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**Commission Opinion on Hungary's Application
for Membership of the European Union**

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A. INTRODUCTION

a) Preface

The Application for Membership

Hungary presented its application for membership of the European Union on 31 March 1994, and the Council of Ministers decided on 18 April 1995 to implement the procedure laid down in Article 0 of the Treaty, which provides for consultation of the Commission.

That is the framework in which the Commission submits the present Opinion, responding to the request of the European Council in Madrid in December 1995 to present the Opinion as soon as possible after the conclusion of the Intergovernmental Conference, which commenced in March 1996 and concluded in June 1997.

The Context of the Opinion

The Hungarian application for membership is being examined at the same time as applications from nine other associated countries. Hungary's accession is to be seen as part of an historic process, in which the countries of Central and Eastern Europe overcome the division of the continent which has lasted for more than 40 years, and join the area of peace, stability and prosperity created by the Union.

The European Council in Copenhagen in June 1993 concluded that:

“The associated countries in Central and Eastern Europe that so desire shall become members of the Union. Accession will take place as soon as a country is able to assume the obligations of membership by satisfying the economic and political conditions. Membership requires:

- that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- the existence of a functioning market economy, as well as the capacity to cope with competitive pressure and market forces within the Union;
- the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.

The Union's capacity to absorb new members, while maintaining the momentum of European integration, is also an important consideration in the general interest of both the Union and the candidate countries”.

This declaration spelled out the political and economic criteria for examining the accession requests of the associated countries of Central and Eastern Europe.

The European Council in Madrid in December 1995 referred to the need, in the context of the pre-accession strategy, “to create the conditions for the gradual, harmonious integration of the applicant countries, particularly through:

- the development of the market economy,
- the adjustment of their administrative structure,
- the creation of a stable economic and monetary environment”.

In its Opinion, the Commission analyses the Hungarian application on its merits, but according to the same criteria as the other applications, on which it is delivering Opinions at the same time. This way of proceeding respects the wish, expressed by the European Council in Madrid, to ensure that the applicant countries are treated on an equal basis.

In addition to the individual Opinions the Commission is presenting separately to the Council, in the framework of its communication “Agenda 2000”, a general assessment of the accession requests, and its recommendations concerning the strategy for successful enlargement of the Union. At the same time, it is presenting an evaluation of the impact of enlargement on the Union’s policies.

The Contents of the Opinion

The structure of the Opinion takes account of the conclusions of the European Council in Copenhagen. It:

- describes the relations up to now between Hungary and the Union, particularly in the framework of the association agreement;
- analyses the situation in respect of the political conditions mentioned by the European Council (democracy, rule of law, human rights, protection of minorities);
- assesses Hungary’s situation and prospects in respect of the economic conditions mentioned by the European Council (market economy, capacity to cope with competitive pressure);
- addresses the question of Hungary’s capacity to adopt the obligations of membership, that is the *acquis* of the Union as expressed in the Treaty, the secondary legislation, and the policies of the Union;
- makes finally a general evaluation of Hungary’s situation and prospects in respect of the conditions for membership of the Union, and a recommendation concerning accession negotiations.

In assessing Hungary in respect of the economic criteria and its capacity to assume the *acquis*, the Commission has included a prospective assessment; it has attempted to evaluate the progress which can reasonably be expected on the part of Hungary in the coming years, before accession, taking account of the fact that the *acquis* itself will continue to develop. For this purpose, and without prejudging the actual date of accession, the Opinion is based on a medium-term time horizon of approximately five years.

During the preparation of the Opinion, the Commission has obtained a wealth of information on Hungary's situation from the Hungarian authorities, and has utilised many other sources of information, including the member states and numerous international organisations.

b) Relations Between the European Union and Hungary

Historical and Geopolitical Context

Hungary is a landlocked country in the centre of Europe, which borders Austria, Slovenia, Croatia, the Federal Republic of Yugoslavia, Romania, Slovakia, and Ukraine. The country's area amounts to 93,033 km² and its population to 10.2 million.

The Magyars migrated into the Carpathian Basin in the 9th century and in the year 1000 established the Kingdom of Hungary. In the centuries up to occupation by the Ottoman Turks in 1526, Hungary developed its economic and cultural links with Western Europe. Following a period of Turkish rule, then division into three parts, the Habsburgs conquered and reunited Hungary in the late seventeenth century. In 1867 the creation of the Dual Monarchy gave Hungary equal status within the Austro-Hungarian Empire. After the empire's defeat in World War I and the Trianon Treaty of 1920, Hungary gained full independence but lost important parts of its territory and population to its newly created neighbours. Between the Wars Hungary pursued recovery of its ethnic territories and, to this end, allied itself with Germany and Italy in World War II.

After the war the country was occupied by Soviet troops and the Communists established a "People's Democracy" under Soviet influence. An uprising in October 1956 pressed for a return to a democratic and independent state. This revolution was brutally put down by Soviet intervention and followed by a period of strong repression under the Communist Party Secretary-General János Kádár.

During the period of Communist rule, a command economy was progressively established and private property nationalised. However, from 1968 the Government began to introduce modest market-oriented economic reforms. In 1982 Hungary became the first country in Central and Eastern Europe to join IMF and IBRD. The economic reforms were nevertheless not sufficient to prevent a major economic crisis in the early 1980s. This crisis, coupled with pressure for political reform, led to gradual and peaceful change culminating in the resignation of Kádár in May 1989 and the adoption of a democratic constitution in October that year.

The previous month, by opening its border to Austria for refugees from East Germany, Hungary had made an important contribution to the dissolution of the Iron Curtain. There were free parliamentary elections in 1990 and 1994, and a peaceful alternation of power from the conservative Hungarian Democratic Forum to a socialist-liberal coalition after the second elections.

Since its return to democracy, Hungary has consolidated and strengthened its relations with its neighbours. Hungary participates fully in the EU initiative for a Pact for Stability in Europe, and has concluded Basic Treaties with Ukraine, Slovenia, Croatia, Slovakia and Romania. These Basic Treaties recognise the inviolability of borders, as well as the principles of the Council of Europe, OSCE, UN and other international organisations in relation to the treatment of national minorities. Hungary also participates actively in OSCE; it was Chairman in Office in 1995 and hosted the Budapest OSCE Summit at the end of 1994.

Hungary's Position Concerning the European Union

Since 1989 there has been a large degree of consensus among Hungarian political forces in support of Hungary's objective of EU membership. As stated in the April 1994 Memorandum accompanying Hungary's application for EU membership, "Since the formation of an independent Hungarian State 1,000 years ago, this country has been closely linked to Western cultures and values ... Within the newly established democratic institutional framework the political conditions for reintegration into the main trend of European development are now fulfilled. For Hungary, joining this process and using the achievements of European integration to carry out fully its social and economic modernisation is a historical necessity. It is also a unique possibility, for which there is no real alternative."

Successive Governments since 1990 have maintained this as the essential objective of Hungary's foreign and domestic policy. As stated by Prime Minister Horn in June 1996 during the Florence European Council, "The decisions of the European Council in Madrid made the process of accession calculable for Hungary. Euro-Atlantic integration is not only the basic condition but also the substance of Hungary's social and economic transformation and modernisation. It means a clear and attractive perspective for the Hungarian society undertaking the burden of transformation".

Hungarian commitment to an ever closer political Union was stated by President Göncz during the 1996 Hungarian National Day:

"... Europe of the future will, let us all hope, irrevocably and protectively embrace Hungary in a full-grown European Union. This will be the shared homeland of European countries all with equal rights. It will offer a viable, though not altogether care-free life to such European countries which are able and prepared to undertake membership of their own free will. It offers a possibility for us to answer together all those economic and political challenges, some of them known and others yet unknown, that the future holds. It promises peace after the sufferings caused by two wars that brought unparalleled destruction and two dictatorships of unparalleled evil.

It promises a predictable future to countries that have suffered immense misery, having been torn, divided and herded into forced union. It promises the strength of unity so that these countries may be able to defend their security, their legal system, the full enforcement of human rights, their made and natural environment, and multi-coloured and yet unified culture and economy of Europe...”

Contractual Relations

Diplomatic relations between the European Community and Hungary were established in 1988. A Trade and Economic Co-operation Agreement was concluded that year, providing for reciprocal most-favoured nation (MFN) treatment and foreseeing the gradual abolition by 1994 of quantitative restrictions applied by the Community on imports originating in Hungary.

An Association Agreement, to be known as a Europe Agreement between the European Communities and Hungary was signed on 16 December 1991 and came into force on 1 February 1994. Its trade provisions entered into force earlier, under an Interim Agreement, on 1 March 1992.

The Europe Agreement is now the legal basis for relations between Hungary and the Union. Its aim is to provide a framework for political dialogue, promote the expansion of trade and economic relations between the parties, provide a basis for Community technical and financial assistance, and an appropriate framework to support Hungary's gradual integration into the Union. The institutional framework of the Agreement provides the necessary mechanisms for implementation, management and monitoring of all areas of relations. Subcommittees examine questions at a technical level. The Association Committee, at senior official level, provides for in-depth discussion of issues and often finds solutions to problems arising under the Agreement. The Association Council examines the overall status of relations and provides the opportunity to review Hungary's progress in preparing for accession.

The Hungarian Government has established a coordinated institutional framework for dealing with European integration matters. Political guidance is exercised by a European Integration Cabinet chaired by the Prime Minister and assisted by a Strategic Task Force on Integration. An Inter-Ministerial Committee for European Integration is chaired by the Minister of Foreign Affairs and serviced by the European Integration Department of the Ministry of Foreign Affairs. The Integration State Secretariat coordinates the conduct of European integration policy. Each Hungarian ministry has a department responsible for EU related matters. A Parliamentary Committee on European Integration is closely involved in the formulation and monitoring of Hungary's EU integration policy.

The Pre-Accession Strategy

Implementation of the Europe Agreement and White Paper

The EU/Hungary Europe Agreement is fully functioning, according to the timetable foreseen. Progressive removal of tariffs on the few remaining industrial goods was completed in January 1995 except for steel and textiles products for which duty free imports were initiated respectively in 1 January 1996 and 1997.

The Association Council has met at ministerial level once each year, supported by the Association Committee and a structure of ten multidisciplinary sub-committees. A Joint Association Parliamentary Committee comprising representatives of the Hungarian and European Parliament has been set up. A Joint Consultative Committee comprising economic and social representatives from the EU's Economic and Social Committee as well as relevant Hungarian bodies was established in 1997.

All areas of cooperation covered by the Agreement are addressed. Main successes in its implementation have been: significant liberalisation of movement of industrial and agricultural products, resolution of several trade issues (eg regarding wine exports, goose liver, citrus fruits VAT), conclusion of a specific protocol (covering agricultural and processed agricultural products) to take into account the results of the Uruguay Round negotiations as well as the accession of Austria, Finland and Sweden to the EU, adoption of implementing rules for competition, improvement of the protection of intellectual, commercial and industrial property rights in Hungary, adoption of the additional protocol for the opening of Community programmes to Hungary, adoption of a new regime of rules of origin integrating Hungary into the new pan-European cumulated regime.

Current discussions seek to accelerate the approximation process, and to progress in areas like competition, state aid related issues, adoption of an equivalency protocol on

phytosanitary and veterinary issues, mutual recognition of professional qualification and diplomas and industrial standards and conformity assessment.

Some trade problems have arisen in the implementation of the Europe Agreement but have been successfully resolved.

The Commission's White Paper of 1995 on the Internal Market set out the legislation which the candidate countries would need to transpose and implement in order to apply the *acquis*, and identified elements essential for the implementation of the single market (known as Stage I measures) which would need priority attention. Hungary has attached considerable importance to this work. 23 working groups have been set up in the ministries concerned. There has also been collaboration with trade unions, business associations, and professional chambers, as well as with the Parliamentary Committee on European Integration. The Hungarian Government published a strategy for the implementation of the White Paper in December 1995, and a revised version in 1997.

Progress in legislative alignment is advanced in Hungary, particularly concerning measures requiring new laws. Most of the remaining legislative alignment work refers to Government decrees. The Hungarian Government anticipates having almost all the Stage I measures in place before the end of 1997.

Relations with Hungary under the Europe Agreement are good. There are few trade problems, and Hungary has made good progress in implementing the Agreement. Hungary is committed to sustaining a comprehensive dialogue and to advancing quickly in cooperation.

Structured Dialogue

Hungary has participated in the structured dialogue, considering it to be an important component in preparing for accession. The Government delivered policy papers for both the Essen and Cannes European Councils, calling for a more effective pre-accession strategy and for an extension of the Europe Agreement to CFSP as well as Justice and Home Affairs. The Hungarian authorities also expressed the hope to make discussion of issues in the reinforced pre-accession strategy more substantive.

Phare

For the period 1990-1996, 672.8 MECU was allocated to Hungary. The allocation for 1996 was 90 MECU. Principal sectors addressed have been economic restructuring, agriculture, environment and nuclear safety, infrastructure, human resources development, public administration reform, social development, employment and health.

Hungary has also benefited from cross-border co-operation programmes with Austria (18 MECU) and Romania (5 MECU), focusing in particular on economic, environment and infrastructure co-operation.

There has been evidence of slow implementation and a lack of impact in some areas, due to an overwide spread of programmes, limited absorption and management capacity, and cumbersome administrative procedures.

Participation in Community Programmes

In accordance with the Additional Protocol to the Europe Agreement, Hungary can participate in Community programmes. It will shortly start to participate in Socrates, Leonardo, Socrates and Youth for Europe. It will be able to join MEDIA II, Ariane, Kaleidoscope, LIFE, SAVE and SME and health programmes as from 1988.

Trade Relations

Between 1989 and 1995, trade between the EU and Hungary increased substantially. EU imports from Hungary jumped from 2.6 to 8.7 billion ECU (+335%), while EC exports to Hungary increased from 3 to 9.9 billion ECU (+330%). The trade balance has presented a steady deficit for Hungary, except in 1990 and 1991, where it registered a surplus of 0.1 billion ECU. Despite the efforts of the Hungarian authorities, the deficit increased in 1995 and 1996 mainly due to the accession to the EU of Austria, Finland and Sweden, and to the needs of re-equipping the Hungarian economy.

Since German reunification, Germany has become Hungary's most important trading partner. In 1996, Germany secured 24% of the total Hungarian foreign trade, followed among EU member states by Austria and Italy.

Hungary has been a founding and active member of the Central Europe Free Trade Agreement (CEFTA).

General Evaluation

Implementation of the EU/Hungary Europe Agreement has generally been successful. Bilateral relations between Hungary and the European Union are considered by both sides to be satisfactory. Obligations resulting from the Europe Agreement have generally been met on time. There is a broad and comprehensive dialogue backed up by a desire to advance quickly on trade and cooperation issues. Hungary has adopted a realistic negotiating position during bilateral discussions, which has greatly assisted the resolution of potential difficulties.

B. CRITERIA FOR MEMBERSHIP

1. Political Criteria

The European Council in Copenhagen decided on a number of “political” criteria for accession to be met by the candidate countries in Central and Eastern Europe. These countries must have achieved “stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities”.

In carrying out the assessment required in this connection, the European Commission has drawn on numerous sources of information: answers given by the Hungarian authorities to the questionnaire sent to them by the Commission services in April 1996, bilateral follow-up meetings, reports from Member States’ embassies and the Commission’s delegation, assessments by international organisations (in particular the Council of Europe and the OSCE), reports produced by non-governmental organisations, etc.

The following assessment involves a systematic examination for each of the candidate countries of the main ways in which the public authorities are organised and operate, and the mechanisms for the protection of fundamental rights. It does not confine itself to a formal description but seeks to assess the extent to which democracy and the rule of law actually operate.

This assessment relates to the situation in June 1997. It does not examine in detail any changes which have taken place in the past or which may come about in the future, though it generally takes account of any stated intention to reform a particular sector. The situation of the administrative structures is mentioned here only in passing: it will be examined in greater depth in chapter 4.

1.1 Democracy and the Rule of Law

The far-reaching reform in October 1989 of the Hungarian Constitution of 1949, which gave rise to the new Constitution of December 1990, led to a smooth transition to a parliamentary democracy. Parliament is still working on the revision of the Constitution. The Hungarian institutions work smoothly, the various authorities being mindful of the limits of their powers and of the need for cooperation.

Parliament and Legislative Powers: Structure

Parliament consists of a single house - the National Assembly. Its 386 members are elected for four years under a system which combines “first-past-the- post” single-member constituencies and proportional representation (with a minimum threshold of 4% of the votes for obtaining a seat in the latter case). The Constitution, and the 1993 law on minorities, provide for the principle of the representation of minorities in Parliament, but these provisions have not always been given practical application. A bill is being prepared which would make it possible to designate representatives for the minorities as soon as the list in which they are included obtains over 10 000 votes.

The President of the Republic may dissolve the National Assembly if it overrules the Government at least four times in a twelve-month period, or if it does not succeed in appointing the Prime Minister within 40 days. Elections must be held within three months of dissolution. The Assembly cannot be dissolved if a state of emergency is declared.

Members of Parliament have a traditional system of immunity. The role and participation of the opposition in the operation of the institutions are recognised in Hungary. They are expressed in particular through the setting-up of committees of parliamentary inquiry (made up of one-fifth of the members of the National Assembly) which are traditionally chaired by a member of the opposition.

Political parties can easily be set up in Hungary (120 took part in the 1994 elections) and they receive financing from the state budget on the basis of their electoral results.

Parliament exercises legislative power. It shares its right of initiative with the President of the Republic and the Government. The Government can be authorised by Parliament in the event of a crisis to adopt rules which derogate from the laws. The law on the “state of crisis” (which, according to the Constitution, must be adopted by a two-thirds majority of Parliament) has still not been adopted.

The Hungarian Constitution also provides for the referendum procedure, either on a decision of Parliament which may be initiated by the President, the Government or 50 Members of Parliament and must be adopted by a two-thirds majority, or at the initiative of at least 100 000 citizens. The Constitutional Court judged that the Constitution could not be amended by referendum.

Functioning of Parliament

Elections have taken place in free and fair conditions. A centre-left coalition won in 1994, (see Annex for the election results) taking over from the conservative coalition which had been successful at the previous general elections in 1990. Hungary presents the characteristics of a democracy the smooth working of which allows the peaceful alternation of political power.

Parliament functions satisfactorily: its powers are respected and the opposition plays a full part in its activities.

The Executive: Structure

The President of the Republic, who is elected by Parliament for a four-year term, which may be renewed once, has essentially a representational function, save in exceptional circumstances. The Government is accountable to the National Assembly. It is made up of a Prime Minister, designated by Parliament upon a proposal from the President of the Republic, and ministers appointed by the President upon a proposal from the Prime Minister and individually responsible to Parliament and the Government.

Following the annulment by the Constitutional Court in October 1996 of ministerial status, a new bill is being examined which would strengthen ministers' immunity, give the Prime Minister the power to initiate without any special reason the procedure for dismissing ministers and draw a sharper distinction between ministries' political management and administrative management functions.

The administrative organisation of the country is based on decentralised units of the central state administration (30 at regional level) and on local authorities whose leaders are elected for four years (1990 and 1994 elections) either at county level (19 plus Budapest) or at the level of towns and villages. The 3 168 local authorities have extensive powers, protected by the Constitutional Court. It should nevertheless be noted that most of their resources come from the state budget. In certain cases they may be assisted by local governments for minorities. The law of 1996 provided for the establishment of local authorities at regional level (six plus Budapest).

The Administration is governed by a Statute which was adopted in 1992. The Government announced in February 1997 that it would be amended. The Hungarian Government has launched a programme to combat corruption under the action plan for reforming public administration launched in February 1997.

The army, the secret services and the police are controlled by the civilian authorities. The constitutionality of some provisions of the law on the police is questionable, and they run counter to certain standards of the Council of Europe (procedures for arrest, use of personal data and "plea bargaining" procedures). The secret services are controlled by a Parliamentary Commission with wide powers of investigation.

Functioning of the Executive

The central institutions of the State function smoothly.

The public administration is still facing certain difficulties: salaries and wages are still low compared with earnings in the private sector and there are certain shortcomings in the training system. The Government has tried to improve the situation by increasing civil servants' pay using the resources made available by the manpower reduction programmes.

There have been a number of cases of corruption in the Hungarian police in the last few years and its effectiveness in combating organised crime has also been called into question (as when in November 1996 top national and local police officials were removed from their posts following a number of violent settlements of account in Budapest).

The Judiciary: Structure

The Hungarian Constitution ensures the independence of the legal system. The judges are appointed, following probation of two years, for an indefinite period. The President of the Republic appoints them upon a proposal from the Minister of Justice, which is in turn submitted to the President and Council of Judges of the Court of Appeal. Judges can be removed from their posts only for serious reasons and in accordance with a procedure laid down by law. The President of the Supreme Court is elected by Parliament on a proposal from the President of the Republic. The Supreme Court judges are appointed by the President of the Republic on a joint proposal of the President of the Supreme Court and the Minister of Justice. Judges are not allowed to engage in political activities or join a party.

The Procurator General is elected by the National Assembly, on a proposal from the President of the Republic, and is answerable to it. He determines the organisation of the various public prosecution offices. The procurators are subject solely to the laws and instructions given by the Procurator General.

In addition, administrative acts are subject to judicial review by the ordinary courts. The military courts, which are qualified in particular to deal with matters concerning the secret services, follow the civil procedure and appeals may be made against their decisions to the Supreme Court.

Under Chapter 5 of the Hungarian Constitution, Parliament has appointed a number of ombudsmen to investigate individual complaints in different sectors: individual rights (two parliamentary commissioners), data protection and minority rights (the last was elected in July 1995).

Since 1989 the Constitutional Court has been keeping a check on the constitutionality of laws and international treaties. It should be made up of 11 members elected by the National Assembly by a two-thirds majority for a nine-year term which may be renewed just once (with an age limit of 70).

Matters may be put to the Court in advance - in this case it has only a consultative role - or subsequently, in which case it can cancel any unconstitutional provisions. The right to refer matters to it is extensive since any party may put matters subsequently to the Court and the Court may even refer matters to itself in certain cases. The Court may also provide interpretations of the text of the Constitution and settle disputes regarding public authorities' powers.

Functioning of the Judiciary

Justice does not yet operate in a satisfactory way at all levels in Hungary. The courts are overloaded; the number of cases put to them has increased greatly in recent years and it takes longer for rulings to be given. The complexity of the rules of procedure and the fact that judges still lack the necessary professional qualifications and that courts have been accorded much greater powers in recent years generally explain this situation. The Hungarian Government has launched a programme to ensure that rulings can be delivered more quickly (reform of rules of procedure and improvement of court facilities) and judges can be trained to a higher standard.

The Constitutional Court has in recent years been in a transitional stage with only nine members, since the parties represented in Parliament have not succeeded in agreeing on who should fill the two vacant posts. Although a solution was recently found, the two-thirds qualified majority needed to appoint judges is still difficult to attain. If no alternative solution is found, this situation could recur in 1998 when two of the terms expire.

1.2 Human Rights and the Protection of Minorities

Hungary has introduced a number of national standards for ensuring that human rights and minority rights are observed. A further guarantee is provided by the application of certain international conventions, in the forefront of which is the European Human Rights Convention and its additional protocols. Under Article F of the Treaty on European Union, these aspects taken together constitute part of the *acquis* any country wishing to join the European Union must first have ratified these texts.

In November 1992, Hungary, which has been a member of the Council of Europe since November 1990, ratified the European Convention on Human Rights and its additional protocols. It also permits individuals to take their case to the European Court if they consider that their rights under this Convention have been violated.

Among the other international conventions protecting human rights and minority rights, Hungary has ratified the Convention on the Prevention of Torture and the Framework Convention on minorities. It has not signed the European Social Charter, however. It has also ratified the main United Nations Conventions concerning human rights.

Hungary applies the agreements only if they have first of all been incorporated by Parliament into internal law.

Civil and Political Rights

Access to justice is guaranteed in Hungary, in particular by very easily accessible appeal procedures and relatively well-developed legal aid machinery. The rights of the defence seem to be properly covered, except in the case of certain categories of foreigners and gypsies, who have difficulty in asserting their rights before the law.

The death penalty was abolished in 1990 in all circumstances.

The right not to be arbitrarily arrested is assured since no citizen can remain in detention for over 72 hours without being charged.

All citizens aged 18 or over have the right to vote.

Freedom of association and peaceful assembly are also guaranteed; evidence of this includes the increase in the number of non-governmental organisations from 8 396 in 1989 to 44 167 in 1995.

Freedom of expression is assured by the Constitution, which prohibits censorship and guarantees journalists' rights.

The public sector still plays a very large role in the media, with a monopoly of television and a dominant position in radio (only one private national channel). The Prime Minister controls, in particular, the budget given to the channels. The question of the opposition's access to the media arose during the campaign preceding the 1994 elections. The lack of legislation on this matter applicable to all the media does not give the opposition all the appropriate guarantees for fair access to new channels resulting from future privatisation. This sector is still not open to foreign operators.

Under the Law of December 1995, however, the Government launched an invitation to tender in December 1996 for the establishment of a private channel to start broadcasting from 1 September 1997. The regulatory body (ORTT), which under the Law of December 1995 is responsible for issuing operating licences for private channels, is made up of representatives of all the political formations present in Parliament.

The right of ownership is guaranteed and expropriation must be in the public interest, with fair prior compensation. For people previously expropriated, the Government has introduced a system of partial compensation with coupons for the purchase of rural property and real estate. A 1990 law provided for restoring to the church the property which the Communist regime had taken away from it. An October 1996 decree provided for the restoration of property to the families of victims of the Holocaust through a Foundation set up for that purpose.

The Hungarian legislation in force limits foreigners' right of ownership of agricultural land to a maximum of 300 ha. A bill before Parliament provides for possible foreign investment in public bodies which own agricultural land. The land register is computerised and at present covers virtually all the land, with almost 99% of the 7.5 million deeds of ownership having been registered.

Respect for privacy is assured by the need to obtain a warrant from the judicial authorities before property can be searched or telephone communications tapped.

As Hungary acceded to the Geneva Convention on refugees only in respect of refugees from other European countries and has still not provided satisfactory access to justice and shelter for these people, the situation regarding political refugees seemed worrying, but the Government has put a bill before Parliament abolishing geographical restrictions on the application of the Geneva Convention and has agreed to close the Kistarcsa refugee camp, which had been very strongly criticised by the United Nations High Commissioner for Refugees.

A number of organisations have reported cases of inhumane, degrading treatment by the police with no steps having been systematically taken to punish the perpetrators. There have also been instances of such treatment in the prisons, despite the steps recently taken by the Hungarian authorities.

Economic, Social and Cultural Rights

The right to social security is ensured without discrimination pursuant to Article 70E of the Hungarian Constitution.

Trade union freedom is recognised in Hungary. Trade union representatives have legal protection against any measures which employers might take against them. The rate of union membership is almost 40%, and most members belong to one of three unions.

A law issued in 1989 guarantees the right to strike, except for the armed forces, police, judiciary and civil defence. It is laid down in the law that in the civil service, exercise of the right to strike depends on an agreement between the government and the trade unions and that it is prohibited where it could prove prejudicial to the population or the environment. A system of minimum service is also provided for in the essential public services (transport, telecommunications, water, gas, etc.).

Free access to education and freedom of religion are also guaranteed. The church is separate from the state but the state provides aid for recognised denominations (in 1995, ECU 110 million was granted for 36 religious groups).

Minority Rights and the Protection of Minorities

Minorities represent some 6% of the population (4% to 5% gypsies (Roma) and the remainder are mainly German, Slovaks, Croats and Romanians).

There are first of all a number of international standards to ensure the protection of minorities. Hungary ratified the Framework Convention on minorities in September 1995 and subscribes to the principles of Recommendation 1201 of the Parliamentary Assembly of the Council of Europe providing for the recognition of collective rights for minorities, although this text is not legally binding.

