



The key to Hungary's cost-competitiveness

After 2010, several market-friendly measures had been introduced in Hungary, which – coupled with the increased growth potential of the economy – resulted in lower costs at enterprises. By now, Hungary has become the most attractive country in terms of labour costs for the subsidiaries of corporations from EU member states, and it was also Hungary where unit administrative costs saw the largest drop within the Visegrád Four. It is also Hungary where starting a business is the fastest and cheapest and the obtaining of a construction permit takes the shortest period of time. The country has also made progress with regard to corporate taxes. Hungary tops the ranking concerning the time and costs of obtaining export licences. Practically, there has been improvement in every segment of the Hungarian economy and that may facilitate a successful economic policy in the coming EU fiscal period.

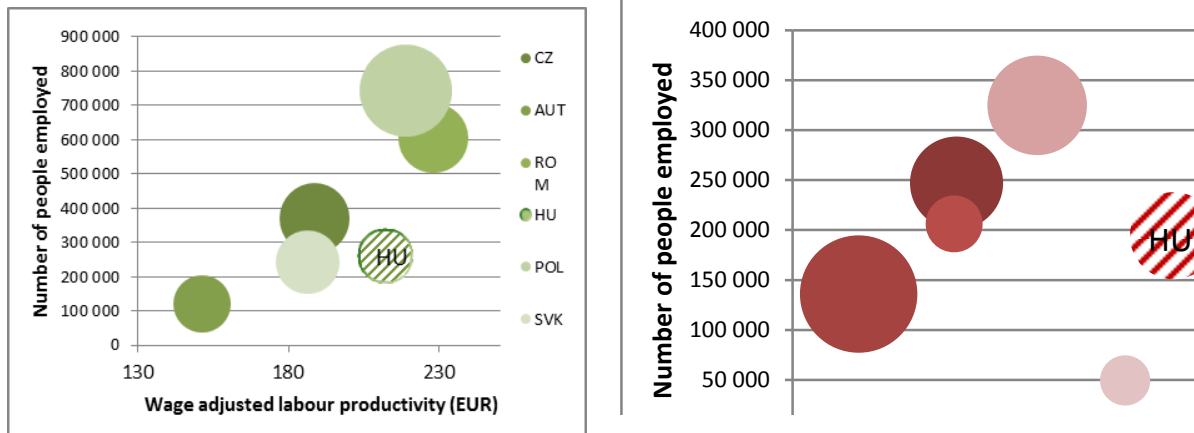
Although Hungary's cost-competitiveness is obviously outstanding when compared to “old” EU members, the situation is less evident when a comparison is made against the costs of V4 countries. It has been a common V4 characteristic that they compensate typically weak domestic purchasing power by focusing on foreign markets. Accordingly, their economic potential mainly depends on the capacity of foreign enterprises to exploit local advantages and on a supportive regulatory system. To this reference group, a late-comer – Romania – and an old, highly developed member – Austria – have also been added.

In the opinion of several economists, the most significant drivers of Hungary competitiveness following the regime change in 1990 were prompt reforms that enabled fast-track privatization which tore the country out of an economic slump. However, not all foreign investors have come to Hungary with long-term plans; they rather sought a place of fast and high returns. Until recently, Hungary has been one of the most profitable locations in terms of labour costs, as wage adjusted labour productivity made the country one of the best investment destinations among EU member states for foreign companies.



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Wage adjusted labour productivity at subsidiaries of non-EU parent companies (left hand side table) and of EU parent companies (right hand side table) (2012)¹



Source: Eurostat (2015)

Note: German enterprises have been removed of this list, but it was not possible in case of productivity data. The size of bubbles shows annual turnovers.

