions had been established to facilitate exports considered important to national economy. It would be useful to hear an assessment of how these institutions had functioned, and were expected to function, against the overall policy background of limited government involvement in measures directly affecting exports.

50. Almost a third of Hungary's technical regulations and national standards were different from international norms. The authorities intended to achieve harmonization with EU standards by 2001, and he was interested to know whether the existing differences, even between national and European technical regulations and standards, had had any significant impact on trade. He enquired about the Government's policy for aligning technical regulations and standards with international norms, in keeping with WTO obligations, and the relevance of experience on mutual recognition among CEFTA countries this context.

51. Sanitary and phytosanitary measures did not discriminate against imported products. Existing measures appeared to be based on environmental considerations. It would be useful to assess the impact

of new measures, such as the new law on plant protection, both in terms of the application of such laws on trade flows, and in terms of their impact on the issue of patenting of plants in general, which in turn could impact on trade.

52. The 1988 tax reform had introduced the concepts of VAT, personal income tax, and corporate income tax; modifications to the corporate tax system had been made in 1997. In the context of the impact of such modifications on Hungary's trade policy, an observation had been made that corporate tax concessions were also used to promote certain sectors; he sought an exchange of views on this matter.

53. Privatization had been a key element in Hungary's transition towards a market economy. As the share of the private sector in the economy had increased, from 15% of GDP ten years ago to 80% currently, the share of the government in the economy had decreased correspondingly. It would be useful to hear how this had affected Hungary's trade policies.

54. Hungary's legislative framework and practice on monopolies and competition were in line with EU competition policy. The new Bankruptcy Law of 1992 was significant for the development and enforcement of market economy rules. Against this background, he asked for comments on the enforcement of relevant Hungarian laws, including the 1996 Competition Act, and the impact these laws had had on the efficient functioning of the regulatory framework, which, in turn, impacted on Hungarian trade policy legislation.

55. There was a natural bias towards regional integration in Hungary's trade policies, which had accompanied the shift in the structure of ownership and production from a planned to a market economy model, redistribution of land, active industrial policy, etc. He was interested to know whether some sectors had been encouraged at expense of others.

56. The agriculture sector had long been the mainstay of the Hungarian economy. The compensation bill system had been used to auction arable land; there had been a fall in agricultural production and in agriculture's share in GDP; and agriculture exports had declined. In terms of trade flows, it was obvious that the main market for imports and exports was the EU. Government assistance to agriculture was provided through import tariffs, tariff quotas, and export licensing; export restrictions were used exceptionally. Export subsidies for some products were expressed in national currency, which operated on a crawling-peg exchange system; budgetary support was extended by the Government through direct payment from agricultural funds, and social insurance subsidies. Against this backdrop, it would be useful to assess how Hungary's trade policies were directed towards preserving the traditional share of agriculture in Hungary's trade; and to ascertain how the Agriculture Market Regulation Act of 1993, which apparently regulated markets for specific products, had functioned, including its impact on new legislation on procedures for plant seed approval and certification, and genetically modified organisms.

57. In the manufacturing sector, the Europe Agreement and EFTA/CEFTA agreements had provided the framework for the removal of tariffs and quantitative restrictions on manufactured imports and exports, which had led to growth of trade with these partners. A feature of these trade flows had been outward processing trade (OPT), which accounted for 15% of total imports and 21% of total exports. A related issue concerned preferential treatment of foreign companies engaged in OPT. He was interested to know the role of OPT in terms of Hungary's trade policies, bearing in mind the preferential nature of such arrangements and the impact of OPT on other countries.

58. The food and beverages subsector accounted for 20% of total manufactured exports and 5% of imports; 40% of exports were destined for CEFTA markets. These products had previously been exported predominantly to CMEA markets, and the discussant asked whether trade flows had undergone any reorientation. The chemicals and pharmaceuticals subsector, apparently dominated by foreign firms,

also exported mainly to former CMEA countries; he requested a similar assessment regarding these products.

59. In the textiles and clothing subsector, there had been a shift in trading patterns away from the CMEA to the EU. This subsector had traditionally played an important role in Hungary's foreign trade, and he suggested that members address some of the important policy issues outlined in the documentation, especially the decision taken by Hungary not to apply textiles quotas to WTO Members from 1 January 1998. Such policy issues would be relevant to a broader discussion of the manner in which Hungary's multilateral commitments were aligned with specific aspects of the trade policy of its major trading partners with which it was currently seeking closer integration agreements.

60. A similar policy issue could be addressed with regard to the automobiles subsector, which was one of the fastest growing subsectors, with a mainly regional export market. The bulk of automobile parts and components manufacturing was exported to the European market. This subsector was the first to experience the practical effects of the Government's trade policy which sought to integrate Hungarian industry into an international network of production and manufacturing. It would be useful to focus on the role assigned to customs free zones.

61. Hungary's financial subsector had achieved major success, as reflected in its comparatively substantial commitments in GATS. The situation was similar in the basic telecom sector. These successes would no doubt play an important role in the future orientation of Hungary's trade policies. Presupposing that there was no divergence between current practice and the specific commitments in the WTO, he wondered whether Hungary's relatively high levels of commitments in services allowed sufficient flexibility if the Government was forced to dilute such commitments. He was also interested in how Hungary dealt with the supply of services through movement of natural persons, given the delicate interface between immigration policy and trade policy. In both of these issues, he asked how the balance could be maintained between protecting domestic interests and projecting Hungary's trade interests in a regional and multilateral context.

62. He was interested to know how Hungary's trade policies on trade-related aspects of intellectual property rights had evolved, bearing in mind its status as an economy in transition, and that most of the provisions in this sector would come into effect in about 18 months' time. Noting the high reputation of many of Hungary's traditional products and the creativity of its citizens, he was particularly interested in the scope of additional protection given to trade of products bearing geographical indications, and the status of intellectual property laws, such as copyright and patent legislation.

63. He believed that this review should focus specifically on Hungary's existing trade policies and practices, and how they had changed since the last trade policy review of Hungary, rather on future developments; and should be placed in the context of Hungary's existing commitments in terms of the current provisions of the multilateral trading system.

V. STATEMENTS BY MEMBERS OF THE TRADE POLICY REVIEW BODY

64. Members complimented Hungary on the changes that had been achieved since 1991 in its transition to a market-oriented economy. These changes had taken place under difficult economic and social conditions, including the collapse of trade with the former socialist countries, the bankruptcy of a large number of companies and the loss of jobs. Members appreciated that, despite these circumstances, Hungary had resisted protectionist pressures and welcomed Hungary's assurances that regional integration would be carried out in conformity with its commitments to multilateralism.

65. The representative of Hong Kong, China expressed appreciation for Hungary's assurances that regional liberalization efforts would be complementary to commitments to multilateralism. He welcomed, in particular, the removal of quota restrictions on textiles and clothing products and the abolition of various trade-related fees on an MFN basis as a result of the Europe Agreement. He noted, however, that quantitative restrictions remained a core non-tariff border measure. In area of applied tariffs, Hungary's commitment to bind 95.7% of all national tariff lines at an average of 10.2% upon full implementation of its Uruguay Round commitments was appreciated. However, the average MFN rate for industrial products, at 8.2%, was significantly higher than preferential rates, between 0.9% and 2.0%. Continued efforts to open its trade regime would be in Hungary's long-term economic interest. He encouraged Hungary to consider acceding to the Plurilateral Agreement on Government Procurement and, as a first step, to apply for observer status in the Committee on Government Procurement.

66. The representative of Japan stated that his delegation had submitted written questions in advance of the meeting and looked forward to hearing the responses. He noted that Hungary had largely resisted protectionist pressures, taking steps to curtail border and internal restrictions, and that Hungary's liberalization efforts had been carried out under difficult economic and social conditions, including the collapse of the CMEA.

67. Hungary's priority during the coming years was to prepare for accession to the EU; much of Hungary's legislation was being modified to conform to relevant EU laws. He emphasized the need for consistency with WTO Agreements, referring in particular to GATT Articles XXIV:6 and XXIV:8 regarding the level of duties and other regulations, and the extent of their elimination, and to GATS Article V:4 obligations regarding raising the level of barriers to trade in services. He pointed out that prior negotiation was required when increasing bound tariff rates; when applying EU anti-dumping measures in Hungary, certain procedures were to be followed, such as investigations to establish injury to the domestic industry; and that, in conformity with the purpose of regional agreements, any change in Hungary's trade policy or measures should be transparent, and avoid creating adverse effects on the trade of other Members. He enquired whether Hungary planned to change its investment promotion policy in the context of its accession to the EU. With regard to the Europe Agreement, he welcomed Hungary's confirmation that the elimination of quantitative restrictions on textiles and clothing imports and certain other products in 1997, and the removal of all restrictions scheduled for January 2000, were on an MFN basis. In the area of rules of origin he requested clarification on: (i) whether Hungary had raised the local-content ratio to grant origin in any sector or product; (ii) whether, in the process of harmonization, rules of origin criteria had changed from change-in-tariff-heading (CTH) to value added; and (iii) whether Hungary had introduced any rule that required regional material or contents to grant origin to final products. He also asked whether Hungary had raised applied MFN tariff rates to third countries since signing the Europe Agreement in 1991.

