Amanda Whitlow

Comprehensive Country Evaluation

Professor Reed

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Country Evaluation: Hungary

As a country located in central Europe, Hungary is a prime location for trade among countries in that region. Although the country has encountered recent drawbacks through several recessions, it is still considered a potential place for foreign direct investment by foreign countries. Hungary’s attractiveness for foreign businesses to invest in is determined by a variety of inputs. While some aspects of contributing foreign direct investment to Hungary may seem positive, other variables may influence a business to shy away from the opportunity. By evaluating all of the factors, a business can then weigh the costs and benefits to choose the option best for them. A U.S. firm considering doing business in Hungary should analyze the following factors: monetary elements, external environmental forces, economic structure, and trade characteristics.

Monetary elements include the exchange rate regime of Hungary along with its foreign direct investment requirements and policies. The current exchange rate regime of Hungary is a free floating exchange rate. This is the same regime which the top four major trading currencies of the world, including the United States, operate under. With this system, Hungary’s exchange rates will fluctuate. The central banks can interfere and attempt to influence the exchange rate by purchasing other currencies, therefore increasing the demand of Hungary’s currency, the Hungarian Forint (Hill 308). One U.S. dollar is equivalent to 225.1 forint as of 2012 (Europe: HUNGARY).

In the past, the forint was stable and doing fairly well. However, once the change from a centrally planned market to a free market occurred in the early nineties due to the fall of communism in Hungary, the forint lost much of its value (2013 Investment Climate Statement – Hungary). Currently, the forint is continuing to weaken. The future outlook of Hungary’s currency does not seem stable either. By rule, Hungary must eventually adopt the euro as their official currency because it is a member of the European Union. It is unlikely that this change will happen prior to 2020, and the expected date continues to be moved out further. The reason Hungary has not yet adopted the euro is because of their debt burden. The country has faced multiple recessions over the past ten years that has limited their economic growth. Inflation has also been high in Hungary lately, rising to 5.7% in 2012 when it was only predicted to be 2-4%, resulting in economic instability beyond the control of the National Bank of Hungary. Because of this, the International Monetary Fund has come to the country’s rescue multiple times by aiding them with loans. However after a falling out with the IMF and EU (Hungary has the highest debt in Central Europe) and adoption of the new constitution, Hungary is no longer able to enter into any circumstances that would continue to increase their debt. Because of this, Hungary has been focusing on stabilizing their current situation before adding the new element of a different currency into the mix (Country Report Hungary).

The instability of the Hungarian exchange rate regime and future uncertainty of the forint’s value or existence may seem overwhelming and problematic to a U.S. firm considering doing business there. Another negative from a firm’s perspective is the intervention the IMF has previously had with Hungary. This shows the country does not do well when trying to deal with monetary issues on their own. Hungary’s debt burden is a potentially threatening factor as well that would influence a country not to invest there. With their approach to riding themselves of debt being overspending, Hungary has trapped itself in a vicious cycle that is unlikely to reduce the debt burden. The fact that Hungary is unable to receive loans or funding at this time is also an unattractive characteristic. However, the backing of Hungary by the EU and understanding that the benefits of a floating rate would add to a firm’s confidence in investing with Hungary. Overall, the uncertainty of Hungary’s future concerning their currency and the long term outlook for stabilization is daunting. It is likely that this is a factor that would deter one from investing in Hungary.

Another monetary element of Hungary to consider is their foreign direct investment policies. Hungary has a prime location directly in Central Europe, because of this, Hungary has been known as the leading destination for FDI in this area. After the recent financial crisis, this has slowed some, but Hungary is still considered to be an attractive place for foreign business. Hungary allows that up to 100% of ownership be granted for certain industries investing in the country. Incentives are allowed for investors that operate in certain facilities as well that may be in the form of cash, tax allowances, training, or job creation. FDI is highly encouraged in Hungary, mainly because the country depends on this source of cash inflow (2013 Investment Climate Statement – Hungary). As for ease to starting a business in Hungary, improvements have been made to make this process easier. The costs of starting a business overall have decreased. Although new tax registration fees for firms have been implemented, property registration fees have decreased, and the abolished community tax has aided to the ease of paying taxes (Ease of Doing Business in Hungary). Hungary implements the “Foreign Investment Act of 1988” which gives investors protection and guarantees international and domestic investors will all receive equal treatment. Hungarian law applies to all investors as to further implement Hungary’s importance on equal treatment (2013 Investment Climate Statement – Hungary). Recently, the government has been limiting the performance of independent institutions by imposing higher taxes on foreign-owned businesses (Country Report Hungary). In addition, specific taxes on several sectors known as “crisis taxes” have been implemented in an effort to lower the country’s budget deficit. For example, the energy sector experienced a rise in taxes of almost 40% from the year 2012 to 2013 (2013 Investment Climate Statement – Hungary).