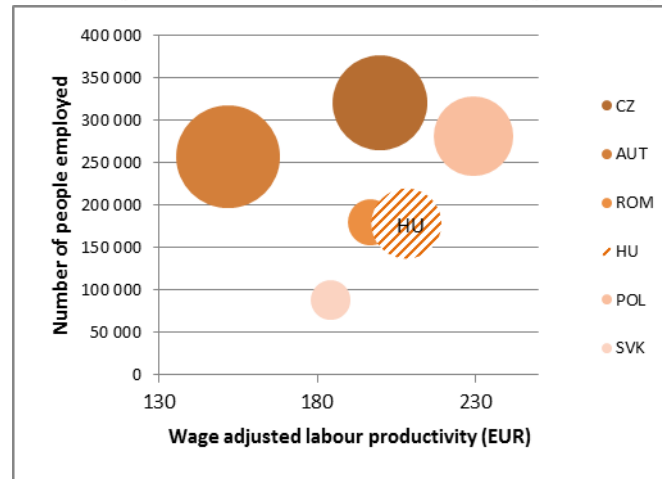
It has to be stressed that the presence of a German parent company has been a key determinant for every observed economy, especially for V4 members. From this aspect, Austria stands out as the country with the poorest wage adjusted labour productivity figure. Nonetheless, it is also true that Germany's competitiveness also hinges on the business environment in Poland, Hungary and the Czech Republic (the size of bubbles show turnover and they are comparable on the three tables).

¹ Statistics on the subsidiaries of foreign parent companies are however distorted, as they only show foreign subsidiaries that identify a foreign parent company of at least 50 percent ownership in their financial statements. Enterprises that are owned through a holding company registered abroad (i.e. Audi Hungary) do not qualify as subsidiaries of a foreign parent company.



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Wage adjusted labour productivity at subsidiaries of German parent companies (2012)



Source: Eurostat (2015)

In Hungary, every foreign parent company can find the right level of productivity. This part of the paper examines and compares the various cost factors in a group of countries.

The World Bank evaluates business regulatory environment of almost 200 countries all over the world in an annual survey. The latest report finds that an increasing share of company costs is a consequence of inadequate regulatory environment; therefore it is of vital importance to examine changes in this field.

One of the key conclusions of the World Bank Business Survey is that the prosperity of individual countries is not necessarily in line with their propensity to adopt internationally recognized best practises in administrative reforms. It is, for example, possible to start a business through procedures at a one-stop shop in Romania, Hungary and Slovakia, but it is not allowed in the more highly developed Austria or the Czech Republic.



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Best practices in lowering administrative burdens (2015)

Economy	Ranking	Can procedures be completed online?	Is there a one-stop shop?	Is there no paid-in minimum capital requirement?
Austria	21	yes	no	no
Czech Republic	44	yes	no	no
Hungary	54	yes	yes	no
Poland	32	no	yes	no
Romania	48	yes	yes	no
Slovak Republic	37	yes	yes	no

Source: World Bank: Doing Business Survey 2015

Although Hungary is at the bottom of the Doing Business Survey's ranking of the observed reference group, the country advanced four places over the past one year. On the other hand, **it is the most competitive country in terms of several cost elements and significant process could be achieved with regard to lowering administrative burdens.**

Administrative procedures, time and cost of starting a business (2015)

	YEAR	Austria	Czech Republic	Hungary	Poland	Romania	Slovakia
Procedures (number)	2004	8	10	6	10	6	10
	2008	8	9	6	4	5	9
	2015	8	9	4	4	5	7
Time (days)	2004	25	40	52	56	29	103
	2008	25	17	16	31	9	27
	2015	25	19	5	30	8	12
Cost (% of income per capita)	2004	6,1	10,8	40,4	21,3	10,9	9,4
	2008	5,4	10,6	17,7	18,9	4,5	4,2
	2015	0,3	8	8,3	12,9	2,1	1,5

Source: World Bank: Doing Business Survey (2015)

In Hungary, the time required for starting a business has been cut **over the past ten years from 52 days to 5 days**. Thus, the country is one of the best within the EU. In the same period, **the costs of establishing an enterprise fell by four-fifth**. Although every V4 member is still lagging far behind top-ranking Austria, the existing Central European trend is encouraging. One of the main achievements in Hungary since 2010 was the introduction of **on-line business registration** that confirms a company registration request within one hour of application and it