68. Concerning tariffs, 4.3% of tariff lines, including fish and mineral products, and footwear were unbound. Due to the high tariff rates on these goods, the simple average applied MFN rate, at 14.3%, was higher than the simple average bound rate of 11.8%; this applied to 40 out of 97 HS chapters in 1997.

69. Japan was concerned about reported export restrictions or prohibitions on agricultural products. He emphasized that export countries, in principle, should not resort to such measures and recalled the provisions of Article 12 of the Agreement on Agriculture regarding prior notification of such measures and consideration of their effects on importing Members' food security. Export subsidies were also a cause for concern, and he requested that Hungary reduce its export subsidies, which were higher than the levels agreed in the Uruguay Round, in accordance with the agreement which has been reached with the interested parties. Doubts had been expressed about the adequate enforcement of laws on intellectual property rights, and these were of concern to Japanese industries. He asked Hungary to ensure that legal measures in this context were enforced. Concerns had also been raised by Japanese industries regarding transparency in the investment incentive scheme and the negative effects of frequent amendments to tax laws. Regarding local-content levels in the automobile sector, in the context of exports to the EU, he requested an amendment to the Secretariat report on the reported local content level achieved by a particular Japanese company based in Hungary. Finally, he referred to concerns regarding foreign capital restrictions: Hungarian residents required prior approval to borrow short-term foreign capital, however, the three to four week approval delay prevented flexible capital management and raised both the risk and the cost of cash-flow management. Japan hoped that Hungary would review this regulation, as well as the prohibition on holding a settlement account abroad.

70. The representative of the European Commission congratulated the Hungarian Government for the introduction of the stabilization package in March 1995 and for its consistent implementation since then. The package contained a number of painful measures such as cuts in government consumption, wage restraint, and devaluation of the forint. The programme had yielded the expected results such as reduction of the government deficit, GDP growth, and reduction in inflation and unemployment. Most of the questions transmitted to the Hungarian delegation by the Commission concerned how the Government intended to continue the efforts and ensure continued macroeconomic stability and growth.

71. The EU had consistently supported Hungary in its continued process of liberalization and shared Hungary's determination to ensure that its relations with the EU remained consistent with, and supportive of, the multilateral system. Important steps in this context were the entry into force of the Interim Agreement on 1 March 1992 and the Europe Agreement on 1 February 1994, and the opening of the Accession Negotiations at the end of March 1998. These steps had had a determining impact on the establishment of a more open trading regime in Hungary that had clearly benefited all partners. Improvements in Hungary's export performance to the Community over the last three years had provided a strong stimulus to the economy and to the development of Hungary's trade with other partners.

72. He disagreed with the suggestion in the Secretariat Report that Hungary's agreement with the EU could have had a trade-diverting effect. Rather, the collapse of the CMEA had caused Hungary to lose its traditional markets and had fundamentally altered the trading patterns. The liberal market access offered by the EU to Hungary had filled a gap and led to an increase in trade with the EU. It was also clear that the Europe Agreement has been one of the major factors in leading Hungary to remove many of the border taxes, licensing levies and non-tariff restrictions that were formerly in place to shelter domestic industries thus stimulating trade with other countries. Against this background, he also questioned the suggestion that the process of accession to the EU risked making Hungary's trade regime less liberal in certain respects. Over the last four years, the process of integration had already led to a more liberal market-oriented regime, replacing a formerly high level of restriction and state control of the economy. This trend would continue as the accession process developed, leading to a reduction, for example, in Hungary's industrial tariff, which was currently higher than that in the EU. The application in Hungary of the principles of the single market, in particular the free movement of goods, services, capital, etc., would represent a further liberalization. All countries would benefit from the existence of common rules and regulations in the EU and Hungary.

73. The Community was examining the current gap between agricultural tariffs in the EU and Hungary in the discussions on "Agenda 2000". Proposals concerning agriculture were intended to prepare EU agriculture for the 21st century, for eastward enlargement, and for the upcoming negotiations on agricultural trade in the WTO. The Community would ensure that any effects of Hungary's accession on third countries were dealt with according to WTO rules. In conclusion, he complimented Hungary on its continued commitment to trade liberalization in WTO, in both traditional and new areas.

74. The representative of Canada stated that his delegation considered the current climate for trade and investment in Hungary to be excellent. In recent years, Canada and Hungary had concluded a number of trade facilitation, investment protection, and other agreements to promote a favourable business environment between the two countries. Canada's exports to Hungary had steadily risen in the past ten years alongside a significant increase in imports from Hungary. Canada was a significant investor in Hungary and had undertaken, and was considering further, large projects. Canadian firms had located in Hungary to serve not only the local market, but also in order to market their goods and services in other central and eastern European countries, and in anticipation of Hungary's accession to the European Union. He reminded Hungary that, like other WTO Members, it must continue to reduce agricultural export subsidies in accordance with the agreed programme.

75. The representative of Australia noted that Hungary was one of the most advanced economies in central and eastern Europe; it had attracted significant levels of foreign investment and had made great progress in liberalizing its economy. The increasing openness of its economy was indicated by the 1997 level of foreign trade turnover of US\$19.1 billion in exports and US\$21.1 billion in imports. However she was concerned that this openness should take place in the context of a commitment to MFN and open regionalism; MFN tariffs applied to less than a quarter of Hungary's imports. She was interested to hear Hungary's views on comments regarding diversion of trade as a result of its preferential agreements. In the context of accession to the EU, she strongly encouraged Hungary to continue its liberalization in agricultural trade, and to encourage the CAP to evolve in the same direction; Hungary's producer subsidy equivalent was currently 12-16% compared to 44% in the EU. She asked for Hungary's comments on the difficulties it would face in bringing its agricultural policies into line with the CAP and in future negotiations in agricultural liberalization.

76. Along with other WTO Members, Australia would be monitoring the implementation of Hungary's waiver for agricultural subsidies, and she urged Hungary to take the necessary steps to adjust its support programmes in order to meet its commitments by 2002 at the latest. Australia welcomed Hungary's statement that the emphasis in agricultural assistance was on green-box type measures, and requested further information on the measures under consideration.

77. The representative of New Zealand commended Hungary's elimination of trade-related charges, including import surcharges, and its progress towards reducing the proportion of tariff lines affected by non-tariff measures. However, MFN tariffs were relatively high for agricultural products; these would act as barriers to trade and leave Hungarian farmers inadequately prepared to participate in a liberalized world market. He was similarly concerned over Hungary's need for a WTO waiver for certain agricultural export subsidies, and encouraged elimination of these restrictions on free trade, which could lead to distortion of investment and reduced efficiency in the domestic market.

78. Hungary received 40% of total foreign direct investment in central and eastern Europe. Two-thirds of the 200 largest Hungarian companies had foreign participation – a testament to the openness of Hungary's investment regime. FDI had made a major contribution to the restructuring of Hungary's economy; the benefits included reduced external debt and improved business practices.

79. Hungary's accession to the EU should further improve, *inter alia*, its competition policies and protection of intellectual property rights, however, he was concerned about pressures on Hungary to raise agricultural support and protection. He hoped that Hungary would adopt a liberalizing stance within the EU, through active support for rules and principles of open trade in all sectors. Hungary had signed a number of preferential free-trade agreements, which could lead to greater trade liberalization and domestic economic efficiency when applied in a non-trade-diversionary manner. However, MFN tariffs currently applied to less than a quarter of Hungary's imports; WTO Members outside FTA coverage were thus facing disadvantageous tariffs compared to the bulk of Hungary's preferential trading partners. He encouraged Hungary to continue to pursue and expand open, multilaterally based trade policies. His delegation had raised a number of specific questions on Hungary's trade regime and looked forward to receiving Hungary's responses.

80. The representative of Switzerland noted the excellent trade relations between Hungary and Switzerland based on their free-trade agreement and membership of the WTO. His delegation had transmitted questions to Hungary regarding the protection of intellectual property rights and envisaged changes of trade regulations for pharmaceuticals, and he looked forward to hearing the responses during the course of the review.

81. The representative of Korea observed that Hungary currently afforded preferential tariff treatment to EU, CEFTA and EFTA countries, with what he believed to be a highly discriminatory impact on parties outside these agreements. For example, imports of PMVs of less than 1,500 cc from non-members were subject to a tariff of 28%, while imports of the same cars from member countries carried a 0% tariff; taking into account additional charges and duties the final difference in selling price amounted to 60%, implying a significant decline in price competitiveness for non-member countries. He requested the Hungarian Government to address this matter promptly. He also requested an explanation of the criteria used by Hungary for allocating quotas, where priority was also given to CEFTA and EU countries. Korea hoped that this quota system would be eliminated.