The changing tax policies in Hungary may seem like a disadvantage to foreign investors, however when compared with the benefits of investor protection and ease of formation, FDI looks promising. Hungary is very open to FDI, and since the move to a free market, there are not as many barriers to entry or regulations that would eliminate a U.S. firm from doing business there. In fact, the U.S. has 40 of their 50 biggest multinationals operating in Hungary including Microsoft Office, General Motors, and Procter and Gamble (2013 Investment Climate Statement – Hungary). Hungary’s willingness to allow foreign businesses to be present in its country shows that this would be a wise opportunity to pursue. With all information considered, a firm may feel comfortable investing with Hungary because of the already successful multinationals located there and overall ease of doing business.

External environmental factors that affect Hungary include the political, and socio-cultural elements of the country. Currently, it can be argued that the political force is the most prominent on Hungary’s economy. Hungary’s political system is that of a parliamentary republic. The ruling party is Fidesz-Hungarian Civic Union, often shortened to simply “Fidesz”, with Janos Ader as the political leader. This party has been accused of gaining power quickly, partially because of their perceived method of attacks on foreign businesses. The government has also been blamed for the falling out between Hungary and the IMF by refusing to compromise with the IMF, but instead flat out refusing their proposal. Another election will be held in 2014, but with Fidesz continuing to gain power, it is unlikely that the party will be replaced (Country Report Hungary). Although Hungary implements as much of a free market economy as it can, the government seems to be limiting that opportunity. It is thought that generally, the Fidesz government is forcing Hungary’s economy to take steps back, rather than steps forward to encourage the free market economy. This would be a discouraging factor for U.S. firms when evaluating Hungary, because if the government continues to gain power and is reelected, the free market economy may be threatened. This would mean the possibility of foreign direct investment being discouraged rather than welcomed. However, a lot is riding on the results of the 2014 election as well.

Another influence from the external environment impacting Hungary is the socio-cultural aspect. There are differences between the way Hungarian people and Americans go about business transactions that could pose a threat to U.S. firms considering doing business there. These differences focus mainly on conversation styles. In Hungary, people tend to behave more seriously and can come off as stressed and worried about the future. Eye contact is important during conversations, and people may stand very close to one another, but refrain from touching. Conversations are kept short and to the point, without including much personal information (Hungary). Americans would have to adapt to this way of interacting with others, because they tend to be more laid back and informal when conversing. This would not be a major challenge to consider when evaluating the opportunity to invest in Hungary, and would most likely not completely convince a U.S. firm to shy away from FDI with Hungary.

Hungary’s economic structure includes many elements inlcuding the degree of privatization, state of infrastructure, performance indicators, and labor markets. Privatization is stated as a right within the new Hungarian constitution. The number of state owned enterprises has continued to decrease over the past few years, and 100% ownership is allowed in most industries from foreign investors. Exceptions to this rule are “defense-related industries and farmland”. Foreign firms are most prominent in manufacturing, telecommunications, and energy industries. The main sector that the government has control over is agriculture. As stated previously, 100% ownership is not allowed in this industry. In addition, the government limits the amount of land allotted in this sector for foreign investors. Foreigners are currently not allowed to own land, but rather have to lease it because they are not Hungarian citizens or members of the EU (2013 Investment Climate Statement – Hungary). As for foreign investors, this information makes it clear that those in the agriculture sector may prefer exporting over FDI because of the harsh regulations on land ownership. In addition, a U.S. firm will want to stay current on information regarding the 2014 election, which could impact the level of involvement they want to have with Hungary as it seems the government is attempting to limit the free market economy.

Infrastructure is not a major problem in Hungary. As for transportation, Hungary is doing well with high availability of airports, railways, roadways, waterways, etc. However, Hungary’s level of communication is lacking. Its rating compared with other countries is low, not because the system of communication is poor, but because there is not a substantial amount of people living in Hungary that utilize it (Europe: HUNGARY). Overall, the infrastructure of Hungary may not be as advanced or as widely spread as it is in the United States’, but this should not be a factor that turns a firm away from investing with this country.