The law of July 1993 recognises as a minority any ethnic or national group which has been living in Hungary for over 100 years and the members of which have Hungarian citizenship. The law recognises the exercise of minorities' collective rights, in particular through the setting-up of minorities' local governments, which have been established to date in 817 municipalities. Under the 1993 law, they have the right of veto over matters concerning education, culture, local media, efforts to sustain traditions and the use of the minorities' languages. In other areas, their function is a consultative one. The Hungarian Government undertook in a report approved by Parliament in March 1997 to specify these local governments' spheres of competence and the areas in which they would have decision-making powers in the future. The financial procedures for these institutions must also be established.

Minorities also have an Ombudsman (see above) and a National Council (KET), which has a consultative function. Each minority also has a "national autonomous government", the members of which are elected by the minority communities themselves. Between 1994 and 1996 the state aid for minorities increased by 68% from 2.6 billion to 4.6 billion forints. The establishment of a number of public foundations to administer operations to help minorities has made it possible to involve minorities' representatives in the financial decision-making procedure.

Contrary to the provisions of the Constitution and the Law of 1993, minorities still do not benefit from a special method of representation in Parliament. The Constitutional Court ruled in 1991 that this shortcoming was a violation by default of Hungary's Constitution.

According to the evaluation carried out by the OSCE High Commissioner on National Minorities, the Law of July 1993 allows education to be provided satisfactorily in the minority languages. The German and Slovak minorities have educational establishments in their language for all stages of schooling, including higher education. The Hungarian Government is at present examining various measures which could encourage the maintenance of minority languages in a context where knowledge of them is constantly declining. The 1996 law on the media makes it compulsory for the public-sector channels to broadcast information in the languages of the various minorities and to include programmes about the minorities' life and culture. Publications and radio and television broadcasts are provided in all the minorities' languages.

The gypsies (Roma) have a special place. The Hungarian Government's report on the situation regarding the national and ethnic minorities approved by Parliament in March 1997 recognises that the gypsies (Roma) are still frequently subjected to attacks and discriminatory measures and considers that the situation is in danger of worsening over the next few years. The same document states that present legislation does not make it possible effectively to prevent the outbreak of "ethnic conflicts" of which the gypsies (Roma) are victims.

Their social situation is often very difficult. According to the government report on this matter, inequality of opportunity between the gypsies (Roma) and the rest of the Hungarian population has increased in recent years, while the standard of education of the gypsies (Roma) has improved. Similarly, the unemployment rate among this population is four to five times that of the national average and life expectancy is ten years less than for the rest of the population. This situation can largely be explained by sociological factors. The gypsies (Roma) are also subject to discrimination on the labour market.

The Hungarian Government has undertaken to implement a programme to reduce the inequality of opportunities between the gypsies (Roma) and the rest of the population. The Council for coordinating matters concerning the gypsies has since the end of 1995 been supervising all the action taken by the various state institutions in this area. The Committee for the Gypsy Programme, established in March 1996, examines the political and social problems encountered by the gypsy community, under the direct authority of the Prime Minister. This community benefits from the protective provisions of the 1993 Law and has 477 local governments for minorities.

1.3 General Evaluation

The Hungarian institutions work smoothly, the various authorities being mindful of the limits of their powers and of the need for cooperation. Elections have taken place in free and fair conditions and have allowed a switch in political power in 1990 and 1994. The opposition plays the customary part in the operation of the institutions.

There are no major problems regarding observance of fundamental rights in the country. The rights of minorities are guaranteed and protected. Although some improvement is still needed, progress has been made in the form of measures recently taken by the

government to ensure justice and protection for the Roma (gypsies). Efforts to combat corruption need to be made more effective.

Hungary presents the characteristics of a democracy with stable institutions which guarantee the rule of law, human rights and respect for, and the protection of, minorities.

2. Economic Criteria

In examining the economic situation and prospects of Hungary, the Commission's approach is guided in particular by the conclusions of the European Council in Copenhagen in June 1993, which stated that membership of the Union requires "the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union".

This section of the Opinion therefore gives a concise survey of the economic situation and background, followed by a review of Hungary's progress in key areas of economic transformation (liberalisation of the price and trade system, stabilization of the economy, structural change, reforms of the financial sector) as well as its economic and social development. It concludes with a general evaluation of Hungary in relation to the criteria mentioned by the European Council and a review of prospects and priorities for further reform.

2.1 The Economic Situation

Background

Hungary, with a population of 10.2 million, has a gross domestic product (GDP) of 65 billion ECU (expressed in purchasing power parity). Its population is thus about 3 percent of that of the Union, while its economy is only about 1 percent and GDP per capita is about 40 percent of the Union average. Wages are low by Western standards: the average non-agricultural gross wage is equivalent to about 230-275 ECU per month.

Hungary joined the GATT in 1973, and was a founder member of the WTO and CEFTA. In 1996, it became a member of the OECD.

Progress in Economic Transformation

Hungary has a long-established record of a gradualist approach to economic reform. Rigorous central planning was abolished as long ago as 1968 when the "New Economic Mechanism" was introduced, while more systematic economic reforms began in 1985. Thus, some elements of the institutional and legal infrastructure for a market economy have been in place for almost a decade: a two-tier banking system was established in 1987; import liberalisation and personal income and value added taxes were introduced from 1988.

Building upon the gradual introduction of reforms from the mid-1980s, Hungary did not implement the "shock therapy" approach to economic reform applied in some other Central European countries. The gradualist approach adopted entailed substantial further liberalisation of trade and prices and the creation of the main institutional and legal foundations of a market economy.

Economic and political developments, however, caused the Hungarian authorities to slow down reform and this resulted in deadlocks in key areas such as agriculture, the financial sector, public finances and privatisation. However, reforms were successfully relaunched in 1995, with dramatic impact. Set-backs in the privatisation of the banking sector were reversed, and large parts of the energy and utilities sector were sold to private investors. Private involvement in sectors such as electricity and gas supply now surpasses the levels in many EU member states.

Notwithstanding the early start to market reforms in Hungary, state enterprise initially remained the dominant form of economic activity: in 1989, the private sector generated about 16% of GDP. Solid progress with privatisation, and strong growth in the number of new private firms resulted in a private sector share in GDP of 60-70% by the end of 1995.

Foreign Direct Investment

Reflecting the sharp acceleration in the pace of privatisation, and Hungary's improving standing with international investors, foreign direct investment (FDI) has been very significant, totalling more than ECU 10 billion (~ECU 1000 per head) by the end of 1996 (source : EBRD).

Economic Structure

Agriculture accounts for about 7.2% of gross value added, and employs 8% of the working population. These figures are above the EU average, but roughly comparable to those of some Member States.

The agricultural and food sectors account for 21% of Hungary's exports (close to 15% of exports to the EU). This is the only major sector in which Hungary is a net exporter. Although the EU is the destination of over three-fifths of Hungary's total exports - a share not much different from that of several member states - only two-fifths of agricultural and food exports are sold on the Union market.

Industry accounts for 23% of gross value added, and a similar proportion of employment. Recent years have seen significant restructuring of the sector. Above average growth has been recorded in machinery manufacture, and modern metallurgy, while there has been a decline in those branches which are heavy users of energy. Industry has attracted substantial inflows of foreign capital, which should help to modernize the sector and improve its competitiveness in the years ahead. Productivity has been rising rapidly - in excess of 10% per year - since 1993, and manufacturing goods accounted for above 50% of exports in 1996. There has been a huge growth in the number of enterprises, with well over 100,000 limited liability enterprises registered by late 1996. These are almost entirely SMEs. The above points to a fairly dynamic industrial sector, able to sell a large part of its output on EU markets.

The **services** sector may be schematically divided into an expanding private sector, and a public services sector which is still in the course of defining and adapting to its role in a market economy.

| Main indicators of economic structure <i>(all data for 1996 unless otherwise indicated)</i> | | |
|---|------------------------|------|
| Population | <i>million</i> | 10.2 |
| GDP per head | <i>PPS-ECU (1995)</i> | 6300 |
| <i>as % of EU-15 average</i> | <i>per cent (1995)</i> | 37 |
| Share of agriculture in: | | |
| gross value added | <i>per cent (1995)</i> | 7.2 |
| employment | <i>per cent (1995)</i> | 8 |
| Gross foreign debt/GDP | <i>per cent</i> | 62 |
| Exports of goods & services/GDP | <i>per cent</i> | 34 |
| Stock of foreign direct investment ¹ | <i>billion ECU</i> | 10.6 |
| | <i>ECU per head</i> | 1040 |
| <i>Source: Commission services, national sources, EBRD</i> | | |
| ¹ FDI stock converted at end -1996 exchange rate of 1 ECU= \$1.25299 | | |

Privatisation of a majority stake in the fixed-line telecommunications company, and progress made from late 1995 with privatisation of state banks will contribute to the development of effective services to business in these areas. Developments in these sectors are likely to pose challenges for the ability of state institutions to ensure the maintenance of competition and/or prevent abuse of dominant position by private monopolies. These issues are also being confronted by member states.

High rates of taxation coupled with the difficulties encountered by the tax administration to keep track of the rapid expansion of private enterprise have led to the emergence of a sizeable **informal sector**. According to Hungarian estimates the size of the “black” economy is between 20-30% of GDP. The growth of the informal sector, however, is believed to have stopped in recent years thanks to the introduction of new legislation and stricter controls on tax compliance.

Liberalisation

Price Regime

Price liberalisation was substantially completed by 1992. A progressive removal of subsidies supported the move to market prices: subsidies as a percentage of GDP decreased from 13% in 1989 to 4% as early as 1992. Price controls still remaining concern for the most part services supplied by “natural monopolies”, such as postal rates, train fares, telephone charges, and household gas and electricity prices. There are some concerns that the priority the government currently attaches to reducing inflation may conflict with the needs of the energy companies which were privatised at the end of 1995.

Trade Regime

Liberalisation of foreign trade began in 1987. A number of restrictive measures relating to foreign trade still exist. First, there is a global quota on the value of imports of consumer goods. This has both been reduced in scope and increased in value in recent years. Second, in order to protect domestic industry, textiles, clothing products, footwear, cars, medicines, telecommunications equipment and detergents are subject to import licensing. Third, an import surcharge of 8% was introduced in March 1995, but was phased out completely by July 1997. Fourth, licensing requirements are also in force for some export goods. With the exception of those sectors covered by the global consumer goods quota, import licensing appears to be an administrative formality in practice. In line with the Europe Agreement, quantitative restrictions are being abolished in stages.

Foreign Exchange Regime

From January 1996, the Hungarian forint became fully convertible for current account transactions. Some types of capital account transactions have also been liberalized. The central bank operates a “crawling peg” exchange rate policy, whereby the forint is devalued each month by a fixed, pre-announced rate against a basket of currencies.

Stabilisation of the Economy

Domestic

The disruption to foreign trade caused by the break-up of the CMEA was a major contributory factor to the deep recession which Hungary suffered from 1989 to 1993, during which period GDP fell by almost one-fifth. From 1994, the economy began a gradual recovery which continued in 1995 (GDP +1.5%) and 1996 (GDP +1%). Growth remains somewhat subdued and may be expected to remain so in the short-to-medium-term as Hungary still needs to contain public and external deficits and reduce its foreign debt.

Employment fell substantially during the recession, by over 1 million in a labour force of around 5 million. Job losses in the state sector were only partly compensated by private sector job growth. Withdrawals from the labour market, facilitated by relatively generous disability and early retirement schemes, have also played a significant role in reducing the level of employment. Unemployment, which had previously been concealed, rose rapidly to reach 12% of the labour force by early 1993. It has since fallen to under 10%, due to a decline in the labour force participation rate. Because of the moderate rate of growth Hungary has not yet seen rising employment.

The pattern of falling employment and a rising number of unemployed and pensioners, so that the tax base shrank while the number of claimants on public expenditures rose, was one factor in the deterioration of the public finances. This threatened to arrest Hungary's recovery from recession. The general government budget deficit reached 8% of GDP in 1994, and public debt, roughly 70% of which is owed abroad, climbed towards 90% of GDP. The unfavourable trend in the public finances was halted in 1995.

Fiscal adjustment was consolidated in 1996 and projections are for a continued improvement. This, however, is dependent on implementation of a wide-ranging reform of the public finances, notably in the area of pensions, which is currently being prepared. This reform is important not only for fiscal sustainability, but also in order to reduce the overall burden of taxation, which will help enterprise competitiveness.

Inflation had already reached double-digit levels by the late 1980s, and accelerated to peak at 35% in 1991, the deepest year of recession. Thereafter, there was a gradual deceleration, and the annual rate of price increase fell to under 20% in 1994. This declining trend was temporarily interrupted in 1995 under the impact of measures taken to reverse the deterioration in the country's finances. The fall in inflation resumed, however, in 1996. By the beginning of 1997, twelve-month inflation had fallen below 20%. This declining trend is expected to continue in the future and could lead to single figures in the coming years. A more rapid reduction of inflation appears difficult, however. More restrictive monetary policy and the ensuing increase in interest rates could slow down the economic recovery and lead to counter-acting speculative capital inflows; more active use of exchange rate policy to slow inflation could harm the competitiveness of Hungarian enterprises.

| Main economic trends | | 1994 | 1995 | 1996 |
|--|--|-------------|-------------|-------------|
| Real GDP growth rate | <i>per cent</i> | 2.9 | 1.5 | 1.0 |
| Consumer price inflation | | | | |
| annual average | <i>per cent</i> | 18.8 | 28.2 | 23.6 |
| December-on-December | <i>per cent</i> | 21.2 | 28.3 | 19.8 |
| Unemployment rate, end-year | <i>per cent</i> <i>ILO definition</i> | 10.2 | 9.3 | 9.2 |
| General government budget balance | <i>per cent of GDP</i> | -8.4 | -6.0 | -3.8 |
| Current account balance | <i>per cent of GDP</i> | -9.4 | -5.7 | -3.9 |
| Debt/export ratio | <i>per cent</i> | 267 | 186 | 144 |
| Foreign direct investment | <i>per cent of GDP</i> | 2.8 | 10.5 | 4.4 |
| <i>Source: Commission services, national sources, EBRD</i> | | | | |
| | | | | |
| | | | | |

External

Hungary entered the transition with a heavy foreign debt burden, and this continues to be the case. Despite this, and in contrast with some other countries in the region, it has always been able to meet fully its debt service obligations. A sharp deterioration in the current account balance occurred in early 1995 on top of large deficits which had already been recorded in 1993 and 1994. Decisive action by the authorities has substantially remedied the situation. In order to reassure international lenders, the central bank maintains a large stock of foreign reserves. At the end of 1996, these amounted to nearly 7 billion ECU, equivalent to more than 7 months of imports.

Hungary's emergence from recession in 1993 was accompanied by the emergence of substantial trade and current account deficits, the latter amounting to over 9% of GDP in 1994. Corrective measures taken in 1995 succeeded in reducing this gap and by 1996 the current account deficit had fallen below 4% of GDP. Aided by large flows of foreign investment linked to an acceleration of privatisation in late 1995, Hungary has succeeded in reducing the level of its outstanding foreign debt from over 24.6 billion ECU in mid-1995 to almost 20.7 billion ECU by late 1996. As a result, Hungary has been capable of borrowing on the international capital market at gradually more favourable interest rates. Nevertheless, cutting the current account deficit to levels where it can be financed by inflows of foreign direct investment (FDI), so that the level of foreign debt continues to be manageable, remains a policy priority for Hungary.

Structural Change

Foreign Trade

The growth in Hungary's trade with the EU has been one of the more remarkable developments of recent years. The dollar value of trade with the EU has approximately tripled since 1989. Combined with a decline in trade with former CMEA countries, this resulted in over 60% of Hungary's foreign trade taking place with the EU in 1996.

These changes in the direction of trade have been accompanied by shifts in the product composition of Hungary's exchanges with the EU. Exports of machinery, spare parts and semi-finished products have increased their share, while agricultural produce now is less important in Hungary's exports to the EU. Hungary's imports of machinery and capital goods from the EU have shown above average growth. Imports of consumer goods now represent a smaller share of total imports from the EU than was the case in the initial years of transition; as much of this fall was concentrated in 1995, it may be due to the impact of the import surcharge and related measures taken in Spring 1995, but the effect of an overall quota on consumer goods imports enforced by Hungary should also be taken into account.

Labour Market

Although there has been a slight decline in the total active population since 1979, this trend has increased significantly since 1990. Employment has fallen by some 1.3 million. The agricultural and industrial sectors were particularly affected. Public employment dropped, and there has been large-scale restructuring in the coal and steel industry. These reductions have been only partially compensated by the increase in private employment.

The reduced demand for labour has been to a large extent absorbed by a reduction in the active population, facilitated by generous provisions for early retirement and disability pensions.

Public Finances

Hungary has a complex system of public finances which makes it difficult to determine precisely the level of general government spending. It is estimated that the expenditure of the “consolidated government” (which does not include all local authority spending) was above 55% of GDP in 1995.

Over one-third of non-interest expenditure goes to finance a relatively generous system of social security. Low statutory retirement ages, disability pensions, and early retirement schemes result in an effective average retirement age of under 55 for both men and women. As a result, and notwithstanding some reduction in contribution rates from 1997, social security charges are very high in relation to gross earnings. But high rates of taxation, and burdensome procedures, increase the rewards to evasion at the same time as the tax administration has to try to keep track of the rapid expansion of private enterprise. This combination of circumstances entails two major consequences for Hungary’s public finances. One is the emergence of a sizeable informal economy. A second consequence is that within the formal economy, social security contribution arrears have become a significant problem. The net result of high levels of government expenditure and difficulties in tax collection has been the emergence of large budget deficits in recent years, averaging around 7% of GDP from 1992 to 1995.

However, notable progress is being made in reforming the public finances. A centralized treasury has been in operation since the beginning of 1996, and the operations of the extra-budgetary funds are gradually being incorporated into the central budget. As part of a general reappraisal of the functions of state institutions in a market economy, a comprehensive reform of the public finances is underway. Within this reform, improvements in the operation of the social security system are a key area. Plans for the reform of the pension system are now at an advanced stage; in parallel with this, the statutory retirement age is to be raised in stages for both men and women.

As a result, the budget deficit has already shown a considerable improvement, falling to an estimated 3.3% of GDP in 1996. This overall improvement, however, concealed a further expansion of the deficit in the social security system. The implementation of the planned reforms in the health and pension systems therefore remains a necessary condition for the long term sustainability of Hungary’s public finances.

Enterprise Sector: Privatisation and Enterprise Restructuring

Privatisation and restructuring have gone further in Hungary than in most other transition economies; indeed, in sectors such as telecommunications and energy supply, the scale of private involvement is greater than that in many EU member states. The scope for public investment in these sectors is severely constrained by the state of the public finances. Increasing private involvement in these key sectors should help to accelerate their modernization and improve the quality of the services they provide to the rest of the economy.

Privatisation has been a significant channel for FDI in the Hungarian economy. FDI has also taken the form of investment in “greenfield” sites. FDI benefits Hungary in a number of

ways. It has enabled the country to finance large current account deficits, without foreign debt rising to even higher levels. It provides capital needed to finance investment in modernising the economy's industrial structure. It provides incentives for local industries to invest in quality improvements, either so as to compete with the “newcomer”, or as suppliers of inputs. Finally, FDI can also generate substantial employment, both directly and indirectly.

Apart from privatisation, the private sector in Hungary has also grown at a spectacular pace through the creation of new enterprises. In comparison with a “typical” market economy, it is likely that the Hungarian enterprise sector will be characterized by a relatively large proportion of very small enterprises in the years to come.

Financial Sector

Initial reforms of the banking sector in 1987 and 1991 did not tackle the problems caused by the common state ownership of enterprises and banks. The state-owned banking sector supported loss-making state-owned companies and accumulated bad loans to a point where they impeded the development of the productive sector. The banks have been partly recapitalised with public funds, and policy now aims at recapitalisation through privatisation. The first success in this area was recorded in 1995. As a consequence of continued privatisation and the spread of partly foreign-owned (joint venture) banks, the banking sector is now mainly in private ownership.

The decline in the profitability of the banking sector came to a halt at the end of 1993. Bank profitability in 1995 was positive, though modest by international standards. The improvement can be attributed to better credit assessment and lending practices. All banks satisfy internationally accepted standards for minimum capital adequacy. Notwithstanding that some 40 banks are operating in Hungary, the banking sector remains relatively highly concentrated. This contributes to large spreads between deposit and lending rates and weak competition within the sector.

High interest rates, and wide spreads between deposit and lending rates also result from the policy of the independent central bank, the National Bank of Hungary (NBH). The NBH kept monetary policy tight in order to offset the impact of fiscal policy, which up until 1995 had tended to be relatively lax. High levels of reserve requirements paying low interest rates have arisen in part from the fact that the NBH's assets included a large non-performing loan to the budget. The transfer, from early 1997, of this debt to the state budget should improve the central bank's financial situation and make possible the reduction of the charges it imposes on commercial banks. The final result could be lower interest rates and cost of capital for corporate investment.

A weakness in the Hungarian financial system is the relatively low level of long-term finance available for enterprise lending. In 1995, short-term loans (less than one year) accounted for three-fifths of all loans to the business sector. This inevitably tends to reduce the time horizon over which enterprises can plan investment projects, although the relative shortage of long-term credits has been partially offset by enterprise borrowing from abroad and increased self-financing. Some of the factors which reduce the amount of long-term lending by domestic banks - uncertainty related to high inflation and interest rates, for example - are gradually being removed as economic stabilization strengthens. However, the availability of long-term loans depends to some extent on the amount of long-term saving which is undertaken. The planned reform of the pension system, which is expected to include a shift towards funded pensions should contribute to filling this gap in Hungary's financial system.

The Budapest Stock Exchange (BSE) began operation in 1990, with one quoted share. By early 1996, 41 companies were listed. Share capitalisation on the stock market tripled since the end of 1994 and the value of average monthly trading in shares increased by 300% over the early months of 1995. The securities market has to an increasing degree, been providing companies with an alternative source of finance to bank loans. Government bond issues dominate the bond market while the corporate bond market is not developed.

Economic and Social Development

Social Indicators

Hungary's population is estimated at about 10.2 million. The population has been falling slightly for some years now, under the impact of a declining birth rate (less than 11 per thousand population, similar to the rate in the EU) and reduced life expectancy. Average life expectancy is low - 65 years in 1991 - and has even declined in recent years. Infant mortality is high compared with the EU. The age structure of the population is also broadly similar to that in the Union, with approximately one-fifth of the population aged under 15, and one-fifth aged 60 or more.

In the longer term, the development of the Hungarian economy will require further improvements in the availability of both human and physical capital. Although Hungary has a long tradition of high education standards, the education system is currently facing a period of budgetary constraints which slows down the pace of required reforms. At primary and pre-primary level, participation rates are very high, at secondary level they are adequate whereas at higher education level they are below the EU average.

Regional Distribution of Income and Employment

Regional data on GDP per capita suggest considerable disparities. Income levels range from 206% of the national average in Budapest down to 67% in the north-eastern country of Nograd. Most of the counties with above average levels of per capita GDP are located in the western and central parts of the country.

The services sector accounts for 77% of GDP in Budapest; industry's share of GDP peaks at 40% in the central parts of the country, while the contribution of agriculture peaks at 16% and is typically highest in the east.

There are substantial differences in unemployment rates across counties. Unemployment is lowest in the western parts and in Budapest, and highest in the east of the country. Indeed, with a ratio of just 5 unemployed persons to each notified vacancy, it is possible that some sectors may be experiencing difficulties in recruiting qualified personnel. In other districts the unemployment rate is close to twice the national average. The unemployment rate for the Roma population is significantly higher than the national average.

Wide differences in unemployment rates in a relatively small country suggest obstacles to the mobility of both capital and labour. In the absence of appropriate policies, there is a risk that regional disparities in economic development may be exacerbated, as more skilled and mobile workers migrate to the capital.

2.2 The Economy in the Perspective of Membership

Introduction

The European Council in Copenhagen in 1993 defined the conditions that the associated countries in central and eastern Europe need to satisfy for accession. The economic criteria are:

- the existence of a functioning market economy;
- the capacity to cope with competitive pressure and market forces within the Union.

These criteria are linked. Firstly, a functioning market economy will be better able to cope with competitive pressure. Secondly, in the context of membership of the Union, the functioning market is the internal market. Without integration into the internal market, EU membership would lose its economic meaning, both for Hungary and for its partners.

The adoption of the *acquis*, and in particular the internal market *acquis*, is therefore essential for a candidate country, which must commit itself permanently to the economic obligations of membership. This irreversible commitment is needed to provide the certainty that every part of the enlarged EU market will continue to operate by

common rules.

The capacity to take on the *acquis* has several dimensions. On the one hand, Hungary needs to be capable of taking on the economic obligations of membership, in such a way that the single market functions smoothly and fairly. On the other hand, Hungary's capacity to benefit fully from the competitive pressures of the internal market requires that the underlying economic environment be favourable, and that the Hungarian economy have flexibility and a sufficient level of human and physical capital, especially infrastructure. In their absence, competitive pressures are likely to be considered too intense by some sections of society, and there will be a call for protective measures, which, if implemented, would undermine the single market.

The capacity and determination of a candidate country to adopt and implement the *acquis* will be crucial, since the costs and benefits of doing so may be unevenly spread across time, industries and social groups. The existence of a broad based consensus about the nature of the changes to economic policy which membership of the Union requires, and a sustained record of implementation of economic reforms in the face of interest group pressure reduce the risk that a country will be unable to maintain its commitment to the economic obligations of membership.

At the level of the public authorities, Membership of the Union requires the administrative and legal capacity to transpose and implement the wide range of technical legislation needed to remove obstacles to freedom of movement within the Union and so ensure the working of the single market. These aspects are examined in later chapters. At the level of individual firms, the impact on their competitiveness of adopting the *acquis* depends on their capacity to adapt to the new economic environment.

The Existence of a Functioning Market Economy

The existence of a market economy requires that equilibrium between supply and demand is established by the free interplay of market forces. A market economy is functioning when the legal system, including the regulation of property rights, is in place and can be enforced. The performance of a market economy is facilitated and improved by macroeconomic stability and a degree of consensus about the essentials of economic policy. A well-developed financial sector and an absence of significant barriers to market entry and exit help to improve the efficiency with which an economy works. Good progress in implementation of the Europe Agreement should help to ensure that the transition to membership of the Union is relatively smooth.

Hungary can be regarded as a functioning market economy. The early abandonment of central planning means that economic agents have relatively long experience of operating within the basic institutional framework of a market economy. In most, if not in all areas, market mechanisms are in place. Almost all transactions take place at market prices. The remaining price controls relate to services such as post, railway transport, telephones, and household gas and electricity supply, typically provided by "natural monopolies". This is similar to the situation prevailing in most member states.

Property rights appear to be well-defined and enforceable. The legal system provides a stable statutory framework in which economic actors can operate. The huge number of small and medium-sized enterprises which have been created in the 1990s is an indication that there are not significant administrative hurdles to the start-up of new activities.

The financial system, an essential feature of a modern market economy, contains some weaknesses in Hungary. These include relatively wide spreads between lending and deposit rates and a degree of concentration which weakens competition in the sector. Enterprises face some difficulty in obtaining long-term loans. However, these problems point to the importance of strengthening the institutional framework rather than to the absence of a key part of the market economy infrastructure: they reduce the efficiency with which the economy functions, but they do not prevent it functioning.

Progress has also been made in establishing macroeconomic stability, a crucial condition to allow economic agents to plan their activity and, thus, facilitate investment. While inflation and interest rates in Hungary are certainly higher than would be desirable, their development is following a relatively stable, predictable, downwards path. Moreover, the effective implementation of the “crawling peg” exchange rate has removed a potential source of uncertainty for economic actors.

The considerable public and political support in favour of market reforms has lessened the risk of any major policy reversal and further contributed to the reduction of uncertainty. This result is partly due to the government’s consensual approach to policy formulation. However, the authorities have shown themselves capable of departing from this approach when needed, as in the case of the stabilisation package introduced in 1995. Their continued commitment to macroeconomic adjustment in the face of considerable social costs and public protest has further strengthened the credibility of the Hungarian reform process.