82. Imports of all industrial goods into Hungary, whether or not they satisfied international standards, were subject to safety inspections. This procedure could take up to three months to complete and constituted a barrier to smooth market access. He asked for Hungary's reasons for believing a duplicate inspection was necessary, and requested the elimination of the procedure.

83. Regarding the Agreement on Government Procurement, he believed that Hungary's accession to this Agreement would enhance transparency and minimize discrimination in a number of areas. In the construction sector, while, officially, a system of open tendering was used, EU firms appeared to be favoured for projects benefiting from EU credit assistance.

84. The representative of the United States expressed concern over the direction of Hungary's trade policies in some specific areas. The recent waiver for export supports in agriculture indicated Hungary's continued dependence on distortive trade practices in this sector. She was also concerned that Hungary had not bound tariffs on certain important items such as transportation equipment and in some areas of agriculture. While appreciating Hungary's difficulties in the past decade, the growing trend for regional trade preferences had resulted in some 75-80% of imports entering Hungary under non-MFN rates. Hungary must remain mindful of its WTO obligations and the MFN principle during its process of accession to EU membership. She was impressed by the resilience of the Hungarian economy and the transformation since the last review, in particular by the development of a strong and dynamic services sector that was largely open to foreign operators.

85. The representative of the Czech Republic commended Hungary's overall successful performance since the last review and successful stabilization and structural reform efforts. The stabilization package

introduced in March 1995 had restored macroeconomic balance and created a sound base for long-term sustained growth and economic development. Noticeable results had been achieved in privatization, attraction of FDI, and reorientation of trade since the collapse of the CMEA. He believed that the liberal trade policies Hungary had been pursuing, based on internationally agreed rules and principles, should continue and hoped that Hungary would not introduce any new, restrictive or safeguard measures in the future.

86. The representative of Turkey drew attention to the extremely difficult economic background against which Hungary had transformed its economy. The impact of trade liberalization was most evident in the volume of Hungary's foreign trade, which had almost doubled, from \$8.6 billion in 1990 to \$16.2 billion in 1996. Hungary's trading partners had also benefited from its more accessible markets, though some more than others. Border and internal restrictions had been liberalized, all tariffs were *ad valorem* and almost 96% of tariff lines were currently bound compared to 83% in 1993; all other trade-related charges had been terminated in 1997. The Europe Agreement had no doubt accelerated the liberalization process. Much of Hungary's legislation was being amended, while legislation on intellectual property rights went beyond the provisions of the WTO Agreement. In addition, Hungary had made extensive commitments under the GATS. He hoped that the free-trade agreement between Turkey and Hungary, which entered into force on 1 April 1998, would further contribute to their rapidly growing bilateral relations.

87. The representative of Norway referred to the various difficulties that Hungary had faced during its period of structural adjustment, and the greatly increased openness and economic performance that had resulted from this transformation. She offered encouragement for the further structural changes that would have to be made during Hungary's preparations for accession to the EU. While Hungary's government procurement regime appeared to be transparent and well developed, she was interested to know why Hungary did not envisage acceding to the Agreement on Government Procurement.

88. The representative of Romania commended Hungary's efforts to ensure the symbiotic relationship between its regional agreements and multilateral commitments. He believed that the results of Hungary's transition process had been extremely positive. Referring to the possibility of trade diversion mentioned in the Secretariat report, he believed that the period used for this evaluation, 1990 to 1997, was not conducive to a meaningful analysis. Statistical evidence in the report showed that the strongest change in trade with the EU and CEFTA countries took place before the respective preferential agreements entered into force and thus were due to reasons other than the preferential agreements.

89. The representative of the Slovak Republic expressed his delegations appreciation for Hungary's positive macro- and micro-economic achievements and support for the continuation of this trend. He praised Hungary's commitment to continue future liberalization efforts and its active role in multilateral negotiations within the WTO.

90. The representative of Poland noted that Hungary's macroeconomic indicators now showed positive trends. Following liberalization efforts, Hungary currently retained only a few non-tariff barriers and these would soon be eliminated. Regarding the effects of regional agreements on non-preferential trading partners, the volume of imports from non-regional partners proved the positive impact of regional agreements on market access in the multilateral context.

91. The representative of India commended Hungary for its effective macroeconomic stabilization programme, which had enabled widespread improvement in Hungary's economic performance. However, she recalled the word of caution in the Secretariat report on the issue of tax evasion being exacerbated by recently introduced privacy laws and the underlying need to restrain the parallel economy. She asked that

the Hungarian authorities monitor the investment-savings gap, which was vulnerable to demand-related factors and inflation.

92. Hungary's commitments under the GATS had to some extent underpinned the improved performance in services sectors *vis-à-vis* trade in goods, and the increased importance of trade in services in the composition of trade. While there had been some change in legislation in connection with commitments under the TRIPS Agreement, some problems associated with piracy apparently remained to be addressed.

93. Noting the shift in the geographical pattern of trade towards industrialized countries, particularly in Europe, and the ongoing process of harmonization of Hungarian legislation with that of the EU, she recommended that Hungary redress the geographical concentration, strengthening its economy through diversified export and import markets. The alignment of Hungary's trade policies with those of the EU were of significant interest to India. The European system of diagonal cumulation or origin, with emphasis on developing outward-processing and assembly operations, would attract foreign investment in Hungary. However, the application in certain sectors, notably the automotive sector, raised concerns for third countries. In addition, built-up passenger cars were subject to high tariffs as well as non-tariff protection for non-preferential-agreement trading partners.

94. The different tariff phase-out schedules contained in Hungary's free-trade agreements made the tariff structure somewhat cumbersome and added to the overall dispersion in applied tariff rates. While dispersion for industrial products had declined marginally, dispersion in overall applied tariffs had doubled since 1991 and a threat of higher degrees of distortion existed from these schedules in the non-industrial sector. It remained to be seen whether dispersion would increase with the alignment of Hungary's agricultural policies to the CAP, which encompassed much higher levels of tariffs and assistance, and a complex framework of subsidies. Hungary was scheduled to reduce the value of export subsidies by 36% and AMS by 20% by the year 2000. Hungary had not signed the Information Technology Agreement in 1997 and she requested clarification on Hungary's possible application of EC tariff reduction commitments on ITA imports from third countries and from the EC as a result of the Europe Agreement.

95. Quantitative restrictions on textile and clothing imports and 40% of other quantitative restrictions on industrial products were eliminated in December 1997 on an MFN basis, and were scheduled for elimination on 1 January 2001. However, core restrictions, which included certain products of some concern to India, were applied through prohibitions, quotas or non-automatic licensing and she questioned their WTO justification. Regarding other trade measures, Hungary had bound almost 96% of its tariff lines, tariffed discretionary import licensing on agricultural products, and currently applied *ad valorem* tariffs; following tariffication, the average applied MFN tariff rate had risen from 11% in 1991 to 14.3% in 1997. She noted that the elimination of other border levies and charges for WTO Members and the simplification of documentation requirements would help to reduce costs at the border.

96. The representative of Morocco recognized Hungary's efforts to transform its economic and trade environment, noting in particular the liberalization of trade in textile on clothing products, reduction of tariffs, and measures taken in the agriculture sector. Her delegation appreciated Hungary's GSP scheme for developing countries and special treatment for agricultural and industrial imports from least developed countries. Referring to privatization measures taken between 1990 and 1997, while the private sector now represented 80% of GDP, a number of transport, agricultural, and research institutions remained outside of this programme. She was interested to know the reason for these exceptions.

VI. REPLIES BY THE REPRESENTATIVE OF HUNGARY AND ADDITIONAL COMMENTS

97. Replies were divided into four main themes: (i) economic background and transition issues; (ii) regional integration issues; (iii) trade and investment measures; and (iv) sectoral issues.

98. The representative of Hungary noted that the unanimous recognition of the results achieved would give a sign of encouragement for the new Hungarian Government to advance the process of economic modernization and structural adjustments. However, the new Government was taking office only today, and he was not in a position to give a detailed description of future plans or intended policies in particular areas.

(i) *Economic background and transition issues*

99. Referring to internal and external balances, he noted that despite a slight increase in 1997, the budgetary deficit had remained below 5% of GDP. Thus, a return to the pre-austerity programme level 9% of was out of the question. The improvement in government finances was due mainly to cuts in government expenditure, and not the result of a one-time windfall from privatization revenue, which was not included in budget deficit calculations.

100. Hungary had succeeded in reducing the relatively high level of inflation by about ten percentage points in the last two years; one of the priority policy objectives of the incoming Government was to continue this process. Under the Government's programme the rate of inflation was envisaged to fall to 10% by the year 2000.