One more factor related to Hungary’s economic structure is its performance. The GDP per capita outlook for Hungary has been decreasing over the past few years since the recession in 2012. The real GDP growth rate predicted for 2013 is that of only .8%. In addition, inflation has been on the rise as a result of the recession, but is expected to begin decreasing. High inflation has created economic instability in Hungary, and is a prime reason the IMF had to get involved in Hungary’s borrowing decisions. As inflation falls, it is possible that the IMF and Hungary could pick up where they left off and begin negotiations for Hungary to receive lending once again. As Hungary beings recovering from this recession, the positive outlook is slow coming, but the future predicts that it will get better from here on out and that there are no foreseeable circumstances which would hinder Hungary’s performance (Country Report Hungary). Interest rates are low and are expected to remain low as Hungary progresses through its recovery stage. One main problem the country faces when trying to rid themselves of the debt burden that was in part caused by the recession is that it continues to increases debt by overspending (Euromonitor). Hungary’s economic instability could be a negative characteristic to U.S. firms looking to invest there. High inflation and overspending are not attractive aspects of a country and signal warning signs of future troubles. However, as Hungary recovers from their recent recession, the future outlook is promising and could bring a firm future benefits if they invested now.

Another element impacting the country’s economic structure is its labor market. In Hungary, there is a labor force of 4.3 million people. This pool is made up of mainly skilled and well educated people. The literacy rate of the labor force is 98%, and more than half of the workers have achieved education beyond the equivalent to high school in the U.S. The country has particularly strong skills in “engineering, medicine, economics, and science training”. As a member of the EU, Hungary’s unemployment rating is low, but when compared to the U.S.’s standards it is very high. This is in part due to the high amount of people in the labor market and the low participation rate (2013 Investment Climate Statement – Hungary). While the decline in unemployment is coming slowly, it is still limited by poor labor mobility. People may be unemployed and willing to work or seeking employment, but unable to relocated to where work is available (Country Intelligence: Report: Hungary). The availability of labor resources in Hungary is a major motivation factor for firms considering doing business there. The fact that there is a large labor force with high unemployment means that workers are there and waiting for employment, as well as skilled and educated. This is a positive characteristic that will most likely draw firms to invest there.

A final influence on the country’s economic structure is corruption. The corruption that takes part in Hungary centers around government activity. This includes Fidesz party members having controversial roles as leaders of influential groups and the members taking bribes from supporters. Other influences of corruption are evident through human trafficking, prostitution, and money laundering (2013 Investment Climate Statement – Hungary). This would be a negative characteristic in the eyes of a U.S. firm. In order for the United States to have successful businesses in Hungary, it may need to take into consideration ahead of time the implied need for its businesses to support the Fidesz government. As the government rises in power and gains control, it could be possible that the government has power over the performance of a multinational in Hungary, and may require bribes from foreign investors in order for them to have a fair chance at competition with other firms located in Hungary.

The final characteristic of Hungary’s economy to consider are its trade characteristics. Exports in Hungary for 2012 totaled $90.23 billion. Its main exports were “machinery, food products, and raw materials”. These products were exported mainly to “Germany, Romania, and Slovakia”. Imports totaled $87.37 in 2012 and consisted of “machinery, fuels and electricity, and food products”. Imports for 2012 came from “Germany, Russia, and China” (Europe: HUNGARY). The U.S. is not a top player in trade with Hungary and vice versa, however trade between them does exist. Hungary has recently implemented some taxes that have discouraged FDI. These include the “crisis taxes” that the EU opposes because they target particular industries and were implemented as a result of the recession in 2012 (2013 Investment Climate Statement – Hungary). In addition, punitive taxes have been imposed on foreign businesses, resulting in other businesses becoming slow to invest because of the extreme recent changes in taxation (Country Intelligence: Report: Hungary). This is yet another factor that could turn a business away from investing in Hungary, because of the uncertainty of taxation. With these taxes being imposed, Hungary is giving off the wrong image and appearing as if they are not interested in receiving FDI and will treat those who do invest unfairly.

Hungary’s attractiveness for foreign businesses to invest has been evaluated on the basis of monetary elements, external environmental forces, economic structure, and trade characteristics. After evaluating the various aspects of foreign direct investment opportunities in Hungary, it can be suggested that industries that should consider FDI in Hungary are those such as machinery and manufacturing that contribute to Hungary’s main exports. Labor for pharmaceuticals is available in Hungary and would be a wise choice for FDI in Hungary as well, based on the large labor force of skilled and educated workers. Although the agricultural industry in Hungary is one of the largest, there are many regulations that would limit a foreign firm’s ability to fairly compete there. Also, ease of formation and investor protection offer benefits for FDI. The agriculture sector would benefit more from exporting, because Hungary has high imports in food products, and the foreign producer could avoid barriers to entry. As long as Hungary keeps their free market stance, firms will benefit from exporting because trade barriers will remain low. All industries need to keep in mind the upcoming election and how the results may change their outlook on investment. Decisions will vary among different firms and industries, but with the following information, it is possible for a firm to make an educated conclusion regarding their approach to foreign direct investment with Hungary.

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