The Capacity to Cope with Competitive Pressure and Market Forces

It is difficult, some years ahead of prospective membership, and before Hungary has adopted and implemented the larger part of Community law, to form a definitive judgement of the country’s ability to fulfil this criterion. Nevertheless, it is possible to identify a number of features of Hungary’s development which provide some indication of its probable capacity to cope with competitive pressure and market forces within the Union.

This requires a stable macroeconomic framework within which individual economic agents can make decisions in a climate of a reasonable degree of predictability. There must be a sufficient amount of human and physical capital including infrastructure to provide the background so that individual firms have the ability to adapt to face increased competitive pressures in the single market. Firms need to invest to improve their efficiency, so that they can both compete at home and take advantage of economies of scale which flow from access to the single market. This capacity to adapt will be greater, the more firms have access to investment finance, the better the quality of their workforce, and the more successful they are at innovation.

Moreover, an economy will be better able to take on the obligations of membership the higher the degree of economic integration with the Union which it achieves ahead of

accession. The more integrated a country already is with the Union, the less the further restructuring implied by membership. The level of economic integration is related to both the range and volume of goods traded with member states. Direct benefits from access to the single market may also be greater in sectors where there are a sizeable proportion of small firms, since these are relatively more affected by impediments to trade.

The authorities are making great efforts to improve competitive conditions in the Hungarian economy. The current Hungarian government has devoted considerable resources to developing a comprehensive medium-term macro- and microeconomic framework within which the necessary measures for EU membership can be identified more easily and executed more smoothly.

Reductions in social insurance charges and in the overall level of taxation, in line with reductions in public expenditure, aim to improve the competitiveness of the economy. Similarly, improved competitiveness in the financial system is to be expected as the central bank lowers its charges to commercial banks. Lower marginal rates of taxation should also reduce incentives for informal economic activities. The growth of the black economy in previous years may point to a need to strengthen public administration in some areas.

Most of the transport network suffers from a considerable backlog in investment, due to the difficult position of the public finances. Telecommunications, however, have made significant progress in recent years, as privatisation and market liberalisation succeeded in attracting sizeable foreign investment.

In industry, double-digit rates of productivity growth which have been maintained for several years now in conjunction with moderate wage rises are a sign of continued improvements in competitiveness. Moreover, the capacity to cope with competitive pressure in the future clearly depends on the strength of the current restructuring process. From this point of view, the substantial growth in the number of new small and medium-sized enterprises constitutes a positive development. Many, or most, of these are still developing, and many can be expected to fail. Nevertheless, the existence of such a large proportion of new firms is a sign that restructuring of the industrial sector in Hungary is well under way. Access to the single market is likely to be particularly beneficial for these smaller companies.

Another indication of Hungary's developing integration with the Union is offered by the proportion of Hungary's total trade that now takes place with the EU, and its rate of growth in recent years. This hints at the existence of a core of Hungarian enterprises which are already quite competitive in EU markets, and which are able to produce goods which are compatible with the demands of the single market.

In addition, foreign direct investment has been playing a large role in the Hungarian restructuring process, at times even contributing to the development of new industries, such as car manufacture. This is particularly important since FDI flows typically constitute an efficient way to transfer technology to the enterprise affected as well as to the rest of the economy through demonstration and spillover effects. FDI can also be expected to help Hungarian industry adapt to the requirements of the *acquis*. The early privatisation to foreign purchasers of key service industries such as telecommunications which Hungary achieved may be of especial significance in allowing Hungarian companies to compete more effectively.

All these considerations, therefore, point to the fact that Hungary's ability to take on the obligations of membership and cope with competitive pressure in the single market is increasing. Obviously, a number of industries are protected from foreign competition by measures which could not be maintained within the single market. However, progress made to date suggests that accession to the Union in the relatively near future would imply more an acceleration of existing patterns of restructuring, rather than posing an entirely new set of challenges to the economy.

Indeed, in the perspective of future membership of the Union, the capacity of Hungary's enterprises to adapt to changing circumstances appears as important as the level of competitiveness they have managed to achieve so far. In this regard, many of the policies aiming at the establishment of a functioning market economy also help to strengthen enterprises' capacity to adjust to competitive pressure in the single market.

In particular, the progress in reducing inflation and in bringing the budget deficit under control has contributed to a considerable reduction in interest rates, thus lowering the financial costs of investment and restructuring. Structural policies increasing the competitiveness of the domestic financial sector will also contribute to a further reduction in the cost of capital while the increased liberalisation of capital movements and the strengthening of macroeconomic stability will improve the terms of access to the international capital markets. Sustained macroeconomic and political stability will consolidate Hungary's already proven attractiveness as a destination for FDI.

The ability of individual enterprises to respond to competitive pressures in the single market depends upon their technological capabilities. From this point of view, Hungary's long tradition of good educational standards is to its advantage. Similarly, the country has a strong record in the area of R&D, although spending has more than halved since 1989. R&D activity should now be expected to increase: the already substantial private share of research expenditure should be boosted by improvements in profitability as the economic recovery gains momentum, and by continuing substantial inflows of FDI. Moreover, Hungary's participation in EU R&D programmes will strengthen this trend, and increase the competitiveness of the Hungarian economy.

Prospects and Priorities

Macroeconomic stability remains somewhat fragile in Hungary. Although inflation is slowing, and the budget and current account deficits are declining, these trends are not irreversible. The improvement in the country's finances which got underway in 1995 was crucially dependent on the confidence of the international community, in particular in the government's commitment to its announced stabilization policies. Continued confidence is essential if the positive economic trends which emerged in 1995 and continued in 1996 are to be sustained. Foreign debt service will constitute a substantial outflow of funds from Hungary for many years to come. Foreign investment helps finance these payments. FDI also contributes to continuing improvements in productivity and competitiveness.

Macroeconomic stability - meaning lower inflation and unemployment, and higher economic growth - needs to be underpinned by structural reforms, if it is to be sustainable. A number of these reforms have been identified in the preceding sections. Reform of the public sector is rightly regarded as a priority by the Hungarian authorities. This includes restructuring the activities of the state so that they better meet the needs of a market economy. This will entail development and strengthening of the legal and regulatory mechanisms needed to enable enterprises to operate efficiently.

Restoring health to the public finances is also essential. Borrowing by government to meet current expenditures drains savings which could be used for investment to enhance the competitiveness of Hungary's economy. Government borrowing reduces the funds available for investments by developing private enterprises. Public finance reform also implies a fairer distribution of taxation, in part by broadening the tax base. This should help improve enterprise competitiveness by reducing non-wage labour costs.

Improvements in transport and communications infrastructure will assist Hungary's integration with the EU, and also help companies to operate more efficiently within the country. The main problem facing the authorities in this area seems to be the cost of the investment which is needed.

Understandably, some of the features of more mature market economies are somewhat underdeveloped in Hungary. Consolidating the institutional and legal framework of a market economy is an important part of creating an environment in which the large number of small enterprises which have been established in recent years, and private enterprise in general, can flourish. Specifically, there is a need to strengthen the regulatory mechanisms which enable a market economy to function effectively.

Equally there is the need for an effective competition policy, including the appropriate regulation of monopoly producers. Having successfully privatised such firms, Hungary now needs to ensure that they operate in an appropriate regulatory/competitive environment.

The large numbers of new, small and medium-sized private enterprises which have been created in Hungary will likely have a particular need for business support services. Financing their expansion may raise special problems, given that banks may be in general somewhat inexperienced in this area of lending. It may be necessary to develop the institutional and legal infrastructure necessary to promote collateralised lending.

If enterprises are to compete effectively they need a well-trained labour force. The large scale restructuring of the Hungarian economy implies considerable changes in the nature

of employment, and in the type of skills which will be demanded by employers. The immediate challenge for the education system is to adapt to better meet these needs in areas such as new technologies, for example. Active labour market policies also have an important contribution to make to this process. Improving geographical mobility of workers means improving the operation of the housing market, possibly requiring the development of new financial institutions. Regional development policies may be needed to tackle the emergence of localised unemployment “black spots”. Overall, a comprehensive range of policies will be needed to ensure that inadequacies in the functioning of the labour market do not hamper Hungary's ability to withstand competition in the Single Market.

2.3 General Evaluation

Hungary can be regarded as a functioning market economy. Liberalisation and privatisation have progressed considerably, and there has been strong growth of new private firms. However, in order to guarantee longer-term stability, the reform of pensions and social security needs to advance rapidly. The proposed method of pension reform would have the added benefit of deepening capital markets.

Hungary should be well able to cope with competitive pressure and market forces within the Union in the medium term, provided the macroeconomic conditions for strong investment growth remain in place. Hungarian enterprises are already quite competitive in EU markets. Restructuring of industry and banks is well underway. Hungary's record of consistent commitment to steady market reforms and its ability to take difficult decisions when they are necessary is an important positive factor. It has had a consistently high level of foreign direct investment. However, the key task now is to avoid unsustainable budgetary or external deficits, which would hinder investment and restructuring and halt the recent acceleration of growth.

3. Ability to Assume the Obligations of Membership

The European Council in Copenhagen included among the criteria for accession “the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union”.

In applying for membership on the basis of the Treaty, Hungary has accepted without reserve the basic aims of the Union, including its policies and instruments. This chapter examines Hungary’s capacity to assume the obligations of membership - that is, the legal and institutional framework, known as the *acquis*, by means of which the Union puts into effect its objectives.

With the development of the Union, the *acquis* has become progressively more onerous, and presents a greater challenge for future accessions than was the case in the past. The ability of Hungary to implement the *acquis* will be central to its capacity to function successfully within the Union.

The following sections examine, for each main field of the Union’s activity, the current and prospective situation of Hungary. The starting-point of the description and analysis is a brief summary of the *acquis*, with a mention of the provisions of the Europe Agreement and the White Paper, where they are relevant. Finally, for each field of activity there is a brief assessment of Hungary’s ability to assume the obligations of membership on a medium-term horizon.

3.1 Internal Market Without Frontiers

Article 7a of the Treaty defines the Union’s internal market as an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured. This internal market, central to the integration process, is based on an open-market economy in which competition and economic and social cohesion must play a full part.

Effective implementation of the liberties enshrined in the Treaty requires not only compliance with such important principles as, for example, non-discrimination or mutual recognition of national regulations - as clarified by Court of Justice rulings - but also concomitant, effective application of a series of common specific provisions. These are designed, in particular, to provide safety, public health, environmental and consumer protection, public confidence in the services sector, appropriately qualified persons to practise certain specialist occupations and, where necessary, introduction or coordination of regulatory and monitoring mechanisms; all systematic checks and inspections necessary to ensure correct application of the rules are carried out on the market, not at frontier crossings.

It is important to incorporate Community legislation into national legislation effectively, but even more important to implement it properly in the field, via the appropriate administrative and judicial structures set up in the Member States and respected by companies. This is an essential precondition for creating the mutual trust indispensable for smooth operation of the internal market.

This chapter must be read in conjunction with, *inter alia*, the chapters on social policy, the environment, consumer protection and sectoral policies.

The Four Freedoms

A step-by-step approach is being taken to absorption of the *acquis* by the candidate countries:

- The Association Agreement between the Community, its Member States and Hungary entered into force on February 1994. With regard to the four freedoms and approximation of legislation, the Agreement provides, in particular, for immediate or gradual application of a number of obligations, some of them reciprocal, covering, in particular, freedom of establishment, national treatment, free trade, intellectual property and public procurement.
- The Commission's 1995 White Paper (COM (95) 163 final), guidelines intended to help the candidate countries prepare for integration into the internal market gives a closer definition of the legislation concerned. It identifies the "key measures" with a direct effect on the free movement of goods, services, capital and persons and outlines the conditions necessary in order to operate the legislation, including the legal and organisational structures. Twenty-three areas of Community activity are examined, dividing the measures into two stages, in order of priority, to provide a work programme for the pre-accession phase. The Technical Assistance and Information Exchange Office (TAIEX) was set up with the objective of providing complementary and focused technical assistance in the areas of legislation covered in the White Paper. A legislative database has recently been established by the Office.
- The candidate countries will have to implement all the *acquis*. The "Action plan for the single market" submitted to the Amsterdam European Council gives details of the priority measures necessary to make the single market work better between the Fifteen in preparation for introduction of the single currency. This will inevitably entail changes to the *acquis*.

General Framework

Whatever their field of activity, undertakings must be able to operate on the basis of common rules. These are important since they shape the general framework within which economies operate and, hence, the general conditions of competition. They include the rules on competition (on undertakings and State aid) and tax measures discussed elsewhere in this Opinion, the opening-up of public works, supply and service contracts, harmonisation of the rules on intellectual property (including the European patent), harmonisation of the rules on company law and accountancy, protection of personal data, transfer of proceedings and recognition of judgments Article 220 EC Conventions).

Descriptive Summary

Public procurement is regulated by a 1995 law and its implementing regulations, whereas concessions are regulated by 1991 legislation. An independent agency, the Public Procurement Council, placed under the supervision of Parliament, is in charge of managing various aspects of public procurement policy.

Hungary has already adapted its legislation concerning intellectual and industrial property. The protection of patents is based on the Munich convention. Protection of copyrights appears to meet most of EU requirements. Hungary is a member of TRIPs (Trade Related Aspects of Intellectual Property Rights).

Company law is largely regulated by the Company Act of 1988. A number of different types of entity are recognised under Hungarian law, including companies limited by shares and limited liability companies. As at 30 April 1996 there were over 94,000 companies registered. Companies may issue shares and there are provisions for the protection of shareholders in that event. Minimum capital requirements are laid down by law and there are provisions equivalent to the protection of authorised capital. Creditors also enjoy a certain level of protection. A Register of Companies is maintained at the Court of Registration, which contains the basic information about each company. There is in addition a computer database making public company data widely available.

With regard to accounting, the Accounting Act (1991) provides the basic framework for the annual accounts of companies. A National Accounting Committee has been created to develop principles of accounting and propose changes to existing decrees as well as new decrees. Rules for consolidated accounts are included in the Accounting Act. The authorisation of auditors is based on provisions in the Accounting Act, a Government Decree and a Decree from the Ministry of Finance. No authority directly supervises the auditors at present. The conditions of operation are checked by an expert panel appointed by the Minister of Finance.

Article 59 of the Hungarian Constitution provides for the protection of the private life of all citizens. Based on this article is the law of 27 October 1992 which establishes the institutional framework for the protection of data, including an independent supervisory authority. This law has been complemented by some sectoral provisions, such as the law on the health care sector adopted in May 1997. The Hungarian Parliament has authorised in May 1997 the ratification of Council of Europe convention No 108 for the protection of personal data. It is planned to deposit the instrument of ratification later in 1997.

Current and Prospective Assessment

The Hungarian legislation on public procurement is largely compatible with the EC directives in this field. It contains all the fundamental principles of the EC public procurement rules. All six Directives in this sector referred to in the White Paper are incorporated into Hungarian law, although in all cases only partially. In particular, the Hungarian legislation does not fully meet all the requirements of EC Directives regarding the utilities sectors (namely energy, telecommunications, water, and transport).

Although it is too soon to judge adequately the effectiveness of the public procurement procedures in practice, the legal remedies are rapid, effective, applied by the courts, and are in line with most of the requirements of the relevant directives. The Public Procurement Council, an independent agency, seems to meet the infrastructure requirement for a correct implementation of the public procurement legislation. In March 1997 it submitted to Parliament the first report on the activities carried out during the period November 1995 to end December 1996. At present, Hungarian firms (or EU firms with subsidiaries located inside Hungary), obtain preferential treatment as regards the award of public procurement contracts.

Firms located in the EU will get equal access only after the expiry of the transition period set out in the Europe Agreement. Further amendments to the 1991 Act on public procurement are envisaged to be completed in 1997. Complete harmonisation in the field of public procurement is expected to be achieved no later than the date of accession.

Significant progress in the protection of intellectual and industrial property has already been achieved. In the view of the Hungarian authorities, the protection of patents is in full accordance with the European Patent Convention, to which Hungary has applied for membership. In the area of pharmaceuticals, further efforts are nevertheless required. A policy paper on copyright and neighbouring rights, due out shortly, will propose further measures which will bring Hungarian legislation in this area into full conformity with EU legislation. A EU-compatible law on trade marks was adopted in March 1997. Regarding copyright on radio and television broadcasting, the existing law has to be significantly adapted to make it compatible with EU legislation and the necessary administrative structures need to be strengthened to ensure that the legislation is adequately enforced. Piracy is still a problem in Hungary.

A comprehensive review of the Company Act is scheduled for 1997 which will include any measures still required to achieve full compatibility with the First, Second, Third and Twelfth Directives. It is understood that preparatory work has begun on legislation corresponding to the Eleventh Directive (at present, foreign companies are not able to establish branches in Hungary) and this is due to be in force in the first half of 1998.

Hungary recognises that some differences remain between Hungarian law and the Accounting Directives. It intends to remove these through amendments, but no timetable has yet been given. A law on auditing is being prepared at the moment and it will implement the substance of the 8th Directive. The creation of a Chamber of Auditors is under way. Certain transitional problems are in evidence relating to the implementation in practice of the new rules, including a shortage of qualified accountants and auditors, but these can be solved in the medium term. Although a National Accounting Committee has been created and appears to be giving sufficient reassurance, no independent standard-setting body has been set up.

The imminent accession of Hungary to Council of Europe Convention no. 108 indicates that Hungarian legislation on data protection is in line with European standards as laid down in that Convention. Moreover, an independent authority competent to supervise the implementation of the legislation has already been established. Although Hungary's legislation is fairly close to the EC framework Directive, it is not yet fully in line with it. No new legislation is yet announced in this respect.

Hungary has recently been invited by the States parties to the Lugano Convention on jurisdiction and enforcement of judgements in civil law and commercial matters to adhere to that Convention. Such development gives a good indication of confidence in Hungary's judicial systems.

Conclusion

Hungary has already taken on the most important directives of the sectors indicated above. Implementation of the provisions of the Europe Agreement and the White Paper's recommendations covering the sectors reviewed has generally been good.

Further work is required, notably in the area of intellectual property and public procurement. Regarding intellectual and industrial property, the legislation which has already been adopted requires enforcement. Efforts of a lesser degree are required in the fields of company law, accounting and data protection, to bring the Hungarian legislation fully into line with the EC legislation. In these three fields, assuming the present harmonisation plan proceeds and is complemented for accounting and data protection, there should no be major difficulties.

Free Movement of Goods

Free movement of goods can be achieved only by removing measures which restrict trade – not only customs duties and quantitative restrictions but all measures with equivalent, i.e. protectionist, effect, irrespective of whether or not they are specifically aimed at domestic or imported products. Where technical standards are not harmonised, the free movement of goods must be ensured by applying the principle of mutual recognition of national rules and accepting the rule that national specifications should be no more stringent than is required to achieve their legitimate objectives. This rule was established in the *Cassis de Dijon* judgment.

For the purpose of harmonisation, the European Community has developed the “New Approach” which introduces an approach carefully balanced between government and private autonomous bodies and in which European Community legislation and European standards play a distinct complementary role. Thus, instead of imposing technical solutions, European Community legislation is limited to establishing the essential requirements which products must meet. Products manufactured in accordance with European standards are presumed to meet such essential requirements, but European standards are not the only way to prove such conformity. The “New Approach” works in conjunction with the “Global Approach” on product certification which governs the apposition of the “CE Mark” on the product. For other products such as pharmaceuticals, chemicals, motor vehicles, and food products, European Community directives follow the traditional regulatory pattern of providing fully detailed rules.

The free movement of goods also dictates that a number of Community harmonisation measures be transposed into national law. Implementation of health and safety harmonisation rules is particularly important and requires the establishment of appropriate mechanisms and organisations, both for businesses and the authorities.

Two of the “horizontal” directives essential to smooth running of the single market are the Directive on general product safety and the Directive on liability for defective products. The regulations concerning general product safety are covered in the section on consumer protection.

The rules on agricultural products (compliance with veterinary and plant-health standards) are explained in detail in the section on agriculture.

Descriptive Summary

In compliance with the provisions of the Europe Agreement, levels of tariff protection in Hungary are low. A legal framework has already been established for the removal of the few discriminatory measures still in place, based to a large extent on the implementation of the Europe Agreement. All prices have been liberalised, with the exception of public utilities (postal services, railways, telecommunications), and household gas and electricity prices.

With regard to technical barriers to trade, the process of alignment is proceeding rapidly in the foodstuffs sector. As regards New Approach directives, some delays seem to be occurring. In the pharmaceutical sector, only legislation relating to veterinary medicinal products is currently fully approximated.

In the field of product conformity and standardisation, efforts are being made to enhance both metrology and the conformity assessment infrastructure. The activities of the Hungarian Standards Institution (1995 legislation) include certification of quality assurance systems and products. Although the application of national standards is voluntary, the law provides for individual legislation to make national standards mandatory.

Current and Prospective Assessment

Hungary has speeded up the resolution of a number of remaining obstacles to trade over the last two years, and has a good track record for meeting the deadlines established under the Europe Agreement. It has made considerable progress towards establishing the conditions for the free movement of goods. It has already liberalised its price, trade and foreign exchange regimes, and put in place basic legal and commercial rules ensuring legal security and transparency for private economic operators. Nonetheless, further efforts are required for the full adoption and implementation of the *acquis*.

There remain a number of restrictive measures relating to foreign trade, including a global quota on the value of imports of consumer goods, the regimes of export and import licensing in a number of sensitive sectors (for example, clothing, footwear, cars, medicines and telecommunications equipment). A new set of pan-European rules of origin which favour trade and free circulation entered into force on 1 July 1997. The list of EU products under mandatory certification when imported into Hungary has been reduced and should soon be aligned with EU standards.

Concerning the free movement and safety of industrial products, full compliance with the White Paper recommendations is expected by 1998. A number of technical directives has already been introduced into the Hungarian legal system. The alignment process is making progress for New Approach directives and is virtually completed in the foodstuffs sector. In the automotive sector, Hungary has announced plans to transpose the framework directive as well as the separate technical directives for the European type-approval system into national law by the end of 1997. On pharmaceutical and chemical products legislative alignment is progressing at a slower pace than previously announced.

With regard to the necessary structures to apply the *acquis*, Hungary has witnessed the massive foreign investment in some sectors as a stimulation for adjusting the necessary regulatory framework and structures. An appropriate legal framework has been created providing for a standardisation activity geared towards voluntary and internationally oriented standards, the establishment of a national accreditation system, including extensive use of EN 45000 standards and international guidelines, and certification and inspection activities basically in line with EU principles.

The national Hungarian Standards Institution is an institution of public interest which also operates in the field of product certification. It is an affiliate member of the European Committee for Standardization (CEN) and the European Committee for the Coordination of Electrical Standards (CENELEC).

An Act on civil liability for defective products came into force on 1 January 1994, which is in complete agreement with EC legislation on nearly all important points.

In the areas subject to national rules and not covered by Community harmonisation, there is too little information available to assess whether Community legal principles on the free movement of goods are properly applied in Hungary. This situation is explained in particular by the fact that the reporting procedures which form part of the internal-market machinery are not yet operational and so cannot be used in the pre-accession period. The most important instruments in this connection are: Directive 83/189, requiring governments to report draft national technical standards and regulations; Decision 3052/95 on measures derogating from the principle of the free movement of goods; procedures by which complaints can be submitted to the Commission; and Article 177 of the Treaty, enabling Member States to ask for preliminary rulings from the Court of Justice. An assessment of whether Hungary complies with the principle of mutual recognition would require more information on its national rules, and on administrative practices, which can have an effect on product sales.

Conclusion

Significant progress has been made. Hungary is progressively taking on the *acquis* communautaire related to the free movement of goods, and has already taken on the most important directives. Implementation of the provisions of the Europe Agreement and the White Paper's recommendations has generally been good.

Further work is required in the areas of standards and certification. Provided current efforts are maintained, free circulation of goods should be made possible in the medium term.

During this period, special attention will have to be paid to type-approval of motor vehicles, tractors and motorbikes, the procedures for authorising market placement and the rules on labelling. The Hungarian authorities will also have to ensure that national legislation in areas not covered by Community harmonisation is not likely to act as a barrier to trade, notably by verifying that the measures in force are proportionate to the objectives they pursue.

Free Movement of Capital

As far as the obligations of Hungary are concerned, the Europe Agreement establishes the principle of the free movement of capital between Hungary and the EU. As far as the obligations of Hungary are concerned, this applies from the entry into force of the EA as regards direct investments made by companies already established in Hungary; as regards branches and agencies of Community companies (as well as the self-employed) gradually during the transitional period.

The White Paper highlights the link between the free movement of capital and the free movement of financial services. It suggests a sequence of capital liberalisation starting from long-term capital movements and those linked to commercial transactions to short term capital.

Descriptive Summary

Hungary's ability to attract Foreign Direct Investment (FDI) has been impressive: Hungary has the largest inflow of FDI in the region, attracting 40% of the total FDI in Central and Eastern Europe. The total amount of FDI reached approximately 13.3 bn USD for the period 1990-1996. This has helped to reduce the foreign debt whilst contributing positively to the restructuring, privatisation and modernisation of Hungarian industry. Capital inflows, in addition to FDI, have been significant, as the long term government securities market is open to foreign investors, and the HUF yields are sufficiently attractive to induce portfolio investment flows. Also, substantial private sector borrowing has contributed to the net inflow of capital. These developments have been in part due to Hungary's liberalised policies concerning the free movement of capital. Hungary joined the OECD in May 1996.

Current and Prospective Assessment

Hungary has accepted the requirements of Article VIII of the IMF Articles of Agreement, providing for currency convertibility for current transactions from 1 January 1996.

Significant progress towards the liberalisation of capital movements was made with the entry into force of a new Foreign Exchange Act on 1 January 1996. The new law partially liberalised long-term capital movements but maintained the obligation for authorisation for short-term capital transactions. The most important changes were the removal of restrictions on outward direct investment, personal capital movements and granting of trade credits.

Further relaxation of restrictions on portfolio investment by residents abroad were introduced from 1 July 1996. Also from 1 January 1997 the acquisition by residents of shares and bonds of OECD based enterprises with investment grade rating was liberalised.

The underlying principle for further capital liberalisation remains the same as that followed so far: first transactions with longer maturities, then transactions with shorter maturities. Based on the above principles, the further opening of the capital account is planned as follows :

- After January 1, 1998, the establishment of branches of foreign companies in all sectors will be allowed.
- Within 1 to 2 years, medium and long-term capital transactions will be liberalised.

Full liberalisation of capital transactions (White Paper, stage II) can be expected by the end of the decade.

Conclusion

The Hungarian government's efforts to liberalise its capital markets have met with considerable success in several areas. The provisions of the Europe Agreement as well as the recommendations of the White Paper have largely been implemented

Further efforts are still required, though, especially in liberalising outward capital movements and removing investment restrictions on institutional investors (e.g. insurance companies.)

Free Movement of Services

The basis of the free movement of services is the prohibition of discrimination, in particular on grounds of nationality, and rules on the alignment of divergent national legislation. These rules often concern both the right of establishment, which comes under the heading of the free movement of persons, and the freedom to provide services. Their implementation implies the establishment of administrative structures (banking control boards, audio-visual control authorities, regulatory bodies) and greater cooperation between Member States in the area of enforcement (mutual recognition arrangements).

A substantial amount of the legislation applicable to the free movement of services relates to financial services. It also concerns the problems relating to the opening-up of national markets in the sectors traditionally dominated by monopolies, e.g. telecommunications and, to a certain extent, energy and transport. These subjects will be dealt with in the sections of the Opinion specifically referring to them.

Descriptive Summary

There is a certain concentration in the market because the five biggest banks represent (end 1996) just under 60% of total assets.