101. Questions raised concerning Hungary's external balance appeared to be based on a misunderstanding. The current account deficit was US\$982 million in 1997, less than a quarter of the 1994 level. With the improving balance of trade, as well as increased invisibles income and capital inflows, Hungary saw no basis for envisaging a possible return to the high pre-1995 current account deficit level. Despite faster economic growth in 1998 compared to the 4.4% rate in 1997, there was no sign of any deterioration in the trade balance: export growth for the first five months of 1998 was 24% compared to 20% growth of imports. These encouraging figures appeared to disprove the assumption of any negative effects stemming from real appreciation of the Hungarian currency. While the crawling-peg devaluation of the Hungarian forint was less than the gap between the rates of inflation in Hungary and its major export markets, this was offset by improvements in productivity in Hungary's export sectors. International competitiveness as measured in unit labour costs had also further improved. He believed that, against this background, the present level of economic growth was sustainable. The new Government expected a higher level of growth due to the continued massive inflow of foreign direct investment and the dynamism of the domestic sector where specific policies aimed at job creation, strengthening of the small and medium-sized enterprise sector, and business-friendly modifications in fiscal policy were foreseen. Such modifications might include cuts in the tax level and social security contributions. The budgetary situation was expected to strengthen further due to improved tax collection methods and the gradual shrinking of the unofficial sectors of the economy.

102. Regarding the possible negative effects from the Asian crisis, while no country could be fully immune to the spillover effects from crisis-hit regions, the Hungarian economy was, in his view, fairly resilient to such effects. Hungary's profound structural adjustment and mainly privatized, well-functioning banking system and regulated capital markets, had created a healthy economic base. The bulk of investment into Hungary was direct investment in the manufacturing and services sectors; portfolio investments played only a secondary role.

103. In the context of a question on Hungary's foreign investment regime, he recalled that a recent review, under the OECD Code of Liberalisation of Capital Movements and Current Invisible Operations and National Treatment Instrument, concluded that Hungary's liberal policy had been maintained for foreign direct investment. Furthermore the establishment of branches of non-resident enterprises was allowed. In the privatization process, Hungary ensured that foreign and domestic investors were given equal access. Concerning other capital movements, Hungary had taken additional liberalization measures, beyond its original commitments in the OECD. As a result of these steps, all medium- and long-term capital movements were now liberalized except for outward financial credits and certain operations in collective investment securities.

104. On the question of privatization, he referred to questions regarding industrial policies and assertions of higher than average protection in certain sectors and sector-specific incentives. It was evident that, as in most countries, tariff and NTM protection was not uniform across sectors. However, higher duties or other measures in a particular sector did not necessarily influence the development of other, less-protected sectors or industries. Investment incentives in general, and tax concessions in particular, were equally available to any sector.

105. Responding to a question alleging large-scale state intervention and support, he recalled that the most important feature of Hungary's transition was the dismantling of state intervention and immense reduction in direct and indirect state support. The current share of the private sector in GDP was, at 80%, comparable to the level in many highly developed west-European countries; total budgetary subsidies to enterprises had declined from over 10% of GDP to less than 2%. Companies that remained in mainly partial state ownership were for the most part in the non-competitive sector, for example, infrastructure and social services.

106. Clarifying the apparent increase in price control, he stated that this was mainly due to developments in the energy and basic utilities sector. With the privatization of the energy distribution system, price formulae had been introduced to control price increases at a time when the weight of energy had greatly increased in total consumption.

107. The first discussant, noting comments on the budget deficit and fiscal policy in general, requested clarification on measures that might be taken to strengthen the taxation system, and the basis for Hungary's certainty regarding the shrinkage of the grey-area of the economy. Broadening of the taxation base, enhancement of revenue collection, and contraction of the grey-area of the economy would strongly contribute to continuing the achievements in reducing the budget deficit and pursuing fiscal consolidation. Regarding inflation, growth of aggregate measures of money supply remained much higher than growth in aggregate output, M2 and M3 growth were currently close to 20%, thus fiscal policy was implicated, and monetary policy might also be an issue in ensuring a return to greater price stability.

108. The second discussant was pleased to note that Hungary did not apply specific sectoral incentive schemes. The share of the private sector in the Hungarian economy was a significant indication of the manner in which the Hungarian economy was evolving and could be compared with many highly developed west-European countries.

109. The representative of Hungary responded that the new Government's programme, which specifically emphasized improving the budgetary situation through an enhanced tax collection system, had identified two policies: gradual reduction of the tax and social security burden to make evasion less attractive, and continual strengthening of the collection system. He noted that recent high-profile economic crimes had resulted in the imposition of stiff sentences.

110. The rate of inflation had continued to decline but at a slightly slower rate than desirable. This was a priority issue for the new Government, and it was expected that the inflation rate would fall from 18% in 1997 to some 14.5% by the end of 1998. He noted that, while the current structure of the Hungarian economy currently left little scope for major increases in private-sector participation, certain areas of the remaining state assets might be earmarked for privatization under the new programme.

(ii) *Regional integration issues*

111. The representative of Hungary noted that European integration was an issue of prime interest to delegations and he confirmed that WTO rules and commitments had been thoroughly observed during the whole process. The Europe Agreement was in full conformity with Article XXIV of the GATT and the Understanding as well as with Article V of the GATS. Hungary had not raised, due to the FTAs, any MFN duty rates that would increase the preferential margins for the EU or other free-trade partners. Article XXIV of the GATT clearly recognized FTAs as legitimate exemptions from the most-favoured-nation principle, thus the application of higher MFN duties to third countries could not be considered inconsistent with GATT rules, nor as being in conflict with the principles of multilateralism.

112. He refuted one delegation's assertion of discrimination in Hungarian tariffs and questioned their complaint regarding the openness of the Hungarian market. Citing trade figures that illustrated the increasing trade imbalance between the two countries, he stated that this country's exports to Hungary were twelve-fold Hungary's exports to the Member country. Thus, Hungary saw no reason to "promptly address this serious matter and reduce this high tariff" as urged.

113. The accession process to the European Union had started only recently: Hungary was still in the first phase of the "acquis screening". The terms and conditions of Hungary's accession would be elaborated during the forthcoming negotiations, therefore, it was premature to ponder its specific effects on third countries. He confirmed that the integration process would continue to respect WTO rules and duly take into account the interests of third countries.

114. On the issue of alleged large-scale trade diversion stemming from the application of preferential tariffs between the EU and Hungary, arguments were based on a comparison of the share of the EU in Hungarian foreign trade in 1990 and in 1996 respectively. He disagreed with the methodology applied on various accounts. First, the base year was incorrect, since the present examination covered the period from 1991. Furthermore, and more importantly, the base year used was misleading for an assessment of the real effects of the FTA and its presumed trade distortion. By 1991, before the entry into force of the Europe Agreement provisions, the EU's share in Hungary's imports had already reached some 57%. Thus, a major increase in the EU's share had already occurred, without any preferences, due to the effect of the geographic reorientation of Hungary's trade following the collapse of the CMEA. In 1996, after five years of operation of the Europe Agreement, the share of the EU was still below 60%, an increase of less than 3%. In light of these figures, he could not agree with the conclusion that major trade diversion had resulted from the tariff preferences. Third, Austria, Finland and Switzerland acceded to the European Union in 1995, thus the trade between these countries and Hungary was not reflected in the 1991 figures, but was included in the 1996 data. Trade preferences with EFTA countries came into force only in 1994, when the present member States already had a reasonable share in Hungarian foreign trade. Fourth, imports from non-European trade partners, both in North America and in the Pacific region had grown faster than those from EU sources. These figures also brought into question the alleged trade diversion disadvantaging third countries in the Hungarian market.

115. Regarding Hungary's free-trade agreements with Bulgaria and the Baltic States, these were similar to those of the CEFTA agreement. The agreements would be notified, following their signature, in accordance with the relevant rules of the WTO.

116. The first discussant welcomed the assurances of the Hungarian delegation that MFN rates to third parties would not be increased as a result of preferential trade arrangements. He believed that this policy set a good example to others and should be standard procedure in this type of arrangement. He recognized that free-trade agreements were, by definition, discriminatory, even though this was allowed for in WTO rules. The problem was with the existing rules. It would not be easy to find this arrangement, or others, in conformity with the rules.

117. He regretted that certain questions had been dealt with in terms of bilateral trade imbalances; bilateral trade surpluses and deficits with different countries represented the working of comparative advantage, the important issue was the overall balance of trade with all partners.

118. With respect to the reorientation of Hungary's trade, he welcomed the remarks of the Hungarian delegation, which had clarified certain misconceptions. There were real concerns about the compilation of data and how this was measured. In general, the issue of trade diversion was extremely difficult to document and to measure. He noted that data cited by Hungary for growth of imports from areas other than the EU was from comparatively very low bases, and it was therefore not surprising, in the context of the general liberalization of the Hungarian economy, that coming from quite different bases those areas would show proportionally more rapid rates of growth.

119. The representative of Japan noted his delegation's keen interest in the impact of regional integration from the standpoint of a country outside of most regional trade agreements. With reference to a previous question, regarding a tariff margin of over 25% between FTA and non-FTA partners, while Article XXIV allowed a difference between MFN and FTA rates, such a margin would make it impossible for a third country to compete. He hoped that the figures stated would be checked and that further clarification would be forthcoming.