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massively accelerates the entire process. Since the change of government in 2010, several economic performance-boosting measures have been introduced that have also come to be acknowledged by the World Bank:

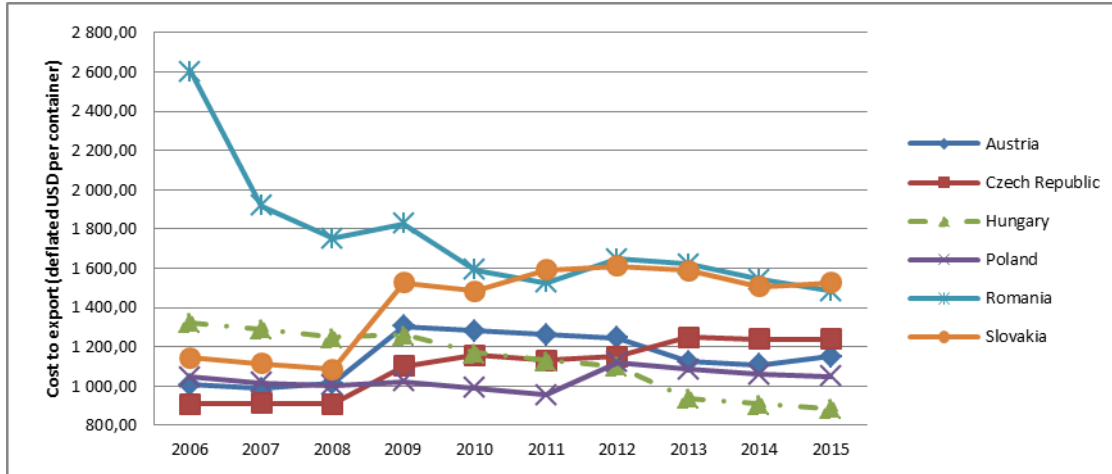
1. **Final deadlines set for the issuance of construction permits;**
2. **Real estate registration fee** reduced by 6 percent;
3. **Simplifying taxes** and the calculation of **tax base;**
4. **Bankruptcy law amendment** enables troubled enterprises to seek out-of-court settlement with creditors;
5. First law on evaluating borrower solvency enables setting up a **public borrower blacklist** (2013);
6. **Abolishment of community tax** simplifies company taxation (2013);
7. **On-line registration of customs documents** boosts foreign trade;
8. **Bank transfer safety measures** improve payment efficiency;
9. **Motor vehicle tax reduced.**

As a result of the aforementioned and other Hungarian economic measures, within the reference group Hungary tops the ranking as the country where **obtaining a building permit is the fastest and cheapest** (91 days; at a cost of some 0.2 percent of industrial real estate value). Together with the Czech Republic, Hungary is also among the fastest in terms of **real estate registration**, while related administrative costs have been reduced to one-fifth since 2004. As far as financial regulation is concerned, Hungary shares the first place with Romania in **enforcing contracts**. Concerning highly-criticized taxes on labour, Hungary is placed in the middle of the ranking with a labour costs-to-net wage ratio of 34.3 percent. The **total tax rate on businesses (as percentage of profit) has fallen from 56.6 percent to 48 percent over the past ten years**. Logistics as well as the cost-efficiency of factors related to foreign trade activities are vital elements for the small open economies of the V4 countries. Among the V4, the time required for obtaining an export licence is the shortest in Hungary (16 days), while it was Hungary was also the only country where export services costs have been reduced.



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Export costs per container (in deflated USD, 2015)



Source: World Bank: Doing Business Survey

Hungary must make the most of its development potential by building on the results achieved thus far. To this end, a more stimulating system must be created through funding programmes, but of course there is still a lot to do in introducing more market-friendly measures within the regulatory system. One of these, for example, is the reduction of the time and costs of a company's access to electricity. As another measure, the state takeover of sectors with high unit production costs aims to tackle some market deficiencies. It is also necessary to do more regarding asset recovery in bankruptcy proceedings or modify several lending regulations.