A new Banking and Financial Market Law, which entered into force at the beginning of 1997, anticipates a structure for credit institutions based on EU requirements.

The current legal framework for the banking sector provides for minimum capital requirements, solvency ratios, deposit guarantee rules, provisions against money laundering, and other provisions. These are consistent with the *acquis*. The EC First Banking Directive, the Own Funds Directive, the Money Laundering Directive, the Large Exposure Directive, and most other elements of the core *acquis* have all been largely approximated. At present, only credit institutions which are established in Hungary and registered according to national law can operate in Hungary, even if they are owned or controlled by foreign interests.

The Budapest Stock Exchange was re-opened in 1990. A future market was opened in April 1995. Credit institutions and insurance undertakings are only allowed to carry out "cash activities".

upervision of banks and capital market institutions functions in a similar way to that in the EU; it is carried out by one body, the Hungarian Banking and Capital Market Supervisory Authority. This Authority is charged with co-operating with the foreign correspondent authorities for supervisory purposes. It is bound to secrecy, on a reciprocal basis, with regard to the supervisory information received from foreign authorities. Although the Hungarian financial market is not yet as developed as those in the EU, progress has been impressive.

Of the 19 insurance companies presently operating in Hungary (including the two former state monopolists), 15 have foreign capital participation, including the largest insurance company. The Hungarian insurance market is open to foreign participation and ownership. Under the present regulations, neither EU or non-EU undertakings with their head offices outside of Hungary may open a branch in Hungary.

Insurance companies may not pursue as in the EU any other business activities outside of the sphere of insurance, and must submit a confidential internal report to the State Insurance Supervisory Authority which evaluates the activities of the company. The minimum guarantee fund is one-third of the solvency margin, as in the EU. However, the requirements for the minimum guarantee fund are even stricter than those of the EU.

Current and Prospective Assessment

Since the bank's consolidation scheme has been completed, State-owned banks do not enjoy any preferential treatment. The bank privatisation programme is due to be completed by the end of 1997, when the government share of bank equity will be limited to 15%.

Considerable progress has been made in adopting the *acquis* related to financial services (banks) particularly with the new Banking Law adopted in 1996. The only major directive not yet sufficiently approximated is the Capital Adequacy Directive, since Hungarian capital adequacy regulations are still based on credit risk alone (it is planned to extend the current regulations to cover market risk within one or two years). The new banking law is largely compatible with the *acquis*, but its practical implementation and functioning needs monitoring.

Free establishment of foreign banks' branches is envisaged as from 1 January 1998, on the basis of the OECD agreement.

Regarding the financial market, the legislative framework is now largely in compliance with EU criteria concerning official stock exchange listing, public offers of transferable securities, insider dealing, disposal of major holdings, and investment services in the securities field. The directive on investment funds (so-called "UCITS") has only been partially implemented by a 1991 law. Investment fund management may be carried out only by companies licensed by the Supervisory Authority, as in the EU. The capital adequacy directive is also applicable to investment firms.

The Hungarian authorities have largely succeeded in their legislation on life and non-life insurance into line with the EC Directives of the first and second generation. In some areas, the Insurance Act of 1995 exceeds the requirements of the first generation of EU directives (for example, in the fields of approval of policy conditions and insurance premia), while not meeting the third generation of objectives, such as the total abolition of prior approval of premia. The Hungarian government has indicated that they wish gradually to implement changes to achieve full approximation to EU regulations and directives, primarily in the interests of their customers.

Conclusion

Important progress has been achieved. The *acquis* in this sector (23 key White Paper measures) has already been largely transposed. Full free establishment in the areas of banking and insurance have still to be adequately introduced in the sectors' legislative frameworks and duly implemented. Under the present regulations, neither EU or non-EU undertakings with their head offices outside of Hungary may open a branch in Hungary. However, in 1997 Hungary intends to establish the general legal background to rectify this situation. The establishment of branches by foreign companies is expected to be permitted from 1998.

Provided harmonisation proceeds as planned, no major difficulties are foreseen in achieving full approximation in relation to free movement of services. With the completion of the privatisation process in the banking and in the insurance sectors scheduled for 1997/98 and given the relatively large role of foreign (mainly European) investors in these two sectors, it is likely that the Hungarian financial services sector will be able to operate competitively in a wider single market after accession.

Free Movement of Persons

The free movement of persons encompasses two concepts with different logical implications in the Treaty. On the one hand, Article 7a in Part One of the Treaty on 'Principles' mentions the concept in connection with the establishment of the internal market and implies that persons are not to be subject to controls when crossing the internal frontiers between the Member States. On the other hand, Article 8a in Part Two of the Treaty on 'Citizenship of the Union' gives every citizen of the Union the individual right to move and reside freely within the territory of the Member States, subject to certain conditions. The abolition of frontier checks must apply to all persons, whatever their nationality, if Article 7a is not to be meaningless. While the rights deriving from Article 8a apply in all Member States, those stemming from Article 7a have not yet been fully applied throughout the Union.

(a) Free Movement of Union Citizens, Freedom of Establishment and Mutual Recognition of Diplomas and Qualifications

The Europe Agreement provides for the non-discriminatory treatment of workers that are legally employed (as well as their families). It covers the possibility of cumulating or transferring social security rights, and encourages Member States to conclude bilateral agreements with Hungary on access to labour markets. During the second phase of the transitional period, the Association Council will examine further ways of improving the movement of workers.

The White Paper considers the legislative requirements in order to achieve a harmonious development of the labour market, whilst simultaneously preventing distortions of competition.

The free movement of workers is one of the fundamental freedoms enshrined in the Treaty; freedom to practise certain professions (e.g. in the legal and health fields) may, however, be subject to certain conditions, such as qualifications. Depending on the case, these may be dealt with through coordination or by applying the principle of mutual recognition. Freedom of establishment is also guaranteed under the Treaty and covers the economic activity of self-employed natural persons and companies.

The free choice of place of residence may thus be subject to minimum conditions as to resources and health insurance where the person does not exercise a profession in the country concerned.

Descriptive Summary

Under Hungarian law, access to employment for foreign nationals with relevant permits cannot be prohibited on grounds of nationality alone. In certain circumstances, however, preference criteria for nationals may be imposed by statutory or collective instruments. Since the beginning of the 1990s, Hungarian legislation has imposed restrictions on the annual quota of possible immigration permits in order to boost employment of Hungarian nationals.

Foreign nationals may only have access to employment if they have a work permit, which is subject to certain conditions. The current regulation also requires visas for the families of foreign workers.

Provided a migrant worker has the appropriate residence permit, he/she is eligible for social security. Members of the family of the foreign worker have access to education although, at least for higher education, the registration fees are higher for foreigners than for nationals. Members of the a worker's family do not acquire a right to work.

A substantial part of the *acquis* concerning the mutual recognition of diplomas and qualifications (55 directives) has already been taken on board and full approximation is expected in the medium term. Negotiations on the mutual recognition of diplomas are due to start soon, and in particular Hungary has expressed an interest in including in the discussions the medium-level professional qualifications issued by vocational training centres.

Current and Prospective Assessment

Hungarian legislation already recognises the principle of non-discrimination between nationals and foreigners legally residing in the country. Therefore, the application of the principle of equal treatment to those EU workers already legally residing in Hungary should not be a problem.

Training, where co-ordinated by directives for seven professions, is broadly in line with the *acquis*, although some adaptation is still necessary. Professional structures (such as professional chambers or associations) are in place for many professions, but these will probably need to be reinforced in the future. Integration with EU professional associations is developing well (for example engineering diplomas already meet the minimum European standards).

Conclusion

The necessary structures in this area seem to be in place, but it is hard to assess their real effect and enforcement. Hungary is aware of the outstanding issues that need to be resolved with regard to the free movement of persons. From a technical point of view, adaptations of regulations will be necessary in the medium term.

(b) Abolition of Checks on Persons at Internal Frontiers

The free movement of persons within the meaning of Article 7a of the EC Treaty, i.e. the abolition of checks on all persons, whatever their nationality, at the internal frontiers has not yet been fully implemented in the Union. Doing away with checks on persons is conditional on the introduction of a large number of accompanying measures, some of which have yet to be approved and implemented by the Member States (see separate section on Justice and Home Affairs). However, that objective has been achieved by a limited number of Member States in accordance with the Schengen Convention (seven Member States already apply it and another six are working towards implementation).

The draft Treaty aims to make that objective easier to achieve within the Union by including a new chapter on Freedom, Security and Justice and incorporating the Schengen Agreement into the Treaty.

Hungary has stated its intention to become party to the Schengen Agreement. It has called for institutional and technical cooperation notably in the field of border control, to the upgrading and modernisation of which significant financial resources are being devoted.

General Evaluation

1. Hungary's progress in the implementation of legislation relating to the White Paper is summarised in the annex. According to the table, Hungary considers that by 30 June 1997 it will have adopted national implementing legislation for 579 of the 899 directives and regulations in the White Paper. That figure covers provisions for which Hungary considers it will have adopted implementing legislation or which it will have checked for compatibility with Community rules and does not prejudge actual compatibility as such, on which the Commission is not able at this stage to state an opinion.

2. For most of the areas linked with the internal market and in particular public procurement, intellectual property, company law and accountancy rules, product liability and financial services, the Community legislative base is almost in place. Legislation has been adopted in full or in part to implement most of the measures according to the

Hungarian authorities' assessment, though the Commission cannot at this stage express a position on its total compatibility with Community law. Legislative efforts are still necessary to achieve full conformity with the *acquis*.

3. Despite the efforts made, the real progress made in taking over texts adopted very recently must be accompanied by specific implementing measures and by the establishment of an efficient administrative structure. Hungary has certain infrastructure which works satisfactorily (e.g. in public procurement, the appeal procedures provided for in the directives are applicable and appeals are made to the courts), but major efforts have still to be made in a number of areas, in particular on standardisation, including on the technical structures needed for implementing the "new approach".

As things currently stand, the Commission cannot yet express an opinion on the capacity of companies, particularly small and medium-sized businesses, to implement the *acquis* .

4. Leaving aside certain specific aspects relating to agriculture, checks at the internal frontiers of the Union can only be abolished once sufficient legislative harmonisation has been achieved. This calls for mutual confidence, based in particular on sound administration (e.g. the importance of safety checks on some products at the place of departure). As far as goods are concerned, the completion of the internal market on 1 January 1993 was only achieved by doing away with all the formalities and checks performed by the Member States at the internal borders of the Union. In particular these checks covered technical points (particularly product safety), veterinary, animal-health and plant-health matters, economic and commercial matters (e.g. prevention of counterfeiting of goods), security (weapons, etc.) and environmental aspects (waste, etc.). In most cases, the abolition of checks was only made possible by the adoption and application of Community measures harmonising the rules on movement and placement on the market (particularly as regards product safety) and, where applicable, by shifting the place where controls and formalities are conducted to within the Member States or on their markets (in particular as regards VAT and excise duties, veterinary and plant-health checks, and the collection of statistics). A section of Hungary's present borders will become the Union's external frontier and this means border checks will need to be stepped up (see separate section on customs).

In view of the overall assessment that can be made of progress achieved to date and the rate at which work is advancing in the various areas concerned, it is difficult at present to put a time-scale on Hungary's ability to take over and implement all the instruments required to abolish internal border checks and to transfer those checks to the Union's external frontier.

5. Hungary has already adopted significant elements of the *acquis* relating to the single market. However, the Commission is not yet able to take a position on every measure whose transposition has been reported by Hungary. In many areas, enforcement needs to be strengthened. Provided that current efforts continue, it can be expected that in the medium term Hungary will have adopted and implemented the legislation and made the necessary progress on the mechanisms of enforcement, in order to be able to participate fully in the single market.

Competition

European Community competition policy derives from Art. 3 (g) of the Treaty providing that the Community shall have *a system ensuring that competition in the internal market is not distorted*. The main areas of application are anti-trust and state aid.

The Europe Agreement provides for a competition regime to be applied in trade relations between the Community and Poland based on the criteria of articles 85 and 86 of the EC Treaty (agreements between undertakings) abuses of dominant position) and in article 92/state aid) and for implementing rules in these fields to be adopted within three years of the entry into force of the Agreement. Furthermore it provides that Hungary will make its legislation compatible with that of the Community in the field of competition.

The White Paper refers to the progressive application of the above provisions and those of the Merger Regulation (4064/89) and of Art. 37 and 90 (Monopolies and Special Rights).

Descriptive Summary

The New competition law “on the Prohibition of Unfair and Restrictive Market Practices” was adopted in June 1996 by Parliament and entered into force on 1 January 1997. It represents a significant step towards achieving the necessary approximation of legislation in the field of *anti-trust*.

Block exemptions on vertical restraints similar to those applicable in the Community are under preparation and are expected to be adopted in 1997.

In order to enforce competition laws, the *Office of Economic Competition (OEC)* was established in 1991. The procedural rules, in particular due process and third party rights, to a large degree satisfy the requirements as concerns approximation of legislation.

In order to be in line with the current and foreseeable situation in the EU as regards *sectors subject to monopolies or dominant positions* such as telecommunications, transport, postal services and energy, necessary measures have already been taken; others are under preparation.

In the field of *state aid* the monitoring authority on state aid has been established within the Ministry of Finance. Rules for its functioning has not yet been clearly established, in particular the powers of the monitoring authority to collect all information necessary to assess the compatibility of state aid granted by all aid granting authorities.

A first aid inventory has been drawn up which represents a step towards creating the transparency required in the granting of state aid. However, it is not complete as it includes solely aid financed by the State budget, not aid financed by other public

authorities, and as it does not provide sufficient information on the objective of the aid granted.

Export aid is granted in Hungary which is incompatible with the Europe Agreement.

Current and Prospective Assessment

With the new Competition Law which entered into force on 1 January 1997 and the foreseen adoption of block exemptions equivalent to those applicable in the Community, Hungary has gone a long way towards satisfying the requirements as regards approximation of legislation in the field of *anti-trust*. Further refinements may be needed in the field of procedures and merger control and as regards *special and exclusive rights*. The staff of the Hungarian competition office seems sufficiently skilled to ensure a credible enforcement of the competition law.

The procedural rules for the monitoring of *state aid* need to be improved to achieve compliance, and the aid inventory developed in order to ensure the necessary transparency.

It should be added, moreover, that certain aid measures seem to be contingent upon export performance which is clearly not compatible with the Europe Agreement. Moreover, state aid seems to be granted through indirect forms of state aid, such as tax reliefs, debt write-offs and tax arrears. These measures constitute operating aid which are only allowed under very strict conditions. Due to the lack of transparency it is as yet unclear whether the conditions for granting operating aid are complied with.

In addition to the adoption of legislation sufficiently approximate to that of the EU, *credible enforcement* of competition law requires the establishment of well functioning anti-trust and state aid monitoring authorities. It requires moreover that the judicial system, the public administration and the relevant economic operators have a sufficient understanding of competition law and policy.

Conclusion

With the adoption of the new Competition Act the progress in approximation of legislation is significant in the field of *anti-trust* and the skills of and the efforts made so far by the Hungarian anti-trust authority represent a significant step forward for a credible competition law enforcement.

In the field of *state aid*, however, more needs to be done to achieve the degree of transparency required. The role and powers of the monitoring authority need to be clearly defined to ensure the compatibility with the Community rules of the aid granted. A considerable effort will be necessary to fulfil the requirements in the field of state aid over the medium term. Close cooperation with the Commission will be necessary in this field.

3.2 Innovation

Information Society

Present Situation

The economic and social effects made possible by the combination of information technology and telecommunications are great. In Hungary these possibilities were neglected before 1989 although general education was a priority. The result is that the size of the information technology market has recently spurred beyond normal expectation deduced from GDP per capita. The number of host computers on the Internet (2.9 per 1000 inhabitants) as a relative measure of development towards the information society (IS), suggests that Hungary has passed the EU average of two years ago. If Internet connections follow the same pattern of growth, the telecommunications infrastructure, which is at present about six years behind the EU average, may remain a brake on IS developments.

Conclusion

Because of the positive approach to telecommunications liberalisation combined with the high level of the national education system. Hungary can be expected to realise the potentialities of the Information Society earlier than the average CEEC.

Education, Training and Youth

Articles 126 and 127 of the EC Treaty provide that the Community shall contribute to the development of quality education and implement a vocational training policy aimed at promoting the European dimension in education and at enhancing industrial adaptation and the responsiveness of the labour market through vocational training policies.

The Europe Agreement provides for co-operation in raising the level of education and professional qualifications. The White Paper includes no measures in this field.

Descriptive Summary

Hungary's spending on education amounts to 6.6 % of GDP. and accounts for 8.9 % of the state budget's expenses.

The Hungarian educational system is structured in a similar way to most western European countries. It includes, at present, 9,500 schools and 89 higher education institutions, of which 30 are universities and 59 colleges. There are 2 million pupils, 186,000 teachers and 180,000 students in Hungary. Hungary has a long tradition of excellent education facilities. The Hungarian educational system already met very high standards before the transformation. According to 1993 data, only 2.3% of the labour force has completed less than full primary education, 25.8% has achieved the general school certificate, 27.2% has a skilled workers' qualification, 29.9% has obtained a baccalaureate and 14.8% has a higher education diploma. More recently, Hungary has been developing vocational training with a view to increase labour market mobility and thus assist economic transition and address unemployment.

The economic downturn since 1990 and the resulting drop in government revenue (itself an explanation for the important wage differences between the public and the private sector, which creates an incentive for the best teachers to leave the public sector) resulted in a potential threat to these standards.

The Tempus programme has contributed to the achievement of the goals of higher education reform and created the basis for cooperation with the EU higher education institutions.

About 15% of the total population of Hungary is aged between 15 and 25. Hungarian youth organisations have been involved in European youth activities since 1990. From 1995, youth co-operation was included in the Youth for Europe programme.

Current and Prospective Assessment

Hungary enjoys a solid background in education and training. The institutional reforms and the development or review of curricula should support education in those professional areas which contribute directly to accession. The development of European Studies, the introduction of new courses and study programmes in the regulated professions, the development of multi- and interdisciplinary professional profiles, the application of modern technology, and the establishment of quality assurance systems are challenges facing Hungary's higher education system.

There has been progress in recent years in the development of new curricula and establishing new programmes at graduate and doctoral level, especially in the fields of technology development and transfer, Business, Management and SME development, and Agriculture. This will help to consolidate and develop the growing market economy. However, lack of resources and low pay compared to the private sector remain a problem.

As from the second half of 1997, Hungary will participate in Community Programmes and this will contribute further to the preparation for integration.

Conclusion

In the perspective of accession, no major problems should be expected in these fields.

Research and Technological Development

Research and Technological Development activities at Community level, as provided for by the Treaty and in the Framework Programme, aim at improving the competitiveness of European industry, the quality of life, as well as supporting sustainable development, environmental protection, and other common policies.

The Europe Agreement and its additional Protocol provide for co-operation in these areas, notably through participation in the Framework Programme. The White Paper includes no direct measures in this field.

Descriptive Summary

The National Committee for Technological Development is the main Hungarian Science and Technology institution responsible for implementing science and technology policy, managing strategic government programmes and planning, co-ordinating and financing all state funded activities in this sector.

Competitive mechanisms for research funding have been introduced. Hungary's spending in this field represents about 0.78 % of GDP; this was 1.07% in 1991.

Current priority subjects are Information Technologies, Materials Technologies and Agro-Food.

Regular cooperation with the European Union started in 1992 with the 3rd Research and Technology Development Framework Programme. So far, cooperation was mainly concentrated on COPERNICUS (Specific Programme for Cooperation with CECs and NIS) and remains rather low for participation in the 4th Framework Programme. Hungary is a member of COST (European cooperation in the field of scientific and technical research) and EUREKA (European Research Coordination Agency).

The statistics on research and technological development are compatible with OECD standards; Hungary is now a member of that organisation.

Current and Prospective Assessment

Important changes and improvements have already taken place. A big effort has been made in the improvement of the internal structure, liberalisation, and financial support in this sector. Human resources and potential remain strong despite the cutbacks.

Despite the fall in investment in and technical services of recent years, Hungary remains one of the strong performers among CEECs. The Hungarian scientific output ranks the country among the top 20 countries world-wide.

Nevertheless, it is necessary to improve the level of innovation in the economy generally and in industry and to enforce the links of research institutes with industry and small and medium enterprises.

Hungary is prepared to play an active role in the European research and technological development and allocate funds to this activity. It has declared its interest in full association with the 5th Framework Programme.

Conclusion

In the perspective of accession, no major problems are expected in this field. Accession would be of mutual benefit.

Telecommunications

The objectives of EC telecommunications policy are the elimination of obstacles to the effective operation of the Single Market in telecommunications equipment, services and networks, the opening of foreign markets to EU companies and the achievement of universally available modern services for EU residents and businesses. These are achieved through harmonisation of the standards and conditions for service offerings the liberalisation of the markets for terminals, services and networks and the adoption of necessary regulatory instruments. The Directives and policies needed to achieve this have now been established, but the liberalisation of public voice telephony and operation of related infrastructure will be deferred for a year or two after 1998 in certain member states.

The Europe Agreement provides for co-operation aimed at enhancing standards and practices towards EC levels in telecommunication and postal policies, standardisation, regulatory approaches and the modernisation of infrastructure. The White Paper focuses on the approximation of regulation, networks and services, followed by further steps ensuring gradual sector liberalisation.

Descriptive Summary

At the beginning of the 1990s Hungary had a poorly developed telecommunications network, despite the fact that economic liberalisation had already begun. The 11% penetration rate in 1991 was very low and process has been made since than, notably by a rapid liberalisation of the telecommunications market.

The legislation and regulatory instruments comprise the Telecommunications Law of 1992; the Frequency Management Law of 1993; the decree of 1993 on Licensing and on the general conditions for services of telecommunications operators; the Law of 1995 on type approval of telecommunications equipment; the decree of 1997 on licensing of those services for which the market has already been liberalised (eg, data transmission, multimedia). Although a significant regional disparity persists, the increase in the penetration rate for telephony in the fixed and mobile networks has been most impressive, (28% for fixed telephony in May 1997). Mobile communications are provided by three operators, all of which are joint ventures between Hungarian and Western investors. Hungary is currently attracting considerable investment in this sector, partly due to the fact that it has privatised the majority of the capital of the public network operator MATAV. MATAV is the only CEEC public operator which is majority- owned by the private sector. The state retains only 23% of the capital.

Current and Prospective Assessment

Degree of Liberalisation

According to the commitments at the WTO negotiations in 1997, the Government will liberalise the market for the fixed network and voice telephony by 1 January 2002. The market for mobile communications has been opened to competition by licensing two GSM networks in addition to the analogue mobile services. Additional mobile phone services are expected to be introduced in 1998 and 2000. Alternative infrastructures are expected to be opened in June 1997 through a license for provision of data transmission and value added services using the network of the Hungarian railways.

Approximation to EC Law

The recent legislation regarding networks and services covers most of the *acquis*. This legislation and regulatory instruments comprise the Telecommunications Law of 1992, the Frequency Management Law of 1993, the Decree of 1993 on Licensing and on the general conditions for Services of Telecommunications operators, the Law of 1995 on type approval of telecommunications equipment, the Decree of 1997 on licensing of those services for which the market has already been liberalised (eg, data transmission, multimedia). Regulatory measures on interconnection and equal opportunities for new market entrants have favoured the rapid start-up of many operators of various services.

The administrative capacity required for the implementation of the *acquis* appears to be sufficient. However, the National Communications Authority is under the direct supervision of the Ministry of Transport. Therefore, the regulatory function is not independent of the ownership function exercised by the state in relation to MATAV.

A tariffs reform programme is under preparation with the objective of introducing cost-oriented tariffs in 1998. In order to finance universal service obligations, a "Communications Fund" will be created in 1997. Policy measures will have to be taken to secure truly universal service availability in the new competitive environment and to reduce large disparities in the penetration rate.

Infrastructure

The penetration rate for the telephone service has increased from 11 lines per 100 inhabitants in 1991 to 26 in 1996 (the average in Ireland, Portugal and Greece is about 43.9 lines per 100 inhabitants). The number of subscribers of mobile telephony was 465,000 in 1996. About 60% of the fixed network and about 85% of the mobile networks was digitised in 1996 (the average in Ireland, Portugal and Greece is about 62.4). All the telecommunications districts of the countries are connected by a fibre optic cable network which is 2500 kilometres long. On the basis of this modernisation of the network, advanced services like ISDN started to be introduced in 1995 and about 2000 ISDN lines are now available. Since 1996 technologies like SDH and ATM have gradually been introduced in Budapest and in the backbone network. As for cable TV, more than 40% of the households are connected.

Foreign investment has been high in the sector. 67% of the stock of the national network operator, MATAV, has been taken over by a consortium between Deutsche Telekom and

Ameritech. The provider of paging services, Operator Hungaria, is a joint venture of TDF Radio-Services, France (49%) and TeleHungaria (51%). The two other paging operators, Easy Call Hungary and Eurohivo Kft Magyar Paging, are joint ventures between Matrix Telecommunications and Telecom Finland as well as Microsystem Telecom Corporation and Gerard AC Sales and Leasing (US). The mobile telephony operator, Pannon GSM, is a joint venture of several Western European countries (74%) and a Hungarian consortium (26%); the second GSM operator WesTel 900 GSM and the analogue mobile telephony operator are joint ventures of MATAV (51%/43.6%) and US and other companies (49%/56.4%).

Competitiveness of the Sector

Hungary has been successful with regard to its strategy of rapid expansion of its telecommunications network. In 1995 there were 10.2 employees per 1000 lines (the average in Ireland, Portugal and Greece is about 6.2). The waiting list for a telephone line is expected to disappear by mid 1997. The price of a standard line for business communications (416 ecu) is the highest in the region and revenue per line (about 270 ecu in 1995) is also among the highest in the region. This should ensure that MATAV can be run as a business profitable enough to allow for further investment.

Conclusion

Hungary should have little difficulty in adopting the EC model of telecommunications liberalisation in the medium term because it has already implemented most of the *acquis communautaire*. If foreign investment continues at its current pace and if a tariff rebalancing scheme is introduced in 1998, the sector should be able to face full competition.

Audio-visual

The audio-visual *acquis* aims, in the context of the Internal Market, for the provision and free movement of audio-visual services within the EU as well as the promotion of the European programme industry. The Television Without Frontiers Directive, which is applicable to all broadcasters regardless of the modes of transmission (terrestrial, satellite, cable) or their private or public nature, contains this *acquis*, setting down basic rules concerning transfrontier broadcasting. The main points are: to ensure the free movement of television broadcasts throughout member states; to promote the production and distribution of European audio-visual works (by laying down a minimum proportion of broadcasting time for European works and those by independent producers); to set basic standards in the field of television advertising; to provide for the protection of minors and to allow for the right of reply.

The Europe Agreement provides for co-operation in the promotion and modernisation of the audio-visual industry, and the harmonisation of regulatory aspects of audio-visual policy.

The Television Without Frontiers Directives is a Stage I measure in the White Paper.

Descriptive Summary

The legal framework for the audio-visual sector is determined by the 1996 Act on Radio and Television Services. This Act dismantled the State's information monopoly and

established the National Radio and Television Board which is responsible for evaluating frequency tenders, supervising the media, providing programme monitoring, and controlling services.

The main public service television broadcaster is Hungarian Television, which operates as a private company but is 100% State-owned. It has about 72% of the market share, with the rest divided between domestic and foreign channels. The process of awarding licences to two private channels is well advanced.

The state monopoly over film production was lifted in the late 1980s. Government subsidies for film production, provided indirectly, amount to approximately 1 billion HUF (5 MECU) per year. The distribution sector is largely controlled by two US enterprises.

Current and Prospective Assessment

The audio-visual sector in Hungary is attempting to reestablish itself after major upheavals in recent years, and is characterised by rapid growth and constant change. Its ability properly to adhere to the *acquis* presupposes an upgrading of the capacity of the programme-making industry to meet the important challenges of an adapted regulatory framework.