120. He welcomed the statement that Hungary would eliminate quantitative restrictions on an MFN basis. He asked whether, in the integration process with the EU, new arrangements had been established giving sole preferential status to the EU in the allocation of quotas. Regarding rules of origin, he noted that Pan-European rules of origin had not yet been notified to the Committees on Regional Trade Agreements and on Rules of Origin. While the system had not yet been examined, he believed that the cumulation system was better than non-cumulation, however, he wished to know whether, in the process of harmonization with the EU, Hungary had raised the local-content ratio to grant origin; whether a new value-added test had been introduced, rather than a change-in-heading system; and whether Hungary now required more than 50% of the value added in local content, which he believed would create trade diverting effects for imports of content from third countries. He asked whether Hungary had introduced a new rule requiring regional content to grant origin to final products. With regard to the issue of trade diversion, he believed that the effects should be tested sector by sector in aggregate form.

121. The representative of the United States stated that careful consideration was required to determine whether there had been distortive trade diversion resulting from Hungary's search for new markets. It was an inevitable part of economics that countries seek their neighbours. Recognizing that it was premature to expect comments on the specific terms of joining the EU, he hoped that Hungary would bear in mind the concerns raised by delegations. For example, agricultural supports were considerably lower in Hungary than in the European Union; the possible increase in the level of support as a result of joining the EU was a source of concern. In the area of services, if Hungary had to adopt the provisions of the broadcast directive, this would constitute a form of assumed protection rather than openness or liberalization. While, in general, accession of countries to the EU was healthy for the WTO, these were just two examples of the potential sources of concern.

122. The representative of India welcomed the assurances of the Hungarian delegation that the integration process would continue to follow the WTO rules. She looked forward to discussing the trade policy elements of the Europe Agreement in the Committee on Regional Trade Agreements and hoped that the integration process would be effected in such a manner that trade from third countries would not be affected.

123. The representative of Canada stated that from a forward-looking perspective, expansion of the network of preferential agreements should reduce the need for residual protection *vis-à-vis* third countries: the necessary adjustment process that occurred when a country opened a large share of its trade regime to its main trading partners should facilitate rather than hinder further multilateral liberalization. He noted, however, that areas or sectors excluded from regional agreements might represent an impediment to further multilateral liberalization.

124. The representative of Korea was pleased to note the active discussions resulting from references to bilateral relations, and appreciated the various comments regarding discriminatory tariffs and bilateral trade imbalances. If there was a discrepancy in the figures quoted he believed that these should be addressed bilaterally.

125. The representative of Australia took note of Hungary's responses regarding regional integration, and was interested in receiving answers her delegation's specific questions, in particular on the Pan-European cumulative rules of origin scheme. On the question of EU accession, she welcomed Hungary's assurances regarding WTO Agreements, however, she wished to register in advance concerns regarding the possible future direction of accession policies, so that they could be taken into account.

126. The representative of the European Communities did not believe that the more rapid rise in Hungary's imports from some groups of WTO countries than from others, between 1990 and 1996, was evidence that Hungary's agreements with other European countries had resulted in trade diversion: diversion occurred when margins of preference enabled preferential suppliers to push traditional suppliers out of the market; there was no evidence that this had happened. To make a judgement it would be necessary to isolate the effects of regional agreements from those of factors such as the collapse of the CMEA, Hungary's other policies, and changes in technology. The collapse of the CMEA had been a major factor in the increase in trade between east and west Europe, and he believed that west Europe would have become Hungary's main supplier even in the absence of its regional agreements. Well designed free-trade areas and customs unions could be trade creating not trade diverting as evidenced by the exception provided in the WTO. The increase in Hungary's imports between 1990 and 1996 from all WTO Members suggested that the agreement between the EU and Hungary had led to trade creation rather than diversion.

127. The representative of Hungary agreed that, while it was preferable not to raise issues of bilateral trade balances in the context of multilateral discussions, he wished to clarify the specific issue of alleged tariff discrimination for cars under 1,500cc. The MFN tariff was currently 13%, rather than the 28% mentioned by one delegation, and the preferential tariff rate was currently 5.9%: thus, the difference was around 7%, which could not be considered prohibitive. The issue of trade diversion had to be considered in terms of the overall picture, the relevant time element, and the collapse of the CMEA. The Hungarian market had expanded very rapidly, imports were playing an increasing share in GDP, and third country suppliers had not suffered from regional preferences. On the question of future liberalization, Hungary was among the countries that had argued for a broad-based new round of negotiations under the WTO, covering all sectors.

(iii) *Trade and Investment Measures*

128. The representative of Hungary drew attention to the marked improvement in the share of Hungary's bound tariffs. He noted certain discrepancies in tariff data included in the Secretariat report and request their correction. In reply to a specific question regarding precious stones he stated that these were bound in the Hungarian customs tariff.

129. Hungary had notified the operation of the global quota on consumer goods in the form of responses to the questionnaire on Import Licensing Procedures. This notification had recently been updated in document G/LIC/N/3/HUN/2. The reason for the under-utilization of some sub-quotas was that the annual 10% increase of quota limits in many cases exceeded actual demand. The increase of the value ceilings also ensured that the quota shares allocated to Hungary's partners in free-trade agreements did not remove import opportunities from third country suppliers. Hungary would continue to use import licensing for products outside the global quota - affecting 2.1% of tariff lines - due to the nature of the products concerned, for example, arms, ammunitions, and works of art. As to the alleged negative impact of quota allocation on imports of cars from one member country, sales of this member's cars in Hungary had risen from 363 units in 1992 to 7,547 units in 1996. One major producer from this member alone held over 10% market share, topped only by two locally manufactured makes of car. These figures were self-explanatory.

130. Responding to questions from various delegations, he noted that the number of Hungarian national standards was continuously decreasing as more international or European standards were introduced. Hungary's objective was to reach a 70 % share of international or European standards by the time of accession to the EU. There were currently 14,682 standards in force in Hungary, of which 2,174 were European and 1,369 international standards. CEFTA did not contain any commitment for the harmonization of standards and technical regulations and CEFTA countries did not intend to introduce such an obligation. Regarding the Hungarian National Accreditation Body, this was a public association not a government body. The accredited testing laboratories were located in Hungary; testing in foreign laboratories might be accepted on the basis of appropriate agreements concluded between the relevant institutions. Accession to the European Accreditation Organisation was in process.

131. Regarding a question on the safety inspection system, there was no inspection system applying to all imported industrial goods in Hungary. The existing safety inspection was applied for 35 products only, including child safety seats, washing ingredients, and ceramic pots, for health and environmental protection reasons. This requirement was applied both to domestic and imported goods in these categories. There was no monopoly for carrying out the inspection.

132. In response to questions regarding subsidies and incentives, he reiterated that the most important feature of the transition was the dismantling of state intervention and the immense reduction in direct and indirect state support. The total budget for subsidies to enterprises had declined from over 10% of GDP to less than 2%. On Hungary's investment policies, he did not agree with the statement in the Secretariat report that "incentives may not be merely ineffective but possibly counter-productive". Neither did Hungary believe that the incentives provided for regional development, research activities, or for investments in general were either excessive or against the interest of the national economy.

133. The restructuring of Hungary's steel industry had been in progress since the mid-1980s: huge capacities had been diminished and thousands of employees had lost their jobs. This restructuring, together with the privatization of the remaining production facilities, would hopefully soon be finished. Hungary did not provide any WTO-inconsistent subsidies to this sector.

134. On the question of subsidies, Hungary confirmed that incentives for R&D and regional development were being provided in conformity with Article 8 of the SCM Agreement. Tax concessions to promote export-oriented product development and to promote investments in the production of exportable goods were abolished on 1 January 1997. Consumer subsidies were being provided for local and long-distance passenger transport and pharmaceuticals.

135. A new law on government procurement had been in force since 1 January 1996. The law provided for very transparent rules for a wide range of public procurements ranging from central government purchases through local government to public company procurement. Provisions included a 10% price preference for suppliers registered in Hungary. On the basis of this legislation, Hungary was actively participating in the work of the Working Group on Transparency in Government Procurement, as well as in the Committee on GATS Rules, where future government procurement rules in services procurement were being negotiated. For the time being Hungary did not intend to join the Agreement on Government Procurement.

136. There were no state trading enterprises in Hungary in the sense of Article XVII of the GATT and the relevant Understanding, since as a result of the economic transformation such activities had been fully discontinued. Privatization in the context of the full market economy had been completed: no sectors or industries were excluded from further privatization. The Government would review privatization possibilities and make its decision accordingly.

137. Hungary's Competition Law, adopted in 1990, provided a coherent and comprehensive regulatory framework for the functioning of a market economy. Based on the experiences gained from its operation, this law was amended in 1996 and at present was fully compatible with competition legislation in the developed market economies.

138. A question had been posed about the evolution of trade policies relevant to TRIPS, and Hungary's views on copyright and patent protection had been sought. He noted that the overall development of Hungary's intellectual property protection had been outlined during the review of national legislations in the TRIPS Council. Hungary was member of the major international agreements and conventions both for copyrights and related rights as well as for industrial property rights. Furthermore, during the period under review several new laws had entered into force, thus Hungarian legislation in this sector not only complied with obligations under the TRIPS Agreement, but as a result of the legal harmonization with that of the EU, in several aspects went beyond those requirements. Regarding Hungary's views on copyright protection, the relevant Hungarian authorities intended to ratify both the new WIPO Copyright Treaty and the WIPO Treaty on Performances and Phonograms. He noted that Hungarian industrial property legislation already provided for the patentability of new plant varieties.

139. Regarding a question on enforcement, he believed that the doubts on low enforcement of intellectual property rights were based on the existence of tax evasion. He emphasized that the enforcement of intellectual property rights had been gaining importance in Hungary even before the TRIPS Agreement entered into force. However, since then efforts to increase the efficiency of law enforcement had been reinforced and extended. Hungarian legislation fully complied with the requirements of the TRIPS Agreement, including Part III. In order to permit effective action against any act of infringement of intellectual property rights covered by the Agreement, Hungary had ensured that adequate remedies and appropriate procedures were available in all branches of legislation. Breach of laws on the protection of patents, copyright, industrial designs, topographies of integrated circuits, utility models, trade marks and geographical indications could be sanctioned through civil and criminal law procedures. By virtue of a government decree customs authorities were empowered to prevent the importation of goods infringing intellectual property rights. The number of infringement cases had been

significantly reduced. Details of laws and regulations on enforcement of intellectual property rights could be found in Hungary's notifications to the TRIPS Council.

140. A question had been raised regarding the exception applied under Hungarian law from exclusive rights conferred by a patent, particularly in the pharmaceutical industry, for experiments and testing. In response, he stated that Section 19(2) of the Patent Act provided for all exclusive rights required by Article 28 of the TRIPS Agreement. The TRIPS Agreement did not require Members to grant exclusive rights concerning experiments, tests and generation of data. Moreover, Article 30 provided that members were permitted to apply limited exceptions to the exclusive rights conferred by a patent as long as such exceptions did not unreasonably conflict with normal exploitation and unreasonably prejudice the legitimate interest of the patent owner. The exceptions provided for in Section 19 of the Hungarian Patent Law were limited to acts done privately or not involved in an economic activity, to acts done for experimental purposes, including experiments and tests necessary for the registration of medicines, and to use of the patent in individual cases, for preparing a medicine. Thus such acts, according to generally accepted international norms, were not considered to be unreasonably in conflict with the normal exploitation of the patent. The creation of the exceptions in the Hungarian Patent Law took due account of the legitimate interests of third parties and in Hungary's view was in accordance with the TRIPS Agreement. Furthermore, Hungarian legislation was fully harmonized with the Luxembourg Agreement on Community Patents (CPC). So far, no case had been reported in Hungary on the application of Section 19(6) of the Patent Act.

141. With reference to trade defence instruments, the applicable procedural requirements and the type of remedial actions were, in Hungary's view, totally different for anti-dumping/countervailing and safeguard measures. The competent authorities evaluated all requests for safeguard, anti-dumping or countervailing actions on the basis of the relevant international rules and Hungarian legislation, and made their decisions according to the merit of the case. At present certain non-WTO members were subject to safeguard measures in the form of import quotas.

142. No incentives were applied in Hungary in the sense of the TRIMS Agreement. Examples cited in the Secretariat report did not support the view that incentives were sometimes conditional upon local-content requirements. The tax allowance conditional upon export performance was not a TRIM, thus it was notified by Hungary under the SCM Agreement. The reference to local content suggested that the requirement for offshore companies to employ only domestic lawyers constituted a TRIM, he questioned how such an employment requirement might be regarded as a local-content condition in the sense of the TRIMs Agreement.

143. Responding a question on rules of origin, specifically the Pan-European Cumulation System, he pointed out that the system was applied in all free-trade agreements within Europe. The new system linked more than thirty countries (the EU Member States, the EFTA States, ten countries in central and eastern Europe and, through special legal instruments, Andorra and San Marino). Turkey and Israel were not yet members of the system. Hungary believed that the implementation of the Pan-European Cumulation System would have positive effect both for the participants and third countries. For firms established in Europe, including foreign-owned firms, it allowed more freedom to use input material or in deciding where to locate their production facilities. With regard to third country materials, the new rules were generally more flexible as they provided general tolerance rules as well as alternative processing rules allowing more input of third country materials. The parties would shortly be sending the relevant notifications to the Committees on Rules of Origin and Regional Trade Agreements for an in-depth review of the system. He believed that there had been a misunderstanding on the effects of the introduction of the new system: there had been no change to European rules of origin, which required 60% originating content.

144. On trade facilitation, the introduction of the fully computerized customs-clearance system was in its final stage; fast-track processing for authorized trade was already in operation. Pre-arrival procedures would be introduced by the time the fully computerized customs clearance system was in operation. In response to a question on the application of the simplified customs valuation procedures, this was only possible for imports of certain products, including fruit, vegetables and cut flowers. An average world market price was calculated by the customs authorities and the importer had the right to choose whether to accept. Importers accepting the average price should not declare the transaction value.

145. Regarding free-trade zones, incorporated companies could obtain permission to operate under customs-free status. These zones were regarded as falling outside the Hungarian customs territory; consequently, all foreign trade regulations were applied on exports and imports between duty-free zones and the Hungarian customs territory.

146. The second discussant asked whether preferences on imports of raw materials were part of a particular trade policy orientation. Regarding standards, he was interested to know whether the differences between Hungarian and international, regional, or European standards had created any market access difficulties for Hungarian products, and whether mutual recognition agreements were a way of resolving these problems. He asked for clarification of the functioning of the regulatory government institutions responsible for the implementation and application of trade policies, given the reorientation of trade, and the accession negotiations.

147. The representative of Japan asked whether the correction requested by Hungary to certain data in the Secretariat report meant that the simple average MFN tariff rate was not beyond the bound tariff rate. Regarding intellectual property rights, he noted that Japanese industries were concerned about the enforcement of intellectual property regulations in Hungary, and hoped that the Government would take appropriate measure to improve enforcement. He noted the statement that Hungary had no incentives falling within the TRIMs Agreement and asked for further clarification of this statement.

148. The representative of New Zealand recalled his delegation's questions regarding the expected completion of Hungary's process of adopting international and/or EU standards, and the proportion that would be based on EU standards and on international standards.

149. The representative of Hungary confirmed that, as was the case in many other countries, raw materials generally carried lower tariffs than processed products. The difference, however, was likely to fall with the tariff reductions undertaken under the Uruguay Round. On the question of standards, Hungary had not experienced problems of access to the European market for two main reasons: the Hungarian technical cultural was largely based on German sciences and specifications, thus a large number of the Hungarian standards were technically very similar to European standards. However, he was unable to clarify the percentage of international as against European standards. Under legal harmonization, Hungary was attempting to approach, as closely as technical and financial conditions allowed, the standards used by the European Union. This was in Hungary's best interests as exports needed to be compatible with European market requirements, and because foreign investors preferred not to face a variety of standards. On the issue of introduction of new regulatory infrastructure due to trade reorientation, all economic and trade regulations were now market based; technical regulations were in the process of harmonization.

150. In response to a question on TRIMS, he reiterated that Hungary did not have any regulations falling under the TRIMs Agreement. The incentive related to production performance had been notified under the WTO subsidies code. On the question of TRIPS enforcement, reinforced laws had recently been introduced, and while it would take time to see any real effects, Hungary was confident that they would prove to be more effective than previous legislation. Concerning the levels of the applied and

bound rates, it was impossible for average applied rates to exceed bound rates in respect of chapters falling under the Agreement on Agriculture, as such products were bound. In some industrial sectors, however, the applied tariff on some products falling within chapters that were not bound, may exceed the average bound rate for the sector; this would inevitably increase the average rate of applied duties.

(iv) *Sectoral issues*

151. With reference to legislation on agricultural land, the proposed Land Bill had recently been withdrawn from Parliament: under the new Government's programme, there was no intention to change the present conditions for land ownership in the near future. Compensation bills had been provided since 1991 to former landowners, based on the value of their land or other expropriated property. These bills had been the major means for the privatization of agricultural land. The process had recently come to an end.

152. Reference had been made to the apparently high level of Hungarian tariffs in the agriculture sector. In response, he draw attention to the Hungarian Schedule. Given the level of agricultural tariffs and the fact that these were expressed in *ad valorem* terms without additional requirements, it was evident that the Hungarian agricultural import regime was not excessively protective, especially in the European context.