Hungarian audio-visual legislation is in large measure compatible with EU requirements. The Hungarian government has said that it can take on the audio-visual *acquis* by the time of accession to the EU and is working toward a more complete transposition in the meantime.

As a result of the progress made, Hungary will shortly be invited to participate in Community audio-visual policy (and, in particular, the MEDIA II programme).

Conclusion

In view of the continuing progress toward legislative alignment, and provided that this is accompanied by the necessary structural adaptations of the industry, Hungary should be able to meet EC requirements in the audio-visual sector in the next few years.

3.3 Economic and Fiscal Affairs

Economic and Monetary Union

By the time of Hungary's accession, the third stage of EMU will have commenced. This will mark important changes for all Member states, including those that do not participate in the Euro area. All Member states, including the new ones, will participate fully in the economic and monetary union. Their economic policies will be a matter of common concern and they will be involved in the coordination of economic policies (national convergence programmes, broad economic guidelines, multilateral surveillance, excessive deficit procedure). They will be required to respect the stability and growth pact, to renounce any direct central bank financing of the public sector deficit and privileged access of public authorities to financial institutions, and to have completed the liberalisation of capital movements.

Accession means closer monetary and exchange rate co-operation with the European Union. This will require strengthening structural reforms in the area of monetary and exchange rate policies. Member states not participating in the Euro area will be able to conduct an autonomous monetary policy and participate in the European System of Central Banks (ESCB) on a restricted basis. Their central banks have to be independent and have price stability as their primary objective. Monetary policy has to be conducted with market-based instruments and has to be "efficient" in transmitting its impulses to the real economy. Therefore, reforms need to be pursued to tackle factors that hinder the efficiency of monetary policy, such as the lack of competition in the banking sector, the lack of development of financial markets and the problem of "bad loans" in the banking sector. Finally all Member states shall treat their exchange rate policy as a matter of common interest and be in a position to stabilise their exchange rates in a mechanism yet to be decided.

As membership of the European Union implies acceptance of the goal of EMU, the convergence criteria will have to be fulfilled by Hungary, although not necessarily on accession. While the fulfilment of the convergence criteria is not a precondition for EU membership, they remain key points of reference for stability oriented macroeconomic policies, and must in time be fulfilled by new member states on a permanent basis. Hence the successful conclusion of systematic transformation and market oriented structural reforms is essential. Hungary's economic situation and progress has already been analysed in preceding chapters of this Opinion.

Current and Prospective Assessment

The Hungarian Central Bank is formally independent from the government. In practice, however, the appointments of new governors have coincided with changes in the government. The objective of price stability is not clearly stated in the CB Law, but it can be claimed that since the launch of the stabilization package (March 1995) the objective of the central bank is to curb inflation. Finally, a recent amendment to the CB Law has almost eliminated any differences between this Law and the Treaty provision concerning the prohibition of budget deficit financing by the central bank.

The monetary policy strategy implemented since March 1995 within the framework of a consistent stabilization programme, has undoubtedly been effective in reducing inflation. In addition, the process of transition towards a market based monetary policy appears to be quite advanced: the Hungarian central bank uses indirect instruments only to control the money supply. Bank privatisation has proceeded at a fast pace, with huge participation of foreign investors; “bad loans” have been reduced to non-critical levels; the bankruptcy law is implemented quite efficiently and banks do certainly not face a soft budget constraint. Finally, the market of government papers is one of the most developed in the region. However, it is important that the privatisation of commercial banks continues and that competition in the banking sector is increased in order to enhance the efficiency of the transmission mechanism and to increase the CB’s ability to control monetary aggregates.

Since March 1995, the exchange rate has been playing the fundamental role of nominal anchor in the stabilization programme. The exchange rate regime chosen at that time (crawling band), has proved to be successful in reducing inflation and curb speculative capital inflows. The authorities will consider reducing over time the actual rate of crawl in order to peg inflation expectations at a lower level. In addition, the sound and stabilising policy mix implemented since March 1995, has helped the exchange rate to move along the pre-announced path without any particular tension.

Conclusion

It is premature to judge whether Hungary will be in a position, by the time of its accession, to participate in the Euro area; that will depend on the success of its structural transformation permitting to attain and to adhere permanently to the convergence criteria, which are not however a condition of accession.

Hungary’s participation in the third stage of EMU as a non-participant in the Euro area should pose no problems in the medium term, provided that central bank legislation is made fully compatible with EC rules and that the stability orientation of current monetary and exchange rate policies is maintained.

Taxation

The *acquis* in the area of direct taxation mainly concerns some aspects of corporation taxes and capital duty. The four freedoms of the EC Treaty have a wider impact on national tax systems.

The indirect taxation *acquis* consists primarily of harmonised legislation in the field of Value Added Tax and excise duties. This includes the application of a non-cumulative general tax on consumption (VAT) which is levied on all stages of production and distribution of goods and services. This implies an equal tax treatment of domestic and non-domestic (import) transactions. The VAT *acquis* also contains transitional arrangements for the taxation of transactions within the European Union between taxable persons. In the field of excise duties the *acquis* contains harmonised tax structures and minimum rates of duty together with common rules on the holding and movement of harmonised excisable goods (including the use of fiscal warehouses). As a result of the introduction of the Single Market, all fiscal controls at the Community's internal frontiers were abolished in January 1993.

The mutual assistance between Member State tax authorities is an important feature of administrative cooperation in the Internal Market; the respective Directive covers both direct and indirect taxation.

The Europe Agreement contains provisions on approximation of legislation in the area of indirect taxation.

The White Paper contains as Stage I measures those which make up the main requirements of the indirect taxation *acquis* (essentially, those measures applied in the Community up to 1993), and as Stage II measures those which are in addition necessary to implement the full indirect taxation *acquis*.

Descriptive Summary

Direct Taxation

The two company taxation Directives and the Arbitration Convention provide for a mechanism which applies on the basis of reciprocity. Respective provisions can therefore by definition not be expected to exist before accession.

Indirect Taxation

The overall contribution of VAT and excise duty revenue to the Hungarian state budget was about 21% and 10% respectively in 1995. This is expected to continue on an upward trend.

Value Added Tax

The current Hungarian VAT system was introduced on 1 January 1988 replacing the previous Single-Stage Consumption Tax. A revised VAT Act entered into force on 1 January 1995. Hungary applies a dual VAT rate system: a standard VAT rate of 25% and a reduced VAT rate of 12%. The reduced rate applies to certain specified products and services. All other goods and services are taxed at the standard VAT rate. In addition Hungary applies a zero-rate to the supply of pharmaceutical products.

Certain activities are exempt from VAT without the right to claim the input credit on such supplies. These exemptions relate mainly to activities in the public interest, financial and insurance services, property and lotteries and similar games. Refund of excessive VAT is in principle only possible in certain specific cases such as when the taxable person has made investments of significant value, or if the taxable person has submitted a declaration declaring the termination of his position as a taxable person. In other situations the excessive VAT is set off against the tax to be paid in the subsequent VAT declaration. Refunds to taxable persons not established in Hungary are granted, on a reciprocity basis.

The Hungarian VAT Act provides for several special schemes in the field of commercial accommodation, the agricultural sector, second-hand goods and for retail traders.

Excise

The current excise duty legislation in Hungary entered into force from 6 January 1992. Excise duties are levied on a wide range of products including products other than those subject to common excise duties within the Community (mineral oils, alcohol and alcoholic beverages and manufactured tobacco). Generally the duty is ad valorem in nature, with an additional specific duty for spirits, beers and cigarette's. Only mineral oils are charged on a purely specific basis.

Mutual Assistance

The tax administration has not yet had to develop its capacity for mutual assistance with the tax authorities of Member States, since mutual assistance is a feature which would only become applicable on accession.

Current and Prospective Assessment

Value Added Tax

The current VAT system in Hungary has been based on the main principles of the VAT legislation of the Community. It is a solid starting point for future alignment with the Community VAT *acquis*.

The definitions of goods and services are not identical with those contained in Community legislation. The Hungarian reduced VAT rate is applied to supplies other than those permitted under the Community legislation.

Hungary's membership of the European Union would require additional adjustments to bring the VAT legislation into line with the requirements of the Community *acquis*. This is in particular the case as regards the system of taxation necessary in a Community with no internal frontier controls.

The Hungarian national strategy plan for implementing the recommendations of the White Paper regarding VAT is planned, in the short term (during 1997), to give priority to the introduction of arrangements for taxing certain services on the basis of the so-called reverse charge mechanism, whereby the service will be either taxed at the hands of the recipient, or he or somebody else may be held jointly and severally liable for the payment of the tax. A flat rate scheme for farmers is also intended to be introduced. A new scheme for second-hand goods is planned to be based on the margin principle. An extension of the current special scheme for small undertakings is envisaged. The aim is, by 1998, to bring the Hungarian VAT system into line with that of the Community.

Excise

There are significant discrepancies between the Hungarian excise regime and EC requirements.

Firstly, there exists no excise suspension system where goods can move between authorised tax warehouses without payment of duty.

Secondly, ad valorem taxation of spirits tends to exaggerate price differentials between products and is open to challenge as being discriminatory against the more expensive imports in favour of local producers. Also, the system of taxation of wine and tobacco (on an ad valorem basis) and taxation of beer (based on two elements) are not compatible with Community law.

In the event of accession, excise duties on products not belonging to the above-mentioned categories could continue to apply provided, however, that they would not give rise to border-crossing formalities in trade between member states and that they complied with the principles of non-discrimination between national products and products originating in other member states.

In order to ensure a correct application of the Community excise legislation it is important that Hungary adopts soon excise tax structures compatible with EC law at the minimum taxation level applicable in the EC; EC compatible arrangements for the effective operation of the excise regime (tax warehouses, registered traders, etc.); and strengthening of control procedures (using tax stamps or other fiscal markings) to combat fraud.

The Hungarian strategy plan for implementing the provisions of the White Paper does not provide a clear timetable for future adjustments to Hungarian excise legislation. A short term objective consists of establishing tax warehouses for the production phase, requiring a financial guarantee, introducing an accompanying document, defining the chargability of the tax, replacing duty on products other than alcohol, tobacco and mineral oils with a “national consumption tax”, switching from ad valorem rates of duty to specific rates applied to the three categories of exciseable products except cigarettes, and implementing tax stamps. However the adaptation of taxes rates to the EU minimum levels as well as the adoption of regulations needed for the free movement of goods have been postponed.

Mutual Assistance

There would also be a need, on accession, to implement the appropriate arrangements for administrative cooperation and mutual assistance between Member States. These requirements are essential for the functioning of the Internal Market.

Conclusion

The *acquis* in respect of direct taxation should present no significant difficulties.

As regards indirect taxation, provided that sustained progress continues in these areas, Hungary should be able to comply with the *acquis* concerning VAT and excise duties within the next few years.

It should be possible to start participating in mutual assistance as the tax administration develops its expertise in this respect.

Statistics

The main principles of the Community *acquis* relate to the impartiality, reliability, transparency, confidentiality (of individual information) and dissemination of official statistics. In addition, there exists an important body of principles and practices concerning the use of European and international classifications, systems of national accounts, business registers, and various categories of statistics.

The Europe Agreement provides for co-operation to develop effective and reliable statistics, in harmony with international standards and classifications.

The White Paper includes no provisions in this field.

Descriptive Summary

The Central Statistical Office (KSH), the central body charged with producing and disseminating official statistics in Hungary, works closely with the National Statistical Council (NSC), particularly in the preparation of the annual survey programme.

The legal basis for Hungarian official statistics consists of the 1993 Law on Statistics

Current and Prospective Assessment

Hungarian legislation is, with a few exceptions, compatible with the current standards applied within the European Union.

Some issues of impartiality and confidentiality need clarification. There are still some deficiencies in sectors such as external trade or business statistics, and a systematic link between business surveys and the national accounts has not yet been established.

Conclusion

Provided that continuing progress is made, Hungary should be able to comply with EU requirements for official statistics within the next few years.

3.4 Sectoral Policies

Industry

EU industrial policy seeks to enhance competitiveness, thus achieving rising living standards and high rates of employment. It aims at speeding up adjustment to structural change, encouraging an environment favourable to initiative, to the development of undertakings throughout the Community, and to industrial co-operation, and fostering better exploitation of the industrial potential of policies of innovation, research and technological development. EC industrial policy is horizontal by nature. Sectoral communications aim at transposing horizontal concepts into specific sectors. EC industrial policy results from an articulation of instruments from a number of Community policies; it includes both instruments related to the operation of markets (product specification and market access, trade policy, state aids and competitions policy) and measures related to industry's capacity to adapt to change (stable macro-economic environment, technology, training etc.).

In order to cope with competitive pressure and market forces within the Union, the industry of applicant countries needs to have achieved a certain level of competitiveness by the time of accession. The applicant countries need to be seen as pursuing policies aimed at open and competitive markets along the lines set out in Article 130 ("Industry") of the Treaty. Co-operation between the EC and the candidate countries in the fields of industrial co-operation, investment, industrial standardisation and conformity assessment as provided for in the Europe Agreement is also an important indicator of development in the right direction.

Descriptive Summary

Industrial output of Hungary in 1995 stood at around 9.2 bn Ecu, equivalent to about three-quarters the industrial production of Ireland. Its share in GDP is 23% (down from 28% in 1990), and industry accounts for 830,000 jobs or 23% of total employment. The total number of enterprises in industry is estimated at around 100,000 most of which are SMEs.

The transition process entailed a marked decline in industrial production in the first five years and industrial production reached its bottom in 1992, at the level of 77% of the 1980 output. Since then, production has grown steadily at an average annual rate of 4%.

Hungarian Industry, main production sectors in 1995

| | %Share in total GDP | % Share in total employment |
|--|------------------------|--------------------------------|
| Chemical Industry and Pharmaceuticals | 5 | 2 |
| Mechanical and electrical engineering | 4 | 3 |
| Foodstuff and Tobacco | 4 | 4 |
| Textiles and Clothing Products | 2 | 3 |
| Wood, Paper, Printing Industry and Furniture | 2 | 2 |
| Mining, excavation, metallurgy and non-metallic mineral products | 2 | 2 |
| Vehicles | 1 | 1 |
| Pressure Vessels, medical apparatus or equipment, meteorological equipment | 1 | 0.5 |
| Telecommunication and Electronics | 1 | 0.5 |
| Total | 23 | 18 |

The **chemical** industry is one of Hungary's most dominant sectors. In the detergent, soap and colours sub-sectors there is considerable foreign involvement. In those sectors where the chemical industry managed to retain the particular strengths it had before the transition (especially in pharmaceutical intermediates, plastics and agro-chemicals), accession should not pose problems. Given the high raw-material-intensity of the chemical industry in general and Hungary's very low endowment with natural resources, some of the other sub-sectors, however, might experience further adjustment strains.

The **pharmaceutical** industry is the most successful and technologically advanced in Central and Eastern Europe. Many firms are producing at quality levels approaching those of the EU. It will however take years of investment and restructuring until companies will be able to launch own internationally-competitive products. Following a period of intense restructuring and successful privatisation, the export market has begun to recover. Nearly all pharmaceutical producers have acquired a strategic Western investor. While most exports go to other CEECs, recently production of generic medicines has been re-orientated towards the EU.

Mechanical/electrical engineering: Some products in this sector are capable of competing with some EU Member States. High FDI from the EU and US is an indicator for a further competitive upgrading. The whole engineering industry is already closely integrated with the German and, to a certain extent, Austrian industry, a process which is likely to be further accelerated. Despite the collapse of CMEA markets, Russia remains the main trading partner of Hungary in this sector. The electrical engineering sector, especially electrical and medical equipment, has managed to increase exports and should be able to integrate itself successfully in the European industrial tissue, whereas prospects of mechanical engineering (notably machine tools and lifting equipment) are more uncertain. The rather good competitive edge of mechanical and electrical industry contributed to stimulate both upgrading of technical infrastructure and a drive for prompt legislative alignment meeting EU requirements.

The **automotive** industry is one of the fastest growing sectors. Assemblies of passenger cars were established in 1993. This was almost exclusively driven by FDI, attracted by relatively low labour costs, flexible labour legislation, and favourable demand forecasts. Major Western car producers have set up production facilities, including a Japanese producer aiming at exporting considerable quantities into the EU. Car production in Hungary is still small compared to that of applicant countries. Hungary developed a hub of engine production for many Western manufacturers. From a structural point of view, the integration of the Hungarian car and components sector into the European and global economy is already advanced and technologically sophisticated. Commercial vehicle construction, however, the traditional sector and still the main employer within the Hungarian automotive industry, is in a serious crisis. This sector, suffering from strong declines in production, is still awaiting privatisation and major restructuring before it can be considered ready to face accession.

Foodstuffs: Roughly half of Hungary's significant foreign trade in this sector takes place with the EU, while a considerable influx of modern production technology has occurred by means of FDI. More structural change is still to take place since concentration in production remains higher in some sub-sectors and capacity utilisation is very low.

The **textile** industry is suffering from the breakdown of former CMEA markets, low productivity and destitute production facilities. In spite of a considerable decline in textiles, there is at the same time a substantial surplus in clothes, mainly due to the strong outward processing trade (OPT) between EU and Hungary. In 1992 more than 75 % of all EU textile imports from Eastern Europe were due to OPT, making it the most important element of EU-CEECs textile trade. Relocation of production to Hungary has continued at a fast pace to make use of low labour costs but activities with a higher value added (innovation, design, marketing) remained in the EU. By the end of 1993 Hungary had the highest number of joint-ventures among the East European countries in this sector, with Italy, Germany, France and Greece being the most active. There is some likelihood that current low productivity will improve over the preaccession period, by increasing competitiveness and industrial restructuring, building on FDI, and improved market access.

The **steel** industry, which is fairly moderate in size and still benefits from import restrictions, is waiting for further steps in modernisation. Although a first international joint venture was set up, the industry has a need for additional cooperation projects. The slow pace of privatisation and restructuring is a cause for concern as it seriously affects the structurally depressed North East of Hungary. Hungary's request to extend certain state aids demonstrates the intention to support actively modernisation in this sector.

The **wood and paper** industry offers good growth-prospects and should experience no difficulties.

Since the beginning of transition the fairly modern Hungarian **cement** industry has been aggressively trying to enter EU markets. Hungary is fast approaching EU standards in this sector and there is strong cooperation with EU companies. As soon as construction demand picks up, so will domestic demand for cement, thus easing competitive pressures on EU firms.

Many types of **glass and ceramic** products (tableware, tiles) are competitive with EU products both in price and quality. These subsectors and the ones with foreign participation have good perspectives.

Hungary has a very strong supply base for a complete range of **railway equipment**. Its access to low-cost input factors and determination to offset the losses of further CMEA markets makes it a strong competitor for EU suppliers, mostly in the low-value-added segments.

After privatisation performance slower than originally envisaged Hungary made a new start in Summer 1995 and hopes to have sold more than 70% of state-owned productive assets by the end of 1997. This would result in one of the lowest shares of state ownership in the candidate countries. In some sectors such as construction, privatisation is already on a very high level (82%).

Almost half of FDI is in the manufacturing industry, the breakdown by sectors including: food and tobacco (28%), mechanical and electrical engineering (26%), chemicals and petroleum refining (20%) non-metallic mineral products (2%) and wood and paper products (7%). Strong FDI performance has created wide spread links with foreign companies to the benefit of Hungarian competitiveness; furthermore it also has a considerable impact on performance of Hungarian industry as a whole as foreign affiliates record significantly higher growth in productivity, sales, and exports than purely domestic companies and thereby stimulate other industries upstream and downstream.

Current and Prospective Assessment

Hungary started to reform early and has now put in place most of the elements of a market economy (including a capital market). These are now working satisfactorily. This largely explains, together with the way privatisation was organised, why Hungary has the highest FDI level of all applicant countries. The industrial structure is relatively diversified with less reliance on large enterprises in energy intensive sectors.

The prospects for a rapid economic development are hampered by an only moderate level of investment (equivalent to 19% of GDP, about the EU average) and by the need to keep interest rates high in order to encourage savings as the large foreign debt already accumulated does not allow the country to call on additional foreign capital. A lot of adjustment is still necessary outside the sectors that are already heavily engaged in trade (usually the ones dominated by foreign capital).

The current stagnation in industrial output, mainly due to the government's austerity programme is expected to end in 1997. With domestic demand recovering and the EU economy picking up, the increase in industrial output growth has already started. The strong productivity growth during the last years can be expected to continue though perhaps on a lower level, and subject (at least in part) to the development of FDI. The strong correlation of FDI with privatisation observed in the past would justify the expectation that after the end of privatisation annual FDI flows may stabilise on a considerably lower level than today.

Hungary's current industrial policy tries to adapt its structural heritage by shifting away from the more traditional sectors of industry, to those with better growth prospects and potential in the EU and other Western markets. Most of the structural adjustment problems of the past (tax/subsidy-type distortions in the domestic price structure, monopoly positions, weaknesses and inefficiencies in financial markets) have already been overcome to a large extent. In general, the more traditional sectors of the Hungarian industry which in the past have grown excessively (mining and metallurgy), and those sectors with high energy, environment and material costs will need to face continued restructuring. Among those sectors which in all likelihood could be competitive by the turn of the century are the food industry and food processing machinery, motor car manufacturing, construction and construction materials as well as pharmaceuticals and specialised chemicals. The biggest need for further restructuring and modernisation exists in commercial vehicles, certain subsectors in food processing, to a certain extent in textiles and clothing, and steel.

Conclusion on Industrial Competitiveness

Given the extent of restructuring and modernisation efforts undertaken so far there are good reasons to expect that most sectors of Hungarian industry in the mid term can be competitive operators in the Single Market. This applies in particular to those sectors benefiting from foreign investment.

An evaluation of the *acquis* specific to the free circulation of industrial goods is to be found in the separate section on the internal market.

Agriculture

The Common Agricultural Policy aims to maintain and develop a modern agricultural system ensuring a fair standard of living for the agricultural community and the supply of food at a reasonable price for consumers, and ensuring the free movement of goods within the EC. Special attention is given to the environment and rural development. Common market organisations exist to administer the CAP. These are complemented by regulations on veterinary health, plant health and animal nutrition and by regulations concerning food hygiene. Legislation also exists in the area of structural policy, originally developed primarily to modernise and enlarge agriculture, but more recently with an increasing emphasis on the environment, and the regional differentiation of the policy. Since reforms in 1992, increasing contributions to farm support have come from direct aid payments increasingly compensating for reduced market support prices.

The Europe Agreement provides the basis for agricultural trade between Hungary and the Community and aims to promote co-operation on the modernisation, restructuring and privatisation of Hungary's agriculture sector as well as the agro-industrial sector and phyto-sanitary standards. The White Paper covers the fields of veterinary, plant health and animal nutrition controls, as well as marketing requirements for individual commodities. The purpose of such legislation is to protect consumers, public health and the health of animals and plants.

Descriptive Summary

Agricultural Situation

The value of the agricultural production in 1995 was approximately 1.97% of that of the Union.

Agriculture and forestry contribute 7.2% to the GDP (1995) and employment in this sector amounts to 8% of total employment. The regional distribution of employment in agriculture and forestry varies between a share of 2.3% to 17.1% of total regional employment.

Since 1990 the recession in agriculture has been even more pronounced than in other sectors in the economy (-34% over the period 1990-93), leading to a sharp reduction in agricultural employment and social problems in rural areas; the main reasons being the restructuring of land ownership and the collapse of traditional export markets. After that sharp decline, crop production has been recovering since 1993.

Hungary has 6.2 million ha of agricultural land (4.3% of EC agricultural area) and 1.8 million ha of forest. Arable land accounts for 4.8 million ha, permanent grassland for

1.15 million ha and permanent crops for 260,000 ha. Following the instability of the transitional period, land-use patterns now seem to have stabilised.

The main characteristic of the Hungarian farm structure in the past has been the predominance of large-scale farms, coexisting with a large number of small individual farms and household plots. The situation is evolving towards a more balanced situation between large corporate farms and co-operatives on the one hand, and individual farms on the other hand. About 7,000 corporate farms and co-operatives, and a further 50-60,000 full time farming units account for about 70% of the agricultural output. Besides, there are about 1.1 million small and auxiliary farms.

At the moment most of the farm land is privately owned, while a minor part has remained in state ownership (state farms involved in seed production, breeding etc.). Farm labour productivity is generally higher than in other CEECs but still well below productivity in the EU.

The main crop is cereals (11 million tons in 1995) and around 15% of production is exported. The second largest crop is oilseeds, mainly sunflower seed (1995: 780,000t), occupying 10% of arable land. Hungary is normally self sufficient in sugar (4.6 million tons in 1995) with exports in years of high production. Hungary produces a large variety of fruit and vegetables and exports relatively significant quantities of fresh and processed products. Hungary has a relatively significant production of wine and is traditionally a net exporter, exporting about 25% of production.

Hungary was a traditional exporter of dairy products, in particular cheese. However, reduced supply, has led to a balance in imports and exports (1995 production: 1.9 Mio t). Production also dropped significantly in the meat sector, (in 1995 beef meat: 39,000t; pig meat: 580,000t; poultry: 364,000t) but declining consumption, in particular of pigmeat, and increased imports have made continued exports possible although at lower levels, especially in the poultry and pigmeat sectors.

The agro-food business has undergone radical change with the emergence of a large number of newly established private enterprises. Prior to transition, state-owned food processing enterprises accounted for 75% of the food industry output. The privatisation of the food industry has progressed considerably and is nearly complete. Foreign investments have played a major role in the privatisation process and by the end of 1995 foreign investors owned about 53% of the former state industry, while the state still had a share of 12% and other domestic investors 35%.

Hungary is a net exporter of agricultural and forestry products. In 1995, agriculture and forestry accounted for 21 % of total exports and 6.7% of total imports, and the trade surplus for this sector amounted to 1.6 billion ECU. Main export products are meat, cereals, fresh and processed fruit and vegetables, and beverages; the most important import product is animal feed, the other products are rather dispersed with a certain concentration on tropical products.

The positive balance is not only due to primary agricultural products but also due to processed products.

The EC is by far the most important trading partner in agricultural products, accounting for more than half of both imports and exports. Hungary has a positive balance of 500 MECUS (1995) with the EU. 40 % of exports went to the other CEECs and the Newly Independent States.

Agricultural Policy

The PSE (producer subsidy equivalent) for Hungary, calculated by the OECD was 16 % in 1995, compared to 49 % in the EU.

Hungarian agricultural policy is traditionally export oriented. During the initial period following transition Hungary's agricultural support was low (PSE 8%), and import tariffs were relatively low (average protection 22%). Imports were regulated mainly by quantitative restrictions.

Since 1993, agricultural policies have gradually changed towards increased protection of domestic markets and the introduction of market stabilization in key sectors. With the introduction of new agricultural policies the overall support level has increased substantially although it is still well below the support level in the EC.

Hungary has introduced two categories of agricultural market policies: (i) Direct market regulations have been introduced for wheat, maize, slaughter pigs, slaughter cattle and cows' milk. The market regulations include a system of guaranteed prices within maximum guaranteed quantities. A particular feature of the system is that it directly supports the farm gate price, rather than the wholesale price as is the case in the EU. (ii) Another group of products (sugarbeet, chicken, sunflower seed, sugar and isoglucose) is supported by indirect market regulations. External trade measures (import regulations, export subsidies) are the main instruments to stabilize these markets.

Hungarian support prices are generally significantly lower than EC support prices (30-50% in 1995/96). Although still lower, wholesale prices in Hungary are relatively close to EC prices for several products. This is especially true for pigmeat, oil seeds and poultry meat.

The main price differences are for cereals, milk and beef, where Hungarian prices are substantially lower than corresponding EU prices.

The total budgetary expenditure on agriculture is about ECU 500 million (1995). About half of the budget is spent on export subsidies, while reorganisation and agricultural development account for close to 20% of the budget. Spending on domestic market support measures was less than 10%, mainly due to the fact that market prices have generally been higher than intervention prices and consequently intervention purchases have been very limited.