153. Since 1995, agricultural products were affected only by tariffs. The increased dispersion of applied tariff rates since 1991 was due to tariffication in the agriculture sector, and was a reflection of the varying effects of NTMs on different agricultural products prior to 1995, not an indication of a higher degree of distortion.

154. Seasonal tariffs were applied to imports of potatoes, tomatoes, cauliflower, broccoli, lettuce, celeriac, cucumbers, leguminous vegetables, other vegetables, avocados, citrus fruit, grapes, melons, apples, pears, apricots, cherries, sour-cherries, peaches, plums, strawberries, and kiwifruit. Seasonal tariffs did not normally vary, since their introduction was mainly the result of applying the EC Combined Nomenclature. Tariff rates for agricultural products had been subject to annual reductions since 1995, in accordance with the Hungarian Schedule. They would reach the final bound commitment level by 2000.

155. In 1997 MFN tariff rates for cereal grains and animal or vegetable fats and oils were below the in-quota tariff rates, consequently tariff quotas were not opened. In the case of two other product groups in-quota tariff rates were set significantly below the levels contained in the Schedule. This was an autonomous liberalization measure by Hungary.

156. Regarding a statement on the lack of preferential agricultural access for EU and EFTA partners, he pointed out that the Europe Agreement did, in fact, contain agricultural market access concessions.

157. Law CXXXI of 1996, on plant certification, and approval, production, and sale of plant seed and propagating material, came into force on 1 March 1997. Its aim was to ensure the preservation and the use of high-quality genetic materials. Under the law only certified plant types may be marketed in Hungary. This practice was in line with the OECD scheme for variety certification of herbage and oil seed in international trade.

158. Besides advisory services and agricultural research programmes, green-box subsidies were mainly aimed at providing assistance for structural adjustment and to disadvantaged regions, and promoting soil conservation activities. The first programme was intended to facilitate the organizational and structural adjustment of the agriculture sector in the context of re-privatization of agricultural land in accordance with paragraph 11 of Annex 2 of the Agreement on Agriculture. The second programme provided assistance for rural development in disadvantaged regions and met the criteria of paragraph 13

of Annex 2. The third programme was aimed at co-financing soil conservation measures and their feasibility studies in order to protect farmland. This support measure fell under paragraph 5 of Annex 2 of the Agreement on Agriculture. These programmes met both the fundamental and the relevant policy-specific criteria of "green box". Agricultural domestic support measures were notified on 11 December 1997 in document nG/AG/N/HUN/10 and Corr.1.

159. On the basis of the Agricultural Market Regulation Act of 1993 guaranteed prices could be set for five products: wheat for human consumption, maize for feeding purposes, milk, beef for slaughter and pig for slaughter. The prices were set below the cost of production and were intended to provide an income safety net. Until 1997, domestic market prices remained above the guaranteed prices and the support programme was therefore not operational. Such purchases first took place between 1 December 1997 and 1 March 1998: subject to a quantity limit of 3.2 tonnes/ha, maize for feeding purposes could be sold to the State at a price of Ft 15,000/tonne; actual sales amounted to 44,000 tonnes. Measures to promote the establishment of optimal farm structures were still under consideration; the criteria had not been elaborated.

160. During the Uruguay Round Hungary committed itself to reducing its level of domestic support measured by total AMS by 20% from the level of the base period (1986-88). There was no obligation under the WTO to reduce current domestic support or notify such reductions. Notifications for the recent period would be submitted in the near future.

161. He understood the concerns expressed regarding the use of export restrictions and agreed that such measures should be used exclusively in cases identified in the relevant WTO provisions. Hungary's export restrictions were introduced in recent years only to address serious shortages. The measures were in conformity with Article XI(2)a of GATT 1994 and Article 12.1 of the Agreement on Agriculture. The restrictions introduced in 1996 were maintained only for maize. Export licences are no longer required for barley, wheat and meslin flour, other cereal flours, cereal groats, meal and pellets, cereals grains otherwise worked and cereal preparations used for animal feed. Export licensing for barley was abolished in 1998 and for the other products in 1997. Export licensing in Hungary was not restrictive: in 1998 export of maize had been limited to 500,000 tonnes, applications had been made for only 400,000 tonnes. A reimbursable deposit of Ft 500 per tonne was payable for these licences; the deposit could be reclaimed if at least 80% of the quantity applied for was exported. Concerns had been raised concerning the feeding method of geese in Hungary. To remedy this situation Hungary had introduced non-discriminatory export licensing as part of the Government's general policy to improve animal welfare, reflected in the recent adoption of Law No. XXVIII on the protection of animals, which would enter into force on 1 January 1999.

162. Several delegations raised the issue of the WTO-waiver on export subsidies granted to Hungary on 22 October 1997. He reaffirmed that Hungary strictly adhered to the terms and conditions laid down in the waiver and contained in its Schedule.

163. EU accession negotiations in agriculture would not commence before 1999, thus, he believed that questions on the treatment of Hungary's export subsidy commitments upon accession were premature.

164. Regarding enquiries on SPS regulations, Law XC on food entered into force on 1 January 1996. The law contained detailed rules on the general conditions of food production, of placing food on the market, on packaging and consumer information, and controls and measures that could be taken by the authorities to ensure compliance with the provisions of the law. Its objectives were to determine production and marketing conditions for raw, semi-processed and processed food for public consumption that ensured the protection of consumer health and interests, and the fairness of market competition, and the promotion of free flow of these goods between countries. Hungary had increasingly used the

standards set by the Codex Alimentarius Commission of the FAO, and EC regulations in this field. The move away from national standards would be completed in 1999. Hungary was in full compliance with the provisions of Article 5.1 of the SPS Agreement.

165. As regards the textiles and clothing sector, Hungary had removed quantitative restrictions on textiles and clothing products for all WTO members as of 1 January 1998. Along with many other countries, Hungary applied the practice of outward processing; the share of OPT was admittedly rather high in the textile and clothing industry. International practice was respected in that imported inputs were duty free on the condition that after processing the end-products were exported.

166. The motor vehicles industry was one of the most dynamic export-oriented industries in Hungary, particularly component production, which attracted a lot of foreign direct investment. As a result of this investment, Hungary had become part of the world-wide production network of component production. In response to a question on PMVs, he noted that the MFN tariff on cars under 1,500 cc was 13% not 28%. The preferential tariff rate for free-trade partners was 5.9% and not 0%. He believed that the 7% difference could not be considered discriminatory, as had been claimed. Concerning charges, Hungary applied no differential treatment.

167. Replying to a question regarding pharmaceuticals, he stated that the protection of consumers was the rationale behind the restriction of sales of medicines to pharmacies only through authorized distributors. He noted that these distributors were not state-owned companies; any enterprise meeting the specific requirements set by law could act as distributor. Distribution services were liberalized in Hungary's GATS Schedule.

168. A question had been raised regarding Hungary's high level of commitments and whether there was enough flexibility to modify these commitments. He stated that it was not the intention of the Hungarian authorities to withdraw commitments made under the GATS. In the event that unforeseen circumstances required Hungary to make any change in its Schedule it would use the relevant GATS provisions on safeguards contained in Article X, or on Modifications of Schedules contained in Article XXI. Hungary was disappointed at the pace and main direction of the negotiation on safeguards and modification of schedules. Hungary had made liberal commitments on the assumption that simple and flexible rules would be developed to adequately address temporary or permanent changes in the economic environment in services.

169. He recognized that movement of natural persons was generally not the most liberal mode of supply under the GATS, as was the case in Hungary's preferential agreements. Hungary's commitments under mode 4 were in line with the general level of liberalization of WTO Members; however, Hungary undertook to provide access for key personnel and business visitors. He agreed that there was a delicate interrelation between immigration policy and trade policy. Hungary, had undertaken to allow the establishment of commercial presence through the form of branches in the recent negotiations on financial services: as of 1 January 1998 branching was allowed not only for financial services.

170. In response to a question regarding Hungary's MFN exemption, he recalled that under the recent negotiations on financial services, Hungary undertook to liberalize not only its Schedule of specific commitments but also its MFN exemption list. Compulsory government licensing for the establishment of financial services providers would thus be withdrawn when the new commitments entered into force, hopefully, in early 1999. Under GATS provisions Hungary's MFN exemption list would be subject to negotiation in the next round.

171. A question was raised regarding the possibility of advancing the date of liberalization of basic telecommunication services. Exclusive rights were granted by the Government in business contracts

under Civil Law, therefore, the Government had legal obligations towards investors to keep the parameters contained in Hungary's telecom schedules unchanged. However, he drew attention to the very competitive nature of the Hungarian telecommunications market as illustrated by the rapid penetration of new technical innovations and of competitive prices. In local districts two operators were licensed in order to enhance competition, in addition there was strong competition between and among wire-based and cellular services providers.

172. On air transport services, he pointed out that the GATS Annex on Air Transport Services practically excluded air transport services from the scope of the Agreement, other than aircraft repair and maintenance, sales and marketing of air transport services, and computer reservations services. These activities were included in the Hungarian Schedule but Hungary had no other obligations on air transport services under the GATS Agreement. He added that the Hungarian national carrier, MALEV was now being privatized; negotiations with potential investors were ongoing.

VII. CONCLUDING REMARKS BY THE CHAIRPERSON

173. The second Trade Policy Review of Hungary was conducted by the TPR Body on 7-8 July 1998. These remarks, prepared on my own responsibility, are intended to summarize the main points of the discussion; they are not intended as a full report. Details of the discussion will be reflected in the minutes.

174. The discussion developed under four main themes: (i) economic background and transition issues; (ii) regional integration issues; (iii) trade and investment measures; and (iv) sectoral issues.

(i) Economic background and transition issues

175. Members congratulated Hungary on the remarkable changes that had been achieved, during the short period since the previous TPR in 1991, in its transition to a market-oriented economy. It was recognized that these changes had taken place under difficult economic and social conditions, including the collapse of trade with the CMEA, the bankruptcy of a large number of companies and the consequent temporary loss of jobs. Members welcomed the fact that, despite these circumstances, Hungary had pursued its liberalization process and continued to make an important contribution to the WTO.

176. With regard to macroeconomic management, Members recognized the Government's achievement in restoring domestic and external balance following the March 1995 stabilization package. However, questions were raised as to whether fiscal consolidation could be maintained in the absence of further large-scale receipts from privatization, now in its final phase, and in view of difficulties in creating an efficient and equitable tax collection system. Questions were also raised whether the impact on the external balance of recent real effective appreciation of the currency might not lead to renewed contractionary measures.

177. In response, the representative of Hungary said that the improvement in government finances was not the result of a one-time windfall from privatization, but due to cuts in government expenditures. The budgetary situation was expected to strengthen further, due to improved tax collection methods and to the gradual shrinking of the unofficial, grey sector of the economy as tax rates were to be reduced. He added that improvements in the trade and current account balances implied that there would be few risks of negative effects from the real appreciation of the currency. While the crawling-peg devaluation of the forint might have been lower than the difference between the rates of inflation in Hungary and in its major export markets, this gap was offset by productivity improvements in Hungarian exporting sectors.

178. While welcoming the considerable structural changes to the economy through privatization and the role of the price mechanism in allocating resources, Members sought clarification of the role of industrial policies, including investment incentives, in influencing the future structure of the economy. In response, the representative of Hungary emphasized that direct investment in Hungary was fully liberalized. Hungary did not apply specific sectoral incentive schemes; investment incentives in general, and tax concessions in particular, were equally available to any sector.

(ii) Regional integration issues

179. Members recognized that the move toward EU accession had been a major element in Hungary's liberalization process. However, questions were raised on possible trade diversion stemming from preferences, and there was a considerable debate on this issue and its systemic implications. In response, the representative of Hungary stressed that WTO rules and commitments had been, and would be, thoroughly observed during the whole process of integration into the European Union. He rejected allegations that European integration had diverted trade to the disadvantage of third countries; on the one hand, trade flows had moved in favour of western markets, following the collapse of the CMEA, and

before the introduction of EU preferences; on the other, imports from non-European trade partners, both in North America and in the Pacific region, had grown faster than those from EU sources.

(iii) *Trade and investment measures*

180. Members raised concerns over the scope of unbound tariffs on a number of items, such as some fish products, footwear, precious stones, transportation equipment and agricultural products, and on the average levels of bound and applied tariffs in some areas. In response, the Hungarian representative noted that 95.7% of tariff lines were bound and that the data on bound and applied items in the Secretariat report reflected averaging of bound and unbound items.

181. While welcoming the phase-out of the global quota on consumer goods, Members raised questions concerning its allocation and the reasons for its under-utilization. Members also sought clarification of the Government's future import and export licensing policies. In response, the Hungarian representative said that details of the operation of the quota had already been notified to the WTO. The reasons for the under-utilization of some subquotas was that the yearly 10% increase of the quota in many cases exceeds the actual demands.

182. Members also raised questions on: the alignment of technical regulations and standards to international norms, as well as inspection procedures; investment incentives conditional upon export performance and plans to notify existing TRIMs to the WTO; Hungary's attitude to joining the Government Procurement Agreement, to which it is not a party; state-trading, and plans and priorities to further reduce Government involvement in enterprises through privatization; and the enforcement of laws pertaining to the protection of intellectual property.

183. In response to these issues, the representative of Hungary pointed out that the number of Hungarian national standards was continuously decreasing, the objective being to reach a 70% share of international or European standards by Hungary's accession to the EU. Only 35 industrial products were subject to inspection (on health and environmental grounds), with domestic and imported products treated identically. He emphasized that Hungary had no incentives in the sense of the TRIMs Agreement. On government procurement, the representative of Hungary called attention to the transparency of the new law introduced from 1996. Having weighed the pros and cons of possible accession, Hungary did not intend to join the Plurilateral Agreement at this stage; however, it was participating actively in the Working Group on Transparency in Government Procurement as well as in the Committee on GATS Rules, where future government procurement rules are being negotiated. On state trading and privatization, the representative of Hungary stated that there was no State trading in the sense of GATT Article XVII. In the context of the full market economy, no sectors or industries were excluded from further privatization. On intellectual property rights, the representative stressed that Hungary's present legislation complied fully with the requirements of the TRIPS Agreement. As a result of new legislation and enforcement efforts, the number of infringement cases had been significantly reduced.

(iv) *Sectoral issues*

184. On agriculture, food and beverages, Members raised various questions referring in particular to land ownership; tariffs; plant certification; SPS measures; the nature and value of various types of support; and export restrictions and subsidies. The representative of Hungary responded that there were no plans to change land ownership regulations at present: compensation for former landowners had recently been ended. The Hungarian agricultural tariff regime was, as shown in its WTO Schedule, one of the most liberal among WTO Members. The increase in tariff dispersion was the consequence of tariffication, which reflected the variable effects of previous agricultural NTMs. Only certified plant types could be marketed in Hungary, consistent with OECD provisions: SPS standards were becoming

internationalized under the 1995 Food Law. Domestic support, justified under "green box" provisions, involved advisory services and agricultural research programmes together with assistance for structural adjustment, to disadvantaged regions, and for the promotion of soil conservation. Guaranteed prices were set for five products, below the cost of production; intervention had been used only once. Export licensing was maintained only on maize, and was not restrictive in practice. As regards export subsidies, the representative reaffirmed Hungary's strict adherence to the terms and conditions laid down in the WTO waiver.

185. On motor vehicles, the representative of Hungary rejected allegations by Members that preferential tariffs and quotas related to regional trade agreements adversely affected third parties, citing the success of a Korean company in increasing exports to the Hungarian market during the period 1992-96. He added that the restriction on importation of used cars over four years old was designed to prevent Hungary becoming a "garbage cemetery" for used cars.

186. Members raised questions on trade measures applying to textiles and clothing, referring in particular to outward processing trade (OPT), and to wholesale activities for pharmaceuticals. The representative acknowledged that the share of OPT was high, reflecting existing patterns of trade. Hungary respected international practices in this regard; i.e., material inputs are imported duty-free on condition that end products are subsequently exported. On pharmaceuticals, legal provisions were in force to maintain health protection; the wholesale sector was open to foreign participation.

187. On services, Members welcomed Hungary's high level of commitments in the GATS. It was asked whether this level provided sufficient flexibility for Hungary; if establishment of foreign branches in Hungary was allowed for services other than financial; and whether the Government would advance the date for liberalization of national and international telephone services. The representative of Hungary replied that Hungary would not withdraw its GATS commitments; in unforeseen circumstances, GATS rules would be followed. He confirmed that, as of 1 January 1998, all restrictions on foreign branching, including in financial services, had been abolished. As regards advanced liberalization of telecommunication services, the representative replied that the Government had a legal obligation to maintain the exclusive rights granted in business contracts with investors for the agreed periods, however, there was strong competition in the market.

188. Hungary's participation in this review has reflected its strong commitment to the WTO process, as well as the positive effects of its transition to a market economy. The statements made on Tuesday, and again this morning, have indeed been helpful to Members.

189. I would agree with the view expressed by several delegations that Members have much to learn from Hungary's process of transition to a market economy and the role of trade and investment liberalization in this process. There has also been quite a lively debate, in this connection, on systemic issues related to regionalism and its effects in terms of possible trade creation and diversion; these issues will, no doubt, be followed appropriately in the CRTA.

190. Finally, I should like to thank the delegation of Hungary, led by Dr. Balás, for their clear statements yesterday and today, and its positive participation in the review; and also thank our two expert discussants, Dr. Raby and Mr. Mukerji, for their very useful opening remarks yesterday and follow-up comments today. The overall success of this review has also largely depended on the full participation of other delegations, to whom I express my gratitude. I wish Hungary success in their endeavours in the further opening up of their economy in line with their WTO obligations.