Hungary applies a general system of investment subsidies with the objective of improving the efficiency of agricultural production and promoting structural adjustments. These measures include direct subsidies for the use of certified seed, interest subsidies on credits for buying inputs for agricultural production, and support to investments in improvement of production capital.

Rural development policies are receiving increased attention and a number of measures are in place. However, funding of these measures has so far been restricted because of limited resources.

Hungary made its commitment to the Uruguay Round Agreement in national currency. The main part of the domestic support is the Aggregate Measurement of Support (AMS) which will be limited to HUF 33,808 million (272 MECU) in the year 2000. The Aggregate Measurement of Support (AMS) represents about 10% of the production value in Hungary. Minimum access quotas have been established on a wide range of products with an average tariff rate of 22%. Hungary's export subsidy commitment is limited to HUF 14,318 million (115 MECU) in the year 2000, the most important products benefiting from export support being poultry (HUF 3,514 million), pork (HUF 3,031 million) and wheat (HUF 1,315 million).

Under the Europe Agreement, in 1997, adaptation of the current EU agricultural concessions to the results of the Uruguay Round and EU enlargement will involve, among other exercises, a 5% yearly increase of tariff quotas and a move to 80% reductions on in-quota duty rates. These improvements should further improve Hungarian access to the EU market. In the veterinary and phytosanitary field Hungary has negotiated with the European Commission an agreement of equivalency which is nearing completion.

Hungary is also a member of CEFTA. Agricultural market liberalisation within CEFTA will be implemented progressively with the intention of achieving in 1999 complete market integration between the contracting parties.

Hungary is harmonising its legislation in accordance with the White Paper.

The main State body responsible for administration in agriculture is the Ministry of Agriculture whose activities cover agriculture, food industry, forestry, hunting and fisheries. Agricultural trade, however, falls under the responsibility of the Ministry of Trade. Within the Ministry of Agriculture, the Office for Agricultural Market Organisations co-ordinates and supervises all work relating to market organisation. 19 County Offices of Agriculture provide the Ministry with primary information and statistical data about the regions, control tasks (land use, subsidies) and liaison with regional agriculture-related organisations.

Current and Prospective Assessment

The agricultural conditions, the farm structure, the relatively advanced restructuring of the food industry, and its capacity to attract foreign investment suggests that Hungarian agriculture is already increasing its competitiveness. However in the medium term livestock numbers are expected to remain lower than they were prior to transition. While the most dynamic restructuring has taken place in the agro processing sector, some further development is needed in first stage processing and marketing of farm produce.

Hungary is making progress in adapting its policies to the CAP, and legislation harmonising market policies with the CAP is under consideration in certain sectors (eg sugar). However, major differences still remain between Hungarian and EC policies.

The market support measures in the pigmeat sector, in particular the public intervention measures, would need to be adapted to EC policies. Market price quotation systems would also be required for market management purposes. Marketing standards in the fruit and vegetable sectors are to a large extent harmonised with EC standards except for products destined for the processing industry. Producer organisations exist in this sector but their structure and function need to be adapted to the EC criteria.

However, certain main policy instruments currently established in the EC for production management, marketing and certain intervention measures are not applied in Hungary. This includes key instruments such as dairy quotas, key features of the arable crop scheme (base area, set-aside, compensatory payments, and premia in the livestock sector), as well as certain rural and structural development programmes.

Management and control of these measures require relatively sophisticated administrative systems, including an appropriate land register and cattle identification and registration systems. As a general observation it appears that the administrative capacity would need to be further developed in these areas if these measures were to be applied in Hungary.

It is difficult to foresee at this stage how agricultural support prices in Hungary will develop in the period before accession; this will depend on a number of factors including the domestic economy, the situation on export markets, and the development of price support levels in the Union.

Although progress has been made in adapting rural and structural policies, some policies and input subsidies appears to be inconsistent with EC policies.

Important problems still exist in the field of export subsidies: in 1995 Hungary exceeded its commitment under the GATT Agreement, which was limited to 21 billion HUF (ECU 169 million). The Government should reconsider its subsidy system, and analyse the possible role of structural and rural policies.

Hungary is correctly applying the provisions of the Europe Agreement concerning trade with the Union in agricultural products.

Hungary is making progress in laying down the legislation foreseen in the White Paper. Preparation of legislation to further harmonize Hungarian legislation with EU legislation is envisaged to be completed within the next few years.

In the veterinary field Hungary has adopted new primary legislation which should provide the basis for implementation of secondary implementation rules and regulations currently under preparation. The completion of the adaptation of legislation is envisaged in 1997.

Further adaptation is however expected to be necessary on compliance with internal market control measures (safeguard, the licence system, veterinary checks, additional guarantees, regionalisation) introduction of HACCP (Hazard Analysis Critical Control Point) and self-control systems, veterinary drugs and animal welfare legislation.

Hungary has an elaborate infrastructure for veterinary control and inspection, both at the borders and internally. However, the increased fragmentation of the livestock units may make inspection and overall disease control more difficult. Furthermore, with the possible restructuring of the services there may be a risk of weakening the direct command and communication lines. The facilities at border inspection posts are still inadequate for Community veterinary control. Complete facilities for the inspection of live animals and animal products at the border inspection posts are not yet available and most border checks are limited to controls on certificates and other documents with the majority of physical checks being undertaken at destination. The Hungarian system does not completely comply with EU import rules from third countries.

As regards internal measures there is a need for the Hungarian authorities to ensure Hungary's animal health status in respect of certain EU requirements. The system of registration of holdings and identification of animals will need to be adjusted to the EU systems.

There is a need to upgrade certain food processing establishments for the national market, to upgrade testing and diagnostic facilities, to develop acceptable veterinary audit and certification procedures and to maintain an adequately structured, resourced, staffed and trained veterinary sector.

Harmonisation of the legislation in the field of animal nutrition, plant protection products, pesticide residues, organic farming, seeds and propagation material, plant health is underway (Law on animal nutrition already into force) and should be in place by the end of 1998. It will be necessary to verify if the existing institutions are able to implement the new legislation.

Conclusion

Further alignment to the acquis is still necessary, although significant progress has been made in adopting the measures mentioned in the White Paper.

Particular efforts are needed in relation to :

- implementation and enforcement of veterinary and phytosanitary requirements and upgrading of establishments to meet EC standards; this is particularly important with regard to the inspection and control arrangements for protecting the EU external borders;
- strengthening of the administrative structures to ensure the necessary capacity to implement and enforce the policy instruments of the CAP;
- further restructuring of the agro-food sector to improve its competitive capacity.

If such progress is accomplished, accession in the medium term should not be accompanied by significant problems in applying the common agricultural policy in an appropriate manner.

Fisheries

The Common Fisheries Policy includes common market organisations, structural policy, agreements with third countries, and management and conservation of fish resources and scientific research in support of these activities.

The Europe Agreement includes provisions concerning trade in fisheries products with the Community..

The White Paper includes no measures in this field.

Descriptive Summary

Hungary has only inland water fisheries. The fishing sector does not play an important role in the national economy. The total catch in 1995 was 22,866 tons, mostly carp. The volume and range of domestic fish processing is small owing to a lack of capital. The employment of this sector is only 250 people.

As a trading partner of the Community, Hungary represents 0.1% of total EC imports (independently of origin) of fisheries products and 4% of EC imports of fisheries products from the candidate countries alone (in terms of value). As regards EC exports, Hungary receives 1.05% of our total exports of fisheries products and 12.6% of our exports of these products to the candidate countries (in terms of value).

Current and Prospective Assessment

Hungary's production and foreign trade data, when compared to the corresponding EU figures, are quite low and therefore should not have a significant impact upon the Community as a whole.

It will be necessary for Hungary to ensure compliance with the EU's health, hygiene and environmental standards.

Conclusion

This sector should not represent a problem for accession.

Energy

Main EU energy policy objectives, as reflected in the Commission White Paper "An energy policy for the EU" include enhancement of competitiveness, security of energy supplies and protection of the environment. Key elements of the energy *acquis* comprise of Treaty provisions and secondary legislation particularly concerning competition and state aids, internal energy market (including directives on electricity, price transparency, gas and electricity transit, hydrocarbons licensing, emergency response including security stock obligations, etc.), nuclear energy, as well as energy efficiency and environmental rules. Development of Trans-European Energy Networks and support for energy R&D are other important elements of energy policy. Ongoing developments include liberalisation of the gas sector, energy efficiency *acquis* and the Auto-oil programme.

In the field of nuclear energy, the Community *acquis* has evolved substantially from the original EAEC Treaty to a framework of legal and political instruments, including international agreements. At present, it addresses issues of health and safety, including radiation protection, safety of nuclear installations, management of radioactive waste, investment including EURATOM financial instruments, promotion of research, nuclear common market, supplies, safeguards, and international relations.

The Europe Agreement provides for co-operation to develop the progressive integration of the energy markets in Europe and includes provisions on assistance within the related policy areas. The White Paper preparing CEECs for the internal energy market underlines the need for full application of key internal market directives in combination with EU competition law. As to the nuclear sector, the White Paper refers to nuclear supply, safeguards and shipments of nuclear waste.

Descriptive Summary

Hungary imports more than 50% of its energy resources and heavily depends on Russia for oil, gas and uranium. Domestic resources are declining (oil and gas) or are of low quality or extracted uneconomically (solid fuels). Solid fuels production declined in the period 1983-1994 from 25 Mio to 14 Mio tons per annum and employment declined from 50,000 to 21,000.

Uranium production ends in 1997 but its social-regional consequences will be addressed with state intervention until 2005.

Hungary's energy sector is, due to its heritage of e.g. low prices or supply orientation, two to three times less efficient than the EU average.

The country is increasingly linking its networks up with the European Union and the test synchronous connection since 1995 with the Western European UCPTTE electricity system as well as the gas connection with Austria should be noted.

The Paks nuclear power station of Russian design produces 40% of the country's electricity and the four reactors of the VVER 440-213 type will be close to objectives generally accepted in the EU once the already planned upgrading programmes (300 MECU) will be implemented of which two-thirds relates to safety upgrades. Two research reactors, using Russian fabricated fuel are also in operation.

Current and Prospective Assessment

Hungary's energy policy objectives are in line with those of the EU and include security of energy supplies, including diversification; introduction of more market principles; environmental protection and increased efficiency.

The competition framework in the energy sector is progressively approximating with the directives of the internal energy market in combination with the application of EC competition law. Here the Competition Law, the 1993 Mining Act and the 1994 Electricity and Gas Acts should be noted. The latter Acts include the establishment of a regulator in the sector.

Energy prices have been increased and also prices for households are now near to covering costs.

Privatisation, a crucial income source is extensive and covers both production and distribution. The State will however retain golden shares in the strategic hydrocarbons and electricity companies.

Hungary has taken important steps for rapid compliance with EU emergency preparedness *acquis* including the obligation to hold 90 days of oil stocks. The 1993 "Law on Security Stockpiling of Imported Crude Oil and Petroleum Products" foresees to reach, the ninety days of emergency stocks by 1999 (calculated on the basis of imports and not on the basis of consumption according to Community rules). Current stocks in the hands of the stockpiling association are estimated at 50-60 days, although total oil stocks in the country exceed the 90 day target.

Restructuring of the solid fuels and uranium mines continue and its social and regional consequences will have to be addressed further, whereas the state interventions should be assessed against EC and ECSC state aid rules.

Hungary has started the development of EC conform efficiency legislation (e.g. labelling appliances, minimum efficiency norms) as well as environmental norms (e.g. fuel quality standards) but more remains to be done.

Hungary uses domestic uranium for its nuclear power plants, but additional supplies, enrichment services and fuel fabrication are all procured from Russia. Hungary's accession would increase the EU's dependence on Russian uranium and enrichment. The common nuclear materials policy of diversification of sources of supply would however apply to contracts concluded after accession.

According to agreements between Hungary and Russia, spent fuel is to be shipped back to Russia. Nevertheless, an interim dry storage facility (50 years operation) is under construction at Paks. Selection of a site for final disposal of High Level Waste and spent fuel is ongoing, with the objective target to have the installation operational by 2040. The construction of a storage facility for low level waste and intermediate level waste, to be ready for 2002, is proceeding. The inclusion of the final disposal and decommissioning costs in the electricity price is foreseen for the near future.

Upon accession, Hungary would need to comply with the provisions of the Euratom Treaty, in particular those related to supply of nuclear material, the nuclear common market, safeguards, health and safety and international agreements. It is already party to the relevant international regimes in these fields and has legislation in force or in preparation which implement these regimes in its national legal order, and has a full-scope safeguards agreement in force with the IAEA. No major difficulties are therefore expected in applying the relevant Community legislation in the above areas. Special attention has to be given to the timely implementation of nuclear safety programmes. The independence of the safety authority should be supported.

Conclusion

Provided that current efforts are maintained, Hungary should be in a position to comply with most of the EU energy legislation in the next few years. However, matters such as the adjustment of monopolies including import and export, access to networks, energy pricing, state interventions in the solid fuels and uranium sectors, and the development of energy efficiency and fuel quality standards need to be closely followed.

No major difficulties are foreseen for compliance with Euratom provisions. Nuclear safety standards should be tackled appropriately in order to bring the nuclear power plant to the level required; and longer term solutions for nuclear waste need attention.

Transport

Community transport policy consist of policies and initiatives in three fundamental areas:

- Improving quality by developing integrated and competitive transport systems based on advanced technologies which also contribute to environmental and safety objectives.
- Improving the functioning of the single market in order to promote efficiency, choice and user-friendly provision of transport services while safeguarding social standards;

- Broadening the external dimension by improving transport links with third countries and fostering the access of EU operators to other transport markets(The Common Transport Policy Action programme, 1995-2000)

The Europe Agreement provides for the approximation of legislation with Community law and co-operation aiming to restructure and modernise transport, the improvement of access to the transport market, the facilitation of transit and the achievement of operating standards comparable to those in the Community. The White Paper focuses on measures for the accomplishment of Internal Market conditions in the transport sector, including such aspects as competition, legislative harmonisation and standards.

Descriptive Summary

The Hungarian transport network is fairly dense and centred on the capital, Budapest. It occupies a strategic position in Central Europe, between Northern Europe and the Balkans and further, the Middle East. Three Trans-European corridors, identified at the Pan-European Transport Conference in Crete, cross the Hungarian territory. Hungary's international trade reorientation towards the West, together with the embargo on Serbia (which has led to very substantial traffic diversion through Hungary), exposed the need to invest in rapid and significant improvements to its rail and road network, most of which suffers from a considerable backlog in maintenance; Hungary will also need to develop the previously limited border crossing infrastructures.

The general improvement and the structural changes in the Hungarian economy has led to a change in the modal split in the transport sector, with an increase in the share of road transport compared to other modes, both for passengers and freight, (with bus transport showing relative stability), whereas car ownership increased in rapidly proportions. Railways in particular have lost market share, especially for passenger traffic. Air traffic is growing steadily with the strengthening of East-West relations.

The Danube runs through Hungary and was a major communications route before 1989, but lost a great deal of its traffic to the roads. The opening of the Rhine-Danube link, and ultimately the joining-up of this link with the Black Sea, could mean that river transport will assume a greater role than at present.

Current and Prospective Assessment

In the area of the Internal Market, Hungary has made relatively good progress in assimilating the *acquis*. Hungary's international transport sector already broadly applies rules similar to the Union's, especially in air transport, shipping, inland waterways, combined transport and road passenger transport. The changes needed to bring Hungarian law on civil aviation into line will have to be made by the end of 1998. In the rail sector, care should be taken to ensure that access rights to the railway network actually correspond in scope to the Community *acquis*, and that the *acquis* is effectively applied; the public service aspects and standardisation of accounts will have to be monitored over the coming years. The road haulage sector complies with most of the provisions of the *acquis* relating to international traffic but the operation of its domestic arm poses greater potential risks.

This aspect will require close attention and is of particular importance in the context of a future Union without internal borders when road haulage cabotage will be totally unrestricted. If it is to be in a position to enter the Union's internal transport market, Hungary will have to step up its efforts in order to align the conditions governing its national road haulage sector on those of the Union, in particular as regards compliance with technical, social and safety rules. Passenger cars must also be subject to technical roadworthiness tests in line with Community standards.

The development of an integrated and competitive transport system is an objective of which the Hungarian authorities are aware; achieving an acceptable level of safety and optimal use of the transport system are probably going to be the two main difficulties. Hungary's progress on safety is relatively satisfactory. In contrast the objective of coherence of the transport system appears harder to attain. Hungary is likely to face a steady rise in the share of road transport and will have to focus its efforts on the use of railways and inland waterways; this might encourage the Hungarian authorities to change their policy, which at present is largely geared to roads.

In order to improve links with the Member States and its neighbours, Hungary plans to invest about ECU 3.7 billion of its own budget over the period 1995-99 in transport infrastructure used by international traffic, primarily trans-European corridors. This sum amounts to around 2.2% of GNP, a respectable effort.

Conclusion

Hungary has made significant progress in the adoption of the Community *acquis* in the transport sector. Provided that it improves the operation of its domestic road haulage market (in particular as regards market access, social rules and safety), makes progress with technical checks on passenger cars, and clarifies the arrangements on financial transparency and access rights in the rail sector - all measures which should not be impossible to achieve, the transport sector is unlikely to pose major problems as regards adoptions of the internal market *acquis*.

It will be necessary, however, to make sure that the resources needed to lay the foundations for the future trans-European network, extended to include the new member countries, are actually made available. It would also be advisable for Hungary's administrative structures, and in particular bodies supervising areas such as safety, to be rapidly reinforced.

Small and Medium Enterprises

EU enterprise policy aims at encouraging a favourable environment for the development of SMEs throughout the EU, at improving their competitiveness and encouraging their Europeanisation and internationalisation. It is characterised by a high degree of subsidiarity. The complementary role of the Community is defined and implemented through a Multiannual Programme for SMEs in the EU. This programme provides the legal and budgetary basis for the Community's specific SME policy actions. The *acquis* has so far been limited to recommendations on specific areas, although legislation in other sectors also affects SMEs (e.g. competition, environment, company law).

The Europe Agreement provides for co-operation to develop and strengthen SMEs, in particular in the private sector, inter alia through provision of information and assistance on legal, administrative and tax conditions. The White Paper contains no specific measures.

Descriptive Summary

Since the start of the economic restructuring process, the share of SMEs in production employment, export and investment has grown dramatically. This is not only the result of the creation of many new micro-businesses, but also of the disappearance of many large, state-owned industrial and mining companies. The distribution of gross value added between enterprises of different size categories, based on 1994 figures, shows that large companies stand for 64.3%, medium-sized companies 20%, and small companies 15.7%. (Hungarian definitions classify enterprises with up to 300 employees as SMEs). In 1994, businesses with fewer than 300 employees provided 33% of the jobs in industry. SMEs with less than 50 employees in industry had a domestic market share of around 26%, companies with 51-300 employees around 18% in 1995. The SME's share in industrial exports was approximately 10% for small companies and 20% for medium sized companies in the same year.

The Hungarian Government has had a policy for SME development since 1989. There are plans to change the tax system in order to alleviate the tax burden for small companies, and to introduce new preferential credit arrangements (from a fund managed by the Ministry for Industry and Trade) which supports SME development

Current and Prospective Assessment

Stabilisation of the share of SMEs in production and employment is under way. Given its structure and comparative advantages, the Hungarian economy will remain characterised by a large percentage of SMEs.

A 1994 Government Resolution on the medium-term development concept for SMEs recognises the need to adopt a uniform definition of SMEs; expand credit and guarantee systems and establish capital market institutions; guarantee that SMEs are not disadvantaged in competition in respect of development and review of legal regulations pertaining to public purchasing and foreign trade (quotas); and the importance of supporting the development of an SME infrastructure in the field of business information and educational systems and through the strengthening of chambers and professional associations. Some progress has been made in these efforts to pursue an active SME policy.

The on-going efforts to strengthen the SMEs during the pre-accession period will therefore need to be continued.

Conclusion

There are no specific problems foreseen in Hungary's integration in this sector.

3.5 Economic and Social Cohesion

Employment and Social Affairs

Community social policy has been developed through a variety of instruments such as legal provisions, the European Social Fund and actions focused on specific issues, including public health, poverty and the disabled. The legal *acquis* covers health and safety at work, labour law and working conditions, equal opportunities for men and women, social security co-ordination for migrant workers, and tobacco products. Social legislation in the Union has been characterised by laying down minimum standards. In addition, the social dialogue at European level is enshrined in the Treaty (Article 118b), and the Protocol on social policy refers to consultation of the social partners and measures to facilitate the social dialogue.

The Europe Agreement provides for the approximation of legislation with Community law and co-operation on improving standards of health and safety at work, labour market policies and the modernisation of the social security system. It also provides for Community workers legally employed in Hungary to be treated without discrimination on grounds of nationality as regards their working conditions. The White Paper provides for measures for approximation in all the areas of the *acquis*.

Descriptive Summary

Since the Interest Conciliation Council was set up by the Hungarian Government in 1992, the tripartite social dialogue has been working relatively well. This could change because of the Government's limited room for manoeuvre following its policy of economic austerity. On the side of employers, there are a number of organisations of similar importance. One of them is a member of the International Organisation of Employers, and another has joined the European Centre of Companies with Public Participation. None of them have joined the Union of Industrial and Employers' Confederation of Europe (UNICE). On the employee side, there are several organisations, and three have joined the European trade Union Confederation (ETUC). To ensure the future efficiency of the social dialogue, many of the existing organisations would need to merge to increase their representativeness.

Hungary's unemployment rate currently stands at about 9.2% according to ILO methodology. The high level of long-term unemployed is likely to remain a major problem. The regional disparities are considerable.

A network of regional and local employment offices has been established to implement labour market policies. Hungary has introduced a policy to make the labour market flexible. If this process is continued, Hungary should be able to adjust to the demands of integration into EU labour market and employment systems.

Hungary spends about 22% of its GDP on social security and welfare. Social spending, including the pension scheme and health care which are the most important items,

constitutes half of government expenditure.. In terms of financing, contributions are more important than taxes, and the employer's share is relatively high. Continued efforts are required to ensure that measures of social protection are developed.

The Hungarian health system needs to be improved.

Current and Prospective Assessment

In 1993, Hungary adopted a new Safety and Health Act laying down the principles and organisational aspects for the protection of safety and health at work. The law takes account of the provisions of the EC framework directive and some individual directives. Hungary has inspection services which are in accordance with ILO Convention N° 81. For a series of specific areas, work needs to be continued to approximate the standards of the *acquis*.

Hungary has already reached a significant degree of protection in the field of labour law. But there are various adjustments which need to be made, particularly on the safeguarding of employee's rights in the event of transfer of undertakings and in cases of collective redundancies. New legislation to ensure full compliance in these areas is under preparation. Although there is a system of works councils in force, the social dialogue on company level needs to be developed.

In the area of equal treatment of men and women, the main provisions of EU legislation are covered by Hungarian legislation.

Concerning the right to the free movement of workers, there would appear to be no obstacles to prevent Hungary from being able to implement the provisions of the *acquis* in this area. The introduction of the right to free movement will however require changes in the national law, particularly as regards access to employment and a treatment free from discrimination on grounds of nationality.

In the field of social security for migrant workers accession does not, in principle, pose major problems, although certain technical adaptations will be necessary. More important is the administrative capacity to apply the detailed co-ordination rules in co-operation with other countries. Although many of the administrative structures required to carry out these tasks are already in place in Hungary, further preparation and training will be necessary before accession.

The EC Directives respectively on the warning labelling of cigarette packages and the maximum tar content have not yet been transposed into Hungarian legislation (although it is claimed that the national regulation of tobacco products complies with the above mentioned directives).

Conclusion

Provided Hungary pursues work in terms of adoption and application of the EC *acquis*, Hungary is likely to be able to take on the *acquis* in the social area in the medium term.

Regional Policy and Cohesion

In accordance with Title XIV of the Treaty, the Community supports the strengthening of cohesion, mainly through the Structural Funds. Hungary will have to implement these instruments effectively whilst respecting the principles, objectives and procedures which will be in place at the time of its accession.

The Europe Agreement provides for co-operation on regional development and spatial planning, notably through the exchange of information between local, regional and national authorities and the exchange of civil servants and experts. The White Paper contains no specific provisions.

Descriptive Summary

In 1995, Hungary was at some 37 % of the EU average GDP per capita. Economic development is distributed rather unequally although, compared with other CEECs, Hungary presents a relatively homogeneous unemployment pattern. According to national sources, regional GDP per capita ranges from twice the national average in Budapest, which together with western regions belongs to the most prosperous parts of the country, to one third of the national average in the eastern parts of the country.

Average unemployment is somewhat above 10%. Unemployment is lowest in the western parts and Budapest (7.2%) and highest in the eastern parts of Hungary (north-east: 16.4%).

The Act on Regional Development and Physical Planning, adopted in 1996, constitutes the legal basis for a specific Hungarian regional development policy. The principles, objectives and institutional structure envisaged in the act present clear similarities with the EU structural policy.

The Ministry of Environment and Regional Development is responsible for both regional policy and spatial planning. Inter-ministerial co-ordination is ensured by the National Council for Regional Development. Moreover, a National Development Agency is involved in the implementation of Hungary's regional policy. A Government decree envisages the establishment of a regional development fund.

Hungary's financial instruments at the disposal of regional policy are clearly limited. However, the share of total development related expenditure which constitutes potential counterpart funds to the EC structural policy cannot yet be determined. Therefore, Hungary's co-financement capacity cannot presently be evaluated with sufficient reliability.

At the regional level, 20 counties represent the highest regional administrative system. They are responsible for implementing the regional policy, but at the same time the new law provides for the establishment of larger regional administrative and planning units, with Regional Development Councils set up on the initiative of the counties.

Approximately 100 associations of local government have been created which are responsible for settlement development and planning. Their representative bodies adopt development programmes. Seven Nuts II regions covering the whole territory are currently under consideration.

Current and Prospective Assessment

The Hungarian government is well aware of the need of an active regional policy involving all government levels. Moreover, Hungary is the first country among Central and European countries which adopted a legal framework closely in line with EC Structural Policy. Many sections of the new law have been drafted in the perspective of taking over the *acquis*.

Problems still exist in implementing the newly adopted regional development policy. Institutions still have to be created and existing ones need support and experience. In addition to the National Council for Regional Development, inter-ministerial co-ordination is strongly required, which needs an appropriate administrative framework and efficient procedures, including the budgetary area.

Lack of co-ordination between the Ministries which have deconcentrated settlements and the elected County Development Councils, which are the major actors for regional development needs to be corrected. Furthermore, regional co-operation between counties should be strengthened.

Conclusion

Through the Act on Regional Development, Hungary is introducing the legal basis for a comprehensive regional policy. Although some of the Act's provisions are still to be implemented, Hungary's administrative capacity to manage integrated regional development programmes seems satisfactory. Thus, subject to the remaining reforms, Hungary should be ready to apply the Community rules and to channel effectively the funds from the EC structural policies

3.6 Quality of Life and Environment

Environment

The Community's environmental policy, derived from the Treaty, aims towards sustainability based on the integration of environmental protection into EU sectoral policies, preventive action, the polluter pays principle, fighting environmental damage at the source, and shared responsibility. The *acquis* comprises approximately 200 legal acts covering a wide range of matters, including water and air pollution, management of waste and chemicals, biotechnology, radiation protection, and nature protection. Member states are required to ensure that an environmental impact assessment is carried out before development consent is granted for certain public and private projects.

The Europe Agreement stipulates that Hungarian development policies shall be guided by the principle of sustainable development and should fully incorporate environmental considerations. It also identifies environment as a priority for bilateral co-operation, as well as an area for approximation legislation to that of the Community.

The White Paper covers only a small part of the environmental *acquis*, namely product-related legislation, which is directly related to the free circulation of goods.

Descriptive Summary

Whilst Hungary's environmental problems are less severe than in many other countries in the region, and the differences throughout the country are less pronounced, the country still faces a major challenge to bring its standards up to those of the European Union in the areas of water, waste and air quality.

Water quality, closely linked to agricultural activities and exacerbated by the lack of waste-treatment plants in many settlements, is the main problem and requires major investment. Waste management has been considerably neglected in the past and there are problems in hazardous and municipal waste. Overall trends in emissions of the main air pollutants show significant decreases since the late 1980s due to changes in fuel use and industrial restructuring. However urban traffic is now the fastest growing source of air pollution. Lastly, some of the country's natural assets, such as the Balaton lake and the Sajo valley, have been damaged by intensive agricultural activity or are endangered by over-exploitation for recreation and tourism.

Hungary's investment levels in environment are just below the average for EU countries in terms of share of GDP. In recent years more than half of environmental investment has been allocated to the water sector.

The country has started a large-scale reform of its environmental policy, aiming primarily at approximation with EU standards. A new overall environmental act has been in place since 1995, while a new medium-term national programme covering sectoral and regional actions is about to be approved by parliament. Supporting framework regulations in some key areas (waste, water, nature) have been recently adopted or drafted. On the other hand, much of the subsidiary legislation, especially in water and waste policies, is old. The monitoring system for most sectors is sufficient. The use of economic instruments has so far been limited. In view of the limited availability of public funds for environmental improvements, the potential of market based instruments as a source of finance needs more attention.

Current and Prospective Assessment

As a result of recent legislation, formal compliance to the EU environmental *acquis* is well advanced and on the basis of current plans additional progress can be expected over the next three to five years, especially in waste management, water and chemicals. Also, a number of general policy measures such as environmental impact assessment, access to information and integrated pollution and prevention control are either already in place or will shortly be enacted. The bulk of remaining legislative work concerns subsidiary laws - e.g. in water and waste- which are still based on the old system rather than the framework legislation. Particular attention should be given to the quick transposition of framework directives dealing with air, waste and water as well as to the Integrated Pollution Prevention and Control (IPPC) directive, as well as the establishment of financing strategies for legislation in the water, air and waste sectors requiring major investments.

With respect to White Paper directives, legislation is in force on in the process of adoption for nearly all environmental sectors, but waste and noise emission legislation is still in preparation.

Important problems remain however, in substantive compliance. More efforts are required in implementing and enforcing environmental policies, especially in relation to supervision and enforcement structures and in raising permit and fine cost levels. In the water sector for example, major investments are required to connect the remaining large proportion of the population to the water system. Substantive compliance is also low in product-related White Paper directives and in waste management, due largely to inadequate enforcement in industry. Improved enforcement in currently low-compliance areas (for example, small manufacturing plants and agriculture) will be critical in implementing legislation. The country's environmental accession strategy should include implementation timetables for meeting the EU environmental *acquis* starting amongst others with implementation of the framework and IPPC directives mentioned above.

Conclusion

Given current trends and plans, full transposition of the environmental *acquis* can be achieved in Hungary in the medium term. However effective compliance with a number of pieces of legislation requiring a sustained high level of investment and considerable administrative effort (e.g. urban waste water treatment, drinking water, aspects of waste management and air pollution legislation) could be achieved only in the long to very long term. Substantive compliance will depend on implementing changes in the structure of the enforcement system and its instruments, and at the same time applying the proposed national environmental accession strategy. It will also depend on an increase in public and private investment.

Consumer Protection

The Community *acquis* covers protection of the economic interests of consumers (including control of misleading advertisements, indication of prices, consumer credit, unfair contract terms, distance selling, package travel, sales away from business premises and timeshare property) as well as the general safety of goods and the specific sectors of cosmetics, textile names and toys.

The Europe Agreement provides for the approximation of the legislation with Community law and co-operation with a view to achieving full compatibility between the systems of consumer protection in Hungary and the Community. Stage I measures of the White Paper focus on improving product safety, including cosmetics, textiles and toys, and on the protection of the economic interests of consumers, notably measures on misleading advertising, consumer credit, unfair contract terms and indication of prices. Stage II measures relate to package travel, sales away from business premises and time-share property. New EU legislation which has been adopted recently (distance selling) or will be adopted soon (comparative advertising, price indication) will also need to be taken into account.

Descriptive Summary

Hungarian consumer protection does not include a general Consumer Protection Act; consumer protection legislation in Hungary is covered by legislation in different sectors. Responsibility is shared between different authorities and ministries, which makes co-ordination difficult.

In 1996, Parliament asked the Hungarian Government to prepare and submit a Consumer Protection Act within a year. In response, the Government adopted a resolution in June 1996 on the concepts of the modernisation of consumer legislation. The Ministry of Industry and Trade, in co-operation with other ministries, was then charged with the preparation of a draft law, which is likely to be put to parliament in the second half of 1997, and which should comply with EU standards. Once the law is agreed, it is likely to help to unify consumer law in Hungary.

Hungary was one of the first countries in Central Europe to develop a consumer movement. The National Association for Consumer Protection acts both as a federation of local consumer unions and as a national pressure group. But there is no institutionalised form of representation for consumer organisations.

Current and Prospective Assessment

Substantial work is required at the legislative level in order to “modernise” consumer legislation in accordance with EC consumer directives, including the need to clarify many consumer policy concepts and definitions. For many areas of consumer policy, there is some legislation but it does not provide the protection required by EC requirements. When a Consumer Protection Act is agreed, it will provide the framework for the progressive alignment of the Hungarian legislation to the EC consumer direction.

For many key measures referred to in White Paper, draft laws or amendments are under preparation. But at the present, the level of implementations of EC law is low. In particular, adjustments to existing legislation are required in areas such as indication of prices, misleading advertising, sales away from business premises, distance selling, unfair contract terms, consumer credit, general product safety cosmetics and safety of toys. There are no legislative measures for timeshare property and textile names.

The development of a strong and independent consumer movement, sustained by public authorities, will need to accompany the introduction of the *acquis*.

Conclusion

The Hungarian Government is seeking to introduce into national law the requirements of EC directives in the consumer sector. Although these efforts will have to be pursued, Hungary is likely to be in a position to take on the full consumer protection *acquis* in the medium term. Work should concentrate on completing, updating and unifying legislation as well as establishing the structures necessary to ensure the effective implementation of the *acquis*.

3.7 Justice and Home Affairs

The Present Provisions

The Justice and Home Affairs (JHA) *acquis* principally derives from the framework for co-operation set out in Title VI (Article K) of the Treaty on European Union (TEU), "the third pillar", although certain "first pillar" (EC Treaty) provisions and legislative measures are also closely linked

The EU JHA framework primarily covers: asylum; control of external borders and immigration; customs co-operation and police co-operation against serious crime, including drug trafficking; and judicial co-operation on criminal and civil matters. The TEU stipulates key principles upon which such co-operation is based, notably the European Convention on Human Rights and the 1951 Geneva Convention on the Status of Refugees. It is also based implicitly on a range of international conventions concerning its fields of interest, notably those of the Council of Europe, the United Nations and the Hague Conference. The legislative content of third pillar *acquis* is different from the first pillar; it consists of conventions, joint actions, joint positions and resolutions, (including the agreed elements of draft instruments which are in negotiation). A number of EU conventions (including the 1990 Dublin Convention, and conventions relating to extradition, fraud and EUROPOL) have been agreed by the Council and are now in the process of ratification by national Parliaments; several other conventions, including one on external frontiers are in various stages of negotiation in the Council. The JHA *acquis* involves a high degree of practical co-operation, as well as legislation and its effective implementation.

The New Treaty

For many of the above matters, the entry into force of the Treaty resulting from the Amsterdam Inter-Governmental Conference will mark the end of the current cooperation framework.

Reiterating the objective of developing the Union into an “area of freedom, security and justice”, the new Treaty brings these matters, including the free movement of persons, asylum and immigration, into the Community’s sphere of competence.

On the free movement of persons in particular, the new Treaty provides for the incorporation of the Schengen *acquis* into the framework of the European Union and binds any candidate for EU membership to accept that *acquis* in full.

With regard to matters remaining within the cooperation framework, i.e. policing and criminal justice, the new Treaty provides for the reinforcement of the cooperation system.

The Europe Agreement and the White Paper

The Europe Agreement includes provision for co-operation in the fight against drug abuse and money laundering.

The White Paper does not deal directly with third pillar subjects, but reference is made to first pillar matters such as money laundering and freedom of movement of persons which are closely related to Justice and Home Affairs considerations. Reference is also made to the Brussels and Rome conventions.

Descriptive Summary

General Preconditions for JHA Cooperation

Hungary joined the Council of Europe in 1990 and has ratified the most important instruments concerning human rights. The Constitution provides for an independent judiciary according to the rule of law.

Institutional reform of JHA institutions is well under way, with the current priority being to build on the civilisation and democratisation measures that have already taken place to develop the effectiveness of the bodies in their specific tasks. The Constitution guarantees data protection: a new data protection law approaching EU requirements is now in place and Hungary has signed the 1990 data protection convention. (See also separate section on Single Market).

Asylum

Hungary signed the Geneva Convention and Protocol in 1989 but expressed a geographical reserve effectively excluding non-European refugees from protection. A new asylum law is in preparation which will remove the geographical restriction and allow Hungary to withdraw the reserve, as well as modernising the administration system. There are currently some 6,000 refugees in the country, with the trend of refugee arrivals being downwards. There are also some 6,000 temporary refugees from former Yugoslavia; Hungary is planning their return in cooperation with international bodies but (as elsewhere) no returns have begun as yet.

Immigration/Border Control

Some 40 million border crossings were made in 1995; of these some 103,000 were illegal. Migrants are coming from Romania, former Yugoslavia and the NIS, aiming to transit Hungary to the west (although Hungary is also becoming a target country). Hungary has visa-free agreements with EU countries and the NIS (for the latter invitation letters are required); Hungary is considering its position on the visa-free agreements with the NIS in the light of the requirement to harmonise with the EU list of third countries for which visas are required. Hungary is also modernising its consular visa issuing procedures, which already stipulate that visas must be issued abroad. A comprehensive review of aliens legislation is under way in the light of EU requirements. Currently some 2,000 immigration permits a year are issued to ethnic Hungarians. Those unable to justify their status within the country can be subject to measures ranging from restrictions on movement to detention and deportation - these measures can be challenged before a court of law. Readmission agreements are in place with Austria and neighbouring countries; such agreements are in preparation with France, Germany, Belgium, NL and Greece and with Russia, Turkey, India, Pakistan, China and Vietnam. Border management is currently being modernised at the Austrian border and the Government plans (in part with PHARE assistance if made available) to upgrade information systems at the borders, introduce passport readable machines and to upgrade all remaining border points. The Government has submitted to parliament a draft law on border management and the organisation of the border guard.

Police Cooperation

Organised crime exists in Hungary in the field of drug trafficking, trafficking in humans and prostitution, money laundering, counterfeiting of money and documents, smuggling of goods and stolen cars, and blackmail; violence and extortion are used. Local criminals are active, as are crime syndicates from a number of countries to the east. The police service has been radically restructured to tackle organised crime more effectively, with specialist units (on organised crime generally and on drugs) being established. Hungary has not yet signed the money laundering convention but a new law and administrative procedures are in place which generally meet the requirements of the convention and a Money Laundering Task Force is active. (See also separate section on Single Market). Nuclear smuggling was a problem in 1993-94 but is now under better control. Hungary sees no domestic threat from terrorism, but is vigilant against international terrorist threats. It has ratified the key international terrorist conventions and has adopted domestic legal and administrative measures against terrorism.

Drugs

Hungary is a transit country for drug trafficking, on the Northern Balkan route (significant quantities of heroin have been seized in recent years). Domestic demand is increasing. Hungary has ratified the main international drugs conventions (except money laundering - see above) and is working within the Phare Multi Country Drugs programme and others to develop its anti-drugs capabilities. Domestic legal measures to tackle drugs investigations are in place and there is a special drugs unit in the police.

Judicial Cooperation

The Ministry of Justice has begun to prepare the judiciary for EU accession. The Government is currently accelerating reforms to the judicial system, including setting up

an intermediate tier of appeal courts at regional level, and is strengthening the system of training of judges. Hungary has ratified the main criminal conventions (except money laundering - see above). Hungary is party to a number of Hague conventions and is developing its capacities on the civil side as well.

Current and Prospective Assessment

There are some important gaps still to be filled in Hungary's legislation but for the most part the legislation is either in place or in preparation and is being implemented. An important priority for the near future will be developing more effective border management systems, especially on the future external borders. The visa systems with regard to the NIS and other non-associated neighbours remain unsatisfactory and Hungary will need to ensure that the facilitation of crossing by ethnic Hungarians from neighbouring countries does not detract in any significant way from the need to carry out effective border controls at the future external border.

The main institutional problems lie in the field of resource constraints, inexperience and the impact of organised crime on the state, including some corruption. The Government is nevertheless taking active steps to prepare the institutions, including the judiciary for participation in the JHA process. Hungary already has in place a small number of experts with knowledge and experience of the requirements of JHA cooperation with EU member states and we can expect this core of expertise to be developed and expanded as preparations for membership continue.

A key gap in Hungary's preparation to date has been the failure to lift the geographical reserve on the Geneva Convention. Assuming the current draft law in preparation within Government is approved by the Parliament, work will still need to be done to develop a working implementation system for the new asylum legislation; moreover there is a need to ensure that sufficient provision is made for support to refugees of non-Hungarian origin.

Conclusion

Hungary is well on track to meet the justice and home affairs *acquis* (present and future) within the next few years, assuming progress continues at the current rate and effective training and institutional development programmes are implemented in the key JHA institutions.

3.8 External Policies

Trade and International Economic Relations

The *acquis* in this field is made up principally of the Community's multilateral and bilateral commercial policy commitments, and its autonomous commercial defence instruments.

The Europe Agreement includes provisions in several areas requiring parties to act in accordance with WTO/ GATT principles, or other relevant international obligations.

The White Paper includes no provisions in this field

Descriptive Summary

Hungary has developed an open, trading economy and is a member of the World Trade Organisation (WTO). Upon accession Hungary would have to comply with the obligations of the plurilateral WTO agreements to which the Community is a party.

At present, Hungary maintains a balance of payments quota on consumer goods, including on textiles and clothing products. This restriction will have to be phased out prior to accession. The import surcharge was eliminated on 1 July 1997. On accession, the Community textiles policy would be extended to Hungary; any Community restrictions still maintained at the date of accession would require adjustment by an appropriate amount to take account of Hungarian accession.

Current and Prospective Assessment

On accession Hungary would have to apply the Community's Common Customs Tariff, and the external trade provisions of the Common Agricultural Policy. The post Uruguay Round weighted average level of most favoured nation duties for industrial products will be 6.9% for Hungary and 3.6% for the Community. The progressive implementation of free trade between Hungary and the Community by the time of accession will, however, reduce the impact on the domestic industry of applying the lower Community Common Customs Tariff.

In its relations with international organisations Hungary should ensure that its actions and commitments respect the Europe Agreement and ensure a harmonious adoption of its future obligations as a member of the Community.

On accession Hungary would become party to the Community's various preferential agreements. Preferential agreements between Hungary and third countries would, in general, have to be terminated on accession.

In the area of trade in services and establishment, there are some inconsistencies between the multilateral commitments made by Hungary, and those of the Community. It should be possible to resolve these wherever necessary.

On accession Hungary would have to repeal national legislation in the field of commercial defence instruments, and EC legislation would become applicable there.

Experience from previous accessions has shown that the automatic extension of existing anti-dumping measures to new member states often prompts third countries to raise questions regarding the compatibility of this approach with relevant WTO provisions. It has also shown that accession creates a potential for circumventing measures adopted by the Community under the commercial defence instruments. This happens when, prior to accession, substantial quantities of the products subject to measures are exported to the territory of the future member state and, on accession, are automatically released for free circulation in the enlarged customs territory. These two problems would have to be addressed during Hungary's pre-accession phase.

Hungary is a member of all four existing regimes for the non-proliferation of weapons of mass-destruction. Hungary is, in practice, implementing the Community control list of dual-use items. Arms export is also controlled. The export control legislation in Hungary is comparable to that of member states, and the obligations imposed on exporting companies are demanding. Hungary appears to have no problems applying EC legislation in this field.

Conclusion

Hungary is well placed to be able to meet Community requirements in this field within the next few years.

Development

The *acquis* in the development sector is made up principally of the Lomé Convention, which runs until early 2000.

Neither the Europe Agreement nor the White Paper include provisions in this field.

Descriptive Summary

Hungary has no preferential trade agreements with ACP countries. However, under its GSP scheme Hungary grants a degree of preferential treatment in the form of reduced duties to a number of ACP countries, and grants duty free access to those ACP countries considered as Least Developed Countries.

Hungary has no budget for development aid, although there is a "Foreign Aid Fund" managed by the Minister of Foreign Affairs (HUF 20 million (about 200,000 ECU) in 1996). Under this fund, Hungary provides development aid under OECD norms, and humanitarian aid. Hungary also participates in the International Development Association.

Current and Prospective Assessment

On accession, Hungary should apply its preferential trade regime to the ACP States and participate, together with the other member states, in financing the European Development Fund (EDF), which provides financial aid under the Lomé Convention.

Applying the Lomé trade regime should not generally be a source of difficulties for Hungary.

Normally, new member states accede to the Lomé Convention by means of a protocol annexed to the Convention, which comes into force on the date of their accession to the EU.

Conclusion

Hungary is well placed to be able to meet EU requirements in this field in the next few years.

Customs

The *acquis* in this sector is the Community Customs Code and its implementing provisions; the EU's Combined Nomenclature; the Common Customs Tariff including trade preferences, tariff quotas and tariff suspensions; and other customs-related legislation outside the scope of the customs code.

The Europe Agreement covers the establishment of a free trade area with the Community and the progressive removal of customs duties on a wide range of products, according to clear timetables starting from the date of entry into force of the agreement.

The White Paper includes in Stage I, measures to consolidate and streamline the free trade established under the Europe Agreement, including legislation compatible with the Customs Code, Combined Nomenclature, etc. Stage II concerns the adoption of the full Community legislation, with a view to joining the customs union upon accession.

Descriptive Summary

On accession the Hungarian customs authorities would be required to assume all the responsibilities necessary for the protection and control of their part of the EU's external border. Besides the provisions on indirect taxation, they would be responsible for the implementation and enforcement at the external border of the Community's common commercial policy, the common agricultural policy, the common fisheries policy etc.

Hungary's capacity to fully apply the *acquis* presupposes the possibility to adopt and implement the Community legislation; and the existence of an adequate level of infrastructure and equipment, in particular in terms of computerisation and investigation means and the establishment of an efficient customs organisation with a sufficient number of qualified and motivated staff showing a high degree of integrity.

With the support of the technical assistance provided by customs programmes, Hungary has adapted the Hungarian customs legislation to make it compatible with the Community's customs code since 1996. In addition, work is in progress for the adaptation of its implementing provisions as well as the customs-related legislation outside the scope of the customs code, and consequently legislation still differs in certain areas.

Hungary aligned its national goods nomenclature to the Community's Combined Nomenclature as from 1 January 1996. The Hungarian administration does not have an Integrated Tariff yet. This will make the comparison of the Hungarian tariff rates with the Common Customs Tariff rates difficult. The introduction of a Binding Tariff Information system is foreseen in a new Code.

Hungary adopted on 1 July 1997 the new system of cumulation of origin between European countries.

Hungary has become a contracting party to the EC/EFTA Common Transit Convention and to the Convention on Simplification of Formalities on 1 July 1996.

Current and Prospective Assessment

Hungary would need to adapt its national procedures to the Community legislation regarding suspensive arrangements and customs procedures with economic impact. At the moment of accession, some technical transitional arrangements would be needed, notably for operations beginning before the date of accession but which are concluded after that date.

At present 106 so-called "industrial" free zones and 105 "warehousing" free-zones are operational in the Hungarian territory. The exact scope of the activities performed in these numerous free zones will require close examination in relation to Community legislation.

It will be important that the Hungarian customs authorities can participate appropriately in the various computerised systems necessary for the management, in the customs union/internal market, of the customs and indirect tax provisions, as well as the computerised systems for mutual administrative assistance in customs, agricultural and indirect tax matters.

On accession Hungary would need to dismantle customs controls at the borders with EU member states and with other acceding countries: in practical terms this should not pose significant difficulties. However, a strong emphasis would need to be given to controlling the external EU frontier, and the resources needed for the reinforcement of the border posts along Hungary's frontiers with non-EU member states should be taken into account in its strategic planning.

Conclusion

Hungary is making a major effort to align its organisation and staff to the duties that have to be carried out by a modern customs organisation.

If it reinforces its efforts, particularly in relation to project management in the computerisation area, Hungary should be ready to fulfill the responsibilities of an EU customs administration within the next few years.

Common Foreign and Security Policy

Since 1989 Hungary has re-oriented its foreign and security policy towards European and Euro-Atlantic integration. Improvement of relations with neighbouring countries and of the situation of the Hungarian minorities abroad have also been considered as key foreign policy priorities of equal importance by successive Hungarian governments. Hungary has been an active participant in the dialogue arrangements provided for under the Union's Common Foreign and Security Policy and whenever invited has supported EU actions within that framework. Hungary is a member of the UN, OSCE, Council of Europe; it is an associate partner of WEU, a participant in NACC and the PfP, and has been invited to open negotiations for membership of NATO; it has provided base facilities and sent troops to participate in IFOR/SFOR operations. It also participates in a number of regional organisations including CEFTA and the CEI.

Hungary strives to contribute to regional security by maintaining and expanding good relations with its seven neighbouring states, with which it has no territorial disputes. Basic treaties, recognising existing borders and aiming at protecting the rights of Hungarian minorities (in total numbering three million) have been concluded with Austria, Slovenia, Croatia, Romania, Slovakia and the Ukraine. There remain differences of interpretation between Hungary and Slovakia concerning implementation of their bilateral treaty. Hungary has not recognised Slovakia as the successor state of Czechoslovakia, partly due to the dispute over the construction of the Gabčíkovo dam; this dispute has been referred to the International Court of Justice, and both Hungary and Slovakia have agreed to abide by the Court's adjudication. No treaty with the Federal Republic of Yugoslavia has yet been agreed, notably as a result of the situation of the Hungarians living in the Voivodina.

Hungary has a sizeable diplomatic service which would permit it as a member of the Union to play a full role. It maintains 100 representations abroad and employs 639 diplomatic staff.

Hungary supports non-proliferation of nuclear, biological and chemical weapons and is a signatory to all relevant international arms control agreements. It exercises strict control concerning the dual use of technology being a member of all the major existing export control regimes. Hungary's armed forces are under democratic control. The defence industrial base has declined sharply in recent years and is in a process of re-organisation.

In its memorandum accompanying its application for membership of the Union, Hungary confirmed that it was ready and able to participate fully and actively in the Common Foreign and Security Policy.

The assessment of Hungarian foreign and security policy to date leads to the expectation that as a member it could effectively fulfil its obligations in this field.

3.9 Financial Questions

Financial Control

The implementation of Community policies, especially for agriculture and the Structural Funds, requires efficient management and control systems for public expenditure, with provisions to fight fraud. Approximation of legislation is moreover needed to allow the system of “own resources” to be introduced, with satisfactory provision for accounting.

The Europe Agreement provides for cooperation in audit and financial control, including technical assistance from the Community as appropriate. The White Paper includes no measures in this field.

Descriptive Summary

The current financial control system in Hungary has been strongly influenced by practices in the EU member states: both branches of control have finally been set up in accordance with the Community model. An internal audit office at the Government level, the Government Control Office (GCO), reporting directly to the Prime Minister, has the mandate to follow the execution of the State budget and to ensure that the principles of sound management are properly respected. The State Audit Office (SAO) is the traditional external control institution which audits the operation of the ministries and authorities of national competence for effectiveness and aspects of rationality, regularity and legality. The SAO reports independently to the Parliament. Its reports are public and can be discussed by the competent committees of the National Assembly.

In addition every organisation managing or consuming public funds (including foreign aid) has to have its own Internal Control Organisation (independent of the SAO and GCO) reporting directly to the Minister or director of the given institution. Its task is to inspect the financial management of the Ministry and the institutions under their control, and its audits and controls cover aspects of regularity and sound financial management.

Generally, the SAO conducts *a posteriori* audits; *a priori* audits are the responsibility of the Treasury. It is expected that efficiency audits will be attributed greater importance in the future.

Special controlling organisations include the Tax and Financial Control Office (Act on Taxation), the Customs and Finance Guard (Customs Act). All of whom operate under the supervision of the Ministry of Finance.

With regard to fraud, the Hungarian financial, civil and criminal legal systems provide protection for the financial interests not only of the Republic of Hungary but also of the EU. A Coordination Committee for Economic Protection, operating under the Prime Minister's Office, co-ordinates nationally the anti-fraud operations of such bodies as the Tax and Finance Control Offices, Customs and the Finance Guard.

With regard to import duties the Hungarian Customs and Finance Guard are responsible for their establishment and accounting but they also participate, by consultation, in the development of legislation.

Regional development policy is integrated into the national economic policy and as such is part of the national budget. There are five special State funds. Most of their control organisations have been established recently and according to Western European systems. In the case of an audit (the SAO is the external auditor) compliance with legal regulations, accounting discipline, efficiency and performance relative to the objectives are checked.

As far as export subsidies and agricultural market support is concerned, the Tax and Finance Control Office has been appointed as disbursing agency since 1 January 1996. Its competence relates to the establishment of eligibility, disbursement and audit of expenditure. The Office is assisted for the audit of payments and the contributions to agriculture the Hungarian State Treasury, the 19 Country Agricultural Offices of the Ministry of Agriculture, the National Institute for Agricultural Quality Control and the Forest Inspectorates.

Current and Prospective Assessment

The structure of the Hungarian Customs and Finance guard (one central office, ten regional offices and 112 local customs offices) seems comparable to the customs organisations that are operated by certain EU member states. The control organisation for the five special funds which finance key tasks of the State have necessary skills and practice and are able to meet the financial control requirements of the EU.

The Hungarian government plans to establish a financial management system corresponding to the structural funds of the EU.

Accounting procedures for import duties and sugar duties will have to correspond to the "own resources" of the EU.

The control of agricultural payments which is now being implemented has to correspond to EU requirements.

The fight against the black market would be greatly accelerated and made more efficient by full computerisation and the establishment of a remote data transfer system.

Conclusion

In the medium term Hungary should be able to fulfil its obligations in relation to the financial control structures without any major problems, provided that measures currently envisaged are put in place.

Budgetary Implications

The communication entitled "Agenda2000" sets out the overall financial framework which should accommodate the budget impact of any future enlargements in the medium term. This is to ensure that any enlargement is compatible with proposed Community policy guidelines within reasonable budget limits.

As things stand, it would be difficult, not to say premature, to attempt precise country-by-country evaluations of the budgetary implications of each of the applicants joining the Union. Exactly what the impact would be may vary considerably depending on a whole series of factors:

- the date on which the applicant country joins;
- developments in Community policies between now and then, in particular the decisions to be taken on further reform of the common agricultural policy and new guidelines for structural measures;
- the progress made by the applicant countries in terms of growth, increasing their competitiveness and productivity and their ability to absorb the *acquis*;
- the transitional measures that will come out of the negotiations.

Only a few orders of magnitude for certain budget categories and an overall estimate can be given purely as a guide.

Expenditure

If the common agricultural policy were to be reformed along the lines suggested by the Commission, once the reforms were fully up and running and in terms of just market intervention measures, Hungary's accession would give rise to only marginal additional expenditure of some 2% to 3% in relation to likely expenditure on the present fifteen Member States.

After a phasing-in period, the allocations for Hungary under the heading of structural measures would be about 4% of its GNP.

Application of the other internal Community policies in the new member countries would be likely to involve additional expenditure probably in excess of their relative proportion of Union GNP, since for certain policies the additional implementing costs also depend on the target population, the geographical area covered or the number of Member States involved in the coordination and harmonisation measures. The GNP of Hungary is currently less than 0.6% of total Union GNP.

By contrast, Hungary's accession should not involve significant additional expenditure as far as Union external action is concerned.

It should not be forgotten that when an applicant country joins, the Community budget will no longer have to bear the costs of grants the country was eligible for under the various pre-accession programmes, such as PHARE.

In light of the above, the estimated costs in the three areas mentioned arising from Hungary's accession should fall within the range of, annually, ECU 2.5 to 3.1 billion in 2005-06 (at constant 1997 prices).

Revenue

Assuming full application of the own resources system, the new members' contributions to the Community budget should, in terms of total GNP and VAT resources (taking account of the capping rules applying to VAT), be close to the proportion of the Union's GNP they account for, which in Hungary's case is about 0.6%. Hungary's portion of traditional own resources will depend on the structure of its trade flows at the time of accession.

To ensure that the own resources are established, monitored and made available in line with Community regulations, Hungary will have to overhaul its current customs system. In addition, for the purposes of accurately calculating the GNP resource considerable improvements will have to be made to the national accounts to ensure that they are reliable, homogeneous and complete. Improving the statistics will also be essential for drawing up the VAT own resources base, which will mean bringing Hungary's VAT system fully into line with the Community directives.

4 Administrative Capacity to Apply the *Acquis*

The European Council in Madrid in December 1995 concluded that the harmonious integration into the EU of the central and eastern European applicant states would, in particular, require the adjustment of their administrative structures. This chapter examines the current state of the public administration in Hungary, including relevant aspects of the judicial system, and assesses the current and prospective ability to carry out the functions required of it in a modern, democratic state, with a particular focus on the need to administer matters related to the *acquis*.

4.1 Administrative Structures

A description of Hungarian constitutional structures, their powers and responsibilities, including those of regional and local government, is given in Chapter 1.

At the central level there are 12 ministries (of equal status) in addition to the Prime Minister's Office, two ministers without portfolio (Privatisation, and National Security), and six national agencies; the EU Integration State Secretariat in the Ministry of Foreign Affairs acts as the central coordinating body for accession-related matters.

The legal basis for the civil service is provided by the 1992 Act on the legal status of Civil Servants, and partly by both the 1973 law on Responsibility and Legal Status of Government Members and State Secretaries and the 1990 Act on Temporary Regulation of the legal status of State Secretaries (though these latter two Acts are scheduled to be significantly amended in the near future).

The public administration is in general politically independent. There are rules for the political independence of recruitment and promotion. It is, however, usual practice for Ministers to make appointments to senior positions in the civil service, such as State Secretary, and often also at lower levels in the administration.

Of the 98,200 civil servants in the Hungarian public administration, about 60,000 are employed in the central and territorial state administration, and about 40,000 are employed directly by local self-government institutions. Public administration at the central government level has been subject to across the board staff cuts to help reduce the budget deficit, including a 16% staff reduction in central public administration. (In spite of this, the total number of civil servants has remained relatively stable over the past few years). Currently, pay levels for comparable jobs are about three times higher in the private sector than in the public sector.

In 1994 the position of Government Commissioner for the Modernisation of Public Administration was created to co-ordinate reform of the public administration. The Commissioner has the rank of Deputy State Secretary and is attached to the Prime Minister's office. A Government decree of September 1996 instructs the Commissioner, in conjunction with other relevant Ministries, to prepare a Public Administration Reform (PAR) action plan. The action plan for 1997-98 lists 57 individual activities, and concentrates on deregulation, training of civil servants, and further development of the local government system.

In late 1995 the Hungarian Government adopted the modernisation programme entitled "Hungary in a new Europe", setting out the country's medium-term strategy. The document develops the framework of Hungary's preparation for EU membership. Regionalisation, regional development and regional policy are highlighted as key elements in the creation of a de-centralised, more efficient administrative structure, and the future framework for industrial development. (See also the section of the Introduction concerning relations between the European Union and Hungary).

4.2 Administrative and Judicial Capacity

Hungary was administered under central planning during the communist period. The communist system rejected the primacy of the rule of law and subjugated the law and the administration to the implementation of Party policy. Against this background, both the administration and the rule of law itself increasingly came to be seen by the public as instruments of political control.

The situation in Hungary has improved greatly since 1989. The administrative framework currently in place is now comparable to that found in EU countries. The tasks of the administrative units, and the control bodies, are reasonably well defined. Over the last five to six years, organisations have been set up in accordance with the requirements of a market economy and have been given the necessary responsibilities and powers.

There are, however, certain issues on which the division of control, scope, tasks, and competence have not been put in order. For example, both in the case of agriculture and consumer protection there is a need to establish central control bodies. The management and supervision of local self-government requires significant improvement, while their remit and institutional structure need to be better defined.

The civil service is not understaffed overall. However, the across-the-board staff cuts, and low pay compared to the private sector, have affected morale and motivation in some areas, especially in the central administration. There has recently been a problem of "brain drain" of experienced staff to the private sector, and a decline in recruitment. It will be important for the future effectiveness of the public administration that these problems are resolved.

Following the high public expectations in the early 1990s, public confidence in the administration as a whole has gradually waned. It is sometimes regarded as being excessively legalistic and non-transparent. Problems of corruption have gained a higher profile over the past few years, although hard evidence to back up specific allegations is generally lacking.

The importance of administrative reform is widely accepted, and the planned reforms are generally well designed. The PAR action plan puts an end to across-the-board staff cuts, and recognizes the particular importance, and specific training needs, of senior civil servants. The implementation of public administration reform, however, is being hindered by the very problems which the reforms are intended to address: a lack of management skills, a shortage of qualified or experienced personnel in some areas, as well as insufficient or ineffective departmental coordination and co-operation. Implementation has been slow. Induction training of new staff, and improved functional training (especially in management skills), will be required to raise the overall quality of the civil service. The civil service has been taking steps to improve the level of professional awareness of EU issues.

As regards the coordination of EU related matters, the EU Integration State Secretariat functions well. Any further reform should build on the useful progress already made.

Key Areas for the Implementation of the Acquis

The uniform application of EC law: The effective application of the *acquis* presupposes that the judicial authorities of member states are able to apply the provisions of the Treaty dealing with ensuring the unity and application of the *acquis*, and are able to ensure the proper functioning of the Single Market and Community policies in general. A high quality and well trained and resourced judiciary is necessary for the application by the courts of EC law, including cases of direct effect, and cases of referral to the European Court of Justice under the terms of Article 177 EC.

Provided that reforms recently adopted in Hungary proceed as intended, including the training of judges, the judicial system should be able effectively to implement the *acquis*.

In certain cases, such as public procurement, Hungarian judges have already applied the principles of Community law.

Single market: The ability of Hungary to ensure the correct application of Community requirements in the Single Market, particularly concerning the free movement of goods and services presupposes the existence of highly developed and effective regulatory, standardisation, certification and supervisory authorities, able to act fully in accordance with EC rules. An analysis of these points is made in Chapter 3.1 (under "The Four Freedoms").

Concerning the administrative capacity in respect of free movement of goods, the situation in Hungary is generally satisfactory. In the various regulatory bodies staffing levels appear to be adequate. Where there are problems these are more due to a lack of communication at times between the different institutions. Concerning the free movement of services the situation is also generally satisfactory. Following the 1996 Banking Law an administrative structure based on EC requirements has been created. Although staffing levels appear to be largely adequate, (the Hungarian Banking and Capital Market Supervisory Authority has 235 staff) there is a need for these to be correctly deployed to perform an adequate number of on-site examinations on banks. The quality of these examinations should be improved by better training of staff. The State Insurance Supervising Authority has 36 staff.

In order to meet EC requirements in this area Hungary needs to consolidate the progress already made in its relevant administrative structures.

Competition: As explained in Chapter 3.1 (under "Competition") enforcement of competition law requires the establishment of anti-trust and state aid monitoring authorities, and that the judicial system, the public administration and the relevant economic operators have a sufficient understanding of competition law and policy.

In Hungary the central authority is the Office of Economic Competition which has 106 staff; this is adequate. The level of expertise is sufficient. Nonetheless, the ability effectively to implement EC requirements in this field will require further training in EU competition law.

Telecommunications: In order to formulate and implement the many liberalisation regulations contained in the *acquis* in this field it is necessary to have a regulatory and policy making body that is effectively separated from any operating company.

In Hungary the regulatory authorities are the Ministry of Transport, Telecommunications and Water Management, and the National Communications Authority (NCA) which deals with the application of regulations and control functions (such as type approvals, frequency and monitoring). The National Communication Authority has 398 staff at the central level, and 276 at the regional level in 7 regional offices. However there remains a need for improvements and reinforcing of the regulatory capacity and enforcement capacities in this area. Also, the NCA is not independent of the ownership function exercised by the State in relation the main telecommunications company.

Indirect taxation: The effective administration of the indirect taxation *acquis* presupposes structures capable of implementing the EC legislation concerning the harmonisation of Valued Added Tax and excise duties in an environment in which fiscal controls at internal EU frontiers have been abolished; and the excise system is based on the tax warehouses,

duty being payable at the local rate in the member state at the time the goods are consumed. This requires a highly developed and well trained and resourced service, with a high degree of integrity.

In Hungary the relevant authority is the Ministry of Finance with a total of 8,000 staff. Due to a large turnover of staff, resulting partly from trained staff being recruited by the private sector, it is difficult to estimate the capacity of existing staff. In order to ensure the effective administration of the *acquis* in this area it will be necessary to consolidate and improve the overall professional standards of the staff, including training measures and improvements in pay.

Agriculture: The administrative requirements in the agricultural area primarily concern veterinary and phytosanitary control, to protect public health and ensure the free movement of agricultural goods; and the ability to administer the mechanisms and requirements of the CAP, including high standards of financial control and official statistics. These points are dealt with in Chapter 3.4 (under "Agriculture"); general standards in the statistical field are examined in Chapter 3.3 (under "Statistics").

Concerning the administrative capacity in respect of veterinary and phytosanitary controls, Hungary has an elaborate infrastructure. As regards staffing, there are 20 Animal Health and Food Control Stations, employing 2,880 staff, and a National Institute for Agricultural Quality Control employing 710 staff. Facilities at border inspection posts still require improvement to meet EU standards. Concerning the administration of general CAP requirements, improvements in administrative structures will be required.

In order to meet EC requirements in this area some important adjustments are still required, although progress has already been made.

Transport: The application of the EU Internal Market and competition requirements to the transport sector, the development of relevant infrastructure products, and other aspects of the transport *acquis* will present administrative challenges to new member states.

The responsible government authority in Hungary is the Ministry of Transport, Telecommunications and Water Management with a total of 342 staff. There is a shortage of qualified staff, and sometimes a lack of communication between administrative units. This raises particular concerns with regard to the enforcement of safety controls.

Employment and social policy: A central administrative requirement in respect of the *acquis* in this area is adequate inspection capacity, particularly concerning health and safety at work.

The Hungarian labour inspectorate is well staffed, with 61 staff centrally, and 5,170 at regional offices (although only a proportion of these staff are involved directly in labour inspection functions). With suitable training and experience the labour inspectorate could be expected successfully to administer the relevant *acquis* in this area.

Regional policy and cohesion: The main administrative requirements in this area are the existence of appropriate and effective administrative bodies, and in particular a high degree of competence and integrity in the administration of Community funds.

In Hungary regional policy is administered by the Ministry of the Environment and Regional Development (381 staff) and regional and local bodies. These arrangements are not yet fully adequate. The situation concerning financial control is generally satisfactory (see the section, below, on "Financial control"). The effective administration of the *acquis* in this area will require improvements in coordination, definition of roles between the various bodies, and further development of administrative expertise.

Environment: Because EU environmental policy, involves the integration of environmental protection into EU sectoral policies the administrative requirement is potentially very wide, affecting many bodies not normally associated with environmental protection. However, the main responsibility lies with environment ministries and various subsidiary bodies.

As noted above (under "Regional policy and cohesion"), the relevant ministry has 381 staff. Monitoring is carried out by sectoral authorities, enforcement by the National Inspectorate of Environmental Protection and 12 regional inspectorates. These arrangements are not yet adequate since better coordination is required with other institutions involved, both at the national and regional level. The effective administration of the *acquis* in this area will require greater financial and human resources, backed by a reinforced commitment from the Government. A planned rationalisation of the system has been on hold for some time.

Consumer protection: In this area, the effective administration of the *acquis* requires the allocation of overall responsibility to a specific State body through which the formulation, implementation and enforcement of consumer policy and consumer protection legislation can be undertaken.

In Hungary the government Department for Technical Development and Environmental Protection shares general responsibility for consumer affairs with the semi-independent Bureau for Consumer Affairs. As regards non-governmental consumer bodies an already strong and independent consumer movement has developed. There remains confusion about the exact scope and objectives of consumer policy. This in part explains difficulties in the effective enforcement of consumer laws; however, other factors which need to be addressed include a lack of expert staff, organisational deficits, and a lack of sensitivity to consumer questions among the judiciary.

Justice and home affairs: Oversight of justice and home affairs questions falls to the justice and interior ministries. The administrative structures need to be able to deal effectively with asylum and migration questions, border management, police cooperation and judicial cooperation. There is an overriding need for sufficient and properly trained staff with a high degree of integrity.

In Hungary the justice and interior ministries are adequately staffed (Ministry of Interior, 549 staff; Ministry of Justice, 335 staff). The capacity to handle asylum and migration questions is not yet assured though a new asylum law is being prepared which will bring the administrative system up to EU standards. Border management is being modernised, though some borders are weak and lack resources to function effectively. The police have created specialist units to combat organised crime, and are improving cooperation with neighbouring states. Reforms to the judiciary are being accelerated. The effective administration of the *acquis* in this area will require increased investment in human resources (in particular specialist and language training), and steps to combat corruption.

Customs: Applying the *acquis* in this area requires an adequate level of infrastructure and equipment, including computerisation and investigation resources, and the establishment of an efficient customs organisation with a sufficient number of qualified and motivated staff showing a high degree of integrity.

In Hungary the customs service employs 6,000 staff. Due to a high turnover of staff, it is difficult to estimate their efficiency, and therefore the adequacy of staffing levels. The effective administration of the *acquis* in this area will require the retention of experienced and qualified staff, and improvements to the existing monitoring system. The public perception of corruption needs to be addressed.

Financial control: The protection of the Community's financial interests requires the development of anti-fraud services, training of specialised staff (investigators, magistrates) and the reinforcement of systems of specific cooperation. The implementation of Community policies, especially for agriculture and the Structural Funds, requires efficient management and control systems for public expenditure, with provisions to fight fraud. Administratively it is essential to have a clear separation between external and internal control. Police and judicial authorities need to be able effectively to handle complex transnational financial crime (including fraud, corruption and money laundering) which could affect the Community's financial interests.

In Hungary the main external control body is the State Audit Office. The number of staff employed is not currently available to the Commission. The organisation and functioning of the financial control systems in Hungary is broadly in line with the EU's requirements.

4.3 General Evaluation

If Hungary continues its comprehensive reform efforts in this area it could be envisaged that the necessary administrative structures would be in place, in the medium term, effectively to administer the *acquis*.

Provided that progress continues as planned, the Hungarian judicial system should be in a position effectively to apply Community law in the medium term.

C. SUMMARY AND CONCLUSION

Hungary submitted its application for membership of the European Union on 31 March 1994. Its request is part of the historic process of ending the division of Europe and consolidating the establishment of democracy across the continent.

In accordance with the provisions of Article O of the Treaty, the Commission has, at the request of the Council, prepared an Opinion on Hungary's request for membership.

Hungary's preparation for membership is going forward notably on the basis of the **Europe Agreement** which entered into force on 1 February 1994. Implementation of the **White Paper** of May 1995 on the Internal Market, another essential element of the pre-accession strategy, is going ahead on the basis of a Plan agreed by the government in December 1995 and revised in 1997. The government has put in place the necessary mechanisms to coordinate its policies for European integration.

In preparing its Opinion, the Commission has applied the **criteria established at the Copenhagen European Council** of June 1993. The Conclusions of this Council stated that those candidate countries of Central and Eastern Europe who wish to do so shall become members of the Union if they meet the following conditions:

- stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- the existence of a functioning market economy, as well as the ability to cope with competitive pressures and market forces within the Union;
- the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.

A judgement on these three groups of criteria - political, economic, and the ability to take on the *acquis* - depends also on the capacity of a country's administrative and legal systems to put into effect the principles of democracy and the market economy and to apply and enforce the *acquis* in practice.

The **method** followed in preparing these Opinions has been to analyse the situation in each candidate country, looking forward to the medium term prospects, and taking into account progress accomplished and reforms already under way. For the political criteria, the Commission has analysed the current situation, going beyond a formal account of the institutions to examine how democracy and the rule of law operate in practice.

1. Political Criteria

Hungary's political institutions function properly. They respect the limits on their competences and cooperate with each other. Elections are free and fair and led to alternation of power in 1990 and 1994. The opposition plays a normal part in the operation of the institutions.

There are no major problems over respect for fundamental rights. The rights of minorities are guaranteed and protected. Certain improvements are still needed in the operation of the judicial system and in protection for the Roma, but the measures recently taken by the government constitute progress. The fight against corruption needs further reinforcement.

Hungary presents the characteristics of a democracy with stable institutions guaranteeing the rule of law, human rights and respect for and protection of minorities.

2. Economic Criteria

After a fall in GDP of nearly 20% between 1989 and 1993, Hungary has seen renewed growth since 1994 (1.5% in 1995, 1% in 1996). This has been accompanied by progress towards stabilisation of public finances, external accounts and inflation (19.8% in 1996). Hungary has 10.2 million inhabitants and its GDP per capita is equivalent to 37% of the EU average. 8% of the working population are employed in the agricultural sector which contributes 7% of gross value added. Trade with the EU has grown considerably since 1989 and now represents 60% of Hungary's external trade.

On the basis of its analysis the Commission's judgement as to **Hungary's ability to meet the economic criteria** established at Copenhagen is as follows:

Hungary can be regarded as a **functioning market economy**. Liberalisation and privatisation have progressed considerably, and there has been strong growth of new private firms. In order to guarantee longer term stability, the reform of pensions and social security needs to advance rapidly. The proposed method of pension reform would have the added benefit of deepening capital markets.

Hungary should be well able to cope with **competitive pressure and market forces within the Union** in the medium term, provided the macroeconomic conditions for strong investment growth remain in place. Hungarian enterprises are already competitive in EU markets. Restructuring of industry and banks is well underway. Hungary's record of consistent commitment to steady market reforms and its ability to take difficult decisions when they are necessary is an important positive factor. It has had a consistently high level of foreign direct investment. However, the key task is now to avoid unsustainable budgetary or external deficits, which hinder investment and restructuring, and halt the recent acceleration of growth.

3. Capacity to take on the obligations of membership

Hungary's ability to take on the *acquis* has been evaluated according to a number of indicators:

- the obligations set out in the Europe Agreement, particularly those relating to the right of establishment, national treatment, free circulation of goods, intellectual property and public procurement;
- implementation of the measures set out in the White Paper as essential for establishing the single market;
- progressive transposition of the other parts of the *acquis*.

Hungary has met the bulk of its obligations under the Europe Agreement, and the timetable set out in the Agreement has been met. The Agreement has functioned very well and it has been possible to resolve any bilateral difficulties which have arisen, in particular in the field of trade. Hungary has achieved a good rate of transposition of the rules and directives set out in the White Paper.

For the whole field related to the **single market**, and in particular competition, public procurement, intellectual property, company and accounting law, taxation, product liability, financial services, the legislative foundation is almost completely in place.

Despite the efforts undertaken, the progress made in transposing legislation still needs to be accompanied by concrete measures of implementation, as well as establishment of an effective administrative underpinning. Hungary has some instruments which operate correctly (for instance in the field of public procurement, appeal procedures set out in the directives are applied and court cases have been started) but substantial efforts are still needed in a number of sectors, notably standardisation.

As for the **other parts of the *acquis***, Hungary should not have difficulty in applying it in the medium term, provided it continues its current preparation for accession in the following fields: education, training and youth; research and technological development; telecommunications; audio-visual; small and medium enterprises; international trade relations, and development.

By contrast substantial efforts will be needed for Hungary to be able to apply the *acquis* in consumer protection and customs controls.

Given the extent of restructuring and modernisation efforts undertaken so far, there are good reasons to expect that most sectors of Hungarian **industry** in the medium term can be competitive operators in the single market.

For the **environment**, very important efforts will be needed, including massive investment and strengthening of administrative capacity for enforcement of legislation. Full compliance with the *acquis* could only be expected in the long to very long term and would necessitate increased levels of public expenditure.

Hungary has already made considerable progress on taking on the **transport** *acquis*. If it continues its efforts on road transport and technical controls this sector should not pose significant difficulties. Hungary will need to provide the investment necessary to extend the European transport network in order to ensure effective operation of the single market.

Hungary should also be able in the medium term to apply the *acquis* on **employment and social affairs** but efforts are still needed to improve the health system and apply EU health and safety at work standards. Hungary already has an effective labour inspectorate.

For **regional policy** Hungary has adopted a regional development policy which, if implemented, should permit it in the medium term to apply Community rules and make effective use of structural funds. Hungary will also need the necessary financial control instruments.

In the **agriculture** sector if progress is made in the veterinary and phytosanitary fields, and if the structures needed in the agrifood sector and for applying the CAP are reinforced, membership in the medium term should not pose significant problems for Hungary in applying the CAP in an appropriate manner.

For **energy** efforts are still needed in respect of monopoly operations, price fixing, access to networks and state intervention in the solid fuel and uranium sectors. Hungary has a nuclear power station at Paks which produces nearly 40% of the country's electricity. It needs to modernise this in the medium term in order to bring it up into internationally accepted safety standards. It will also need to find a solution for nuclear waste.

On the basis of the analysis of its capacity to apply the *acquis*, Hungary could be in a position in the medium term to take and implement the measures necessary for removal of controls at its **borders** and establishment of these at the Union's external border.

Hungary should be in a position to participate at the appropriate time in the third stage of **economic and monetary union**, which implies coordination of economic policy and complete liberalisation of capital movements. But it is premature to judge whether Hungary will be in a position, by the time of its accession, to participate in the Euro area. That will depend on how far the success of its structural transformation enables it to achieve and sustain permanently the convergence criteria. These are, however, not a condition for membership.

Hungary should be able to meet the **justice and home affairs** *acquis* in the next few years, even though particular attention will need to be paid to frontier controls, treatment of asylum seekers, visa policy and the fight against organised crime. Hungary has indicated a wish to join the Schengen Agreements.

Hungary should be able to fulfil its obligations in respect of the **common foreign and security policy**.

In addition, Hungary has reinforced its relations with its neighbours since 1989, and has signed Friendship and Good Neighbourliness Agreements with them recognising existing frontiers and resolving almost all the potential disputes with them. It has played an important role in regional stability.

4. Administrative and Legal Capacity

If Hungary pursues the administrative reforms which have already been started, the necessary structures could be in place in the medium term to apply the acquis effectively.

The capacity of the judicial system to ensure uniform application of Community law is of great importance, particularly for the implementation of the single market. If Hungary pursues its efforts, the judicial system should be capable of applying Community law in the medium term.

CONCLUSION

In the light of these considerations, the Commission concludes that :

- Hungary presents the characteristics of a democracy , with stable institutions guaranteeing the rule of law, human rights and respect for and protection of minorities;

- Hungary can be regarded as a functioning market economy and it should be able to cope with competitive pressure and market forces within the Union in the medium term;

- if Hungary continues its efforts on transposition of the acquis relating particularly to the single market, and intensifies its work on its implementation, Hungary should become capable in the medium term of applying it fully. In addition, particular efforts will be needed to meet the acquis in sectors such as environment, customs control and energy. More generally, further administrative reform will be indispensable if Hungary is to have the structures to apply and enforce the acquis effectively.

In the light of these considerations, the Commission recommends that negotiations for accession should be opened with Hungary.

The reinforced pre-accession strategy will help Hungary to prepare itself better to meet the obligations of membership, and to take action to improve the shortcomings identified in the Opinions. The Commission will present a report no later than the end of 1998 on the progress Hungary has achieved.

ANNEX

COMPOSITION OF PARLIAMENT

| <u>Political party</u> | <u>Abbreviation</u> | <u>Seats</u> |
|-------------------------------------|---------------------|--------------|
| Hungarian Socialist Party | MSZP | 208 |
| Union of Free Democrats | SZDSZ | 67 |
| Independent Smallholders' Party | FKGP | 25 |
| Christian Democratic Party | KDNP | 23 |
| Union of Young Democrats | FIDESZ-MPP | 21 |
| Hungarian Democratic Forum | MDF | 19 |
| Hungarian People's Democratic Party | MDNP | 15 |
| Independent candidates | - | 8 |

Market: White Paper Measures

This table is based on information provided by the Hungarian authorities and confirmed by them as correct as at the end of June 1997. It does not indicate the Commission's agreement with their analysis. The table includes directives and regulations cited in the White Paper which total 899. These have been listed in accordance with the categorization used in the White Paper and in relation to the policy areas covered. The table shows the number of measures for which the Hungarian authorities have notified the existence of adopted legislation having some degree of compatibility with the

corresponding White Paper measures.

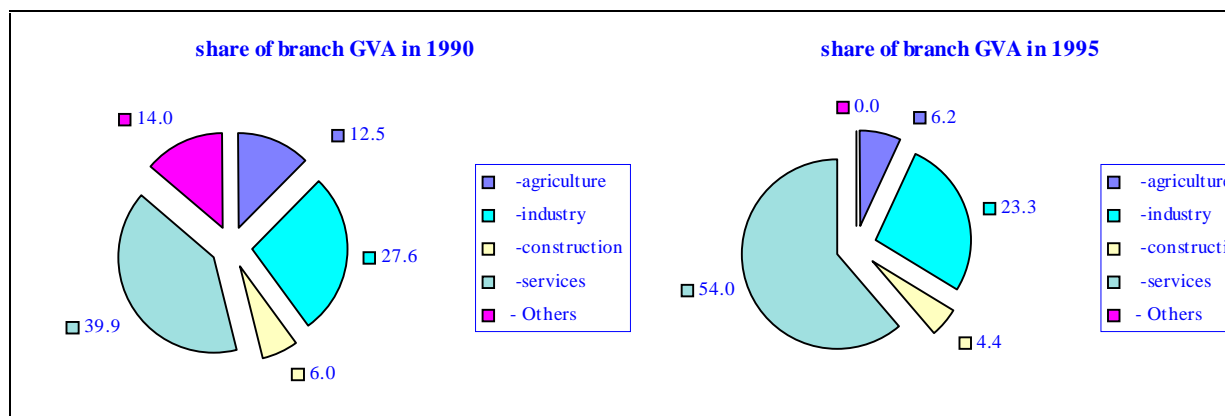
| 1.1.1.1.1.1.1 White Paper chapters | | Directives | | Regulations | |
|---|--------------------------------|------------|--------------|-------------|--------|
| | | Stage I | Stage II/III | Stage I | St. II |
| 1.Free Movement of Capital | Hungary | 3 | 1 | 0 | |
| | Number of White Paper measures | 3 | 1 | 0 | |
| 2.FM and Safety of Industrial Products | Hungary | 22 | 50 | 1 | |
| | Number of White Paper measures | 56 | 104 | 4 | |
| 3.Competition | Hungary | 3 | 0 | 1 | |
| 1.2 | Number of White Paper measures | 3 | 0 | 1 | |
| 4.Social policy and action | Hungary | 11 | 7 | 0 | |
| | Number of White Paper measures | 12 | 15 | 0 | |
| 5.Agriculture | Hungary | 83 | 42 | 44 | |
| 1.2.1 | Number of White Paper measures | 93 | 46 | 62 | |
| 6.Transport | Hungary | 11 | 4 | 4 | |
| 1.2.2 | Number of White Paper measures | 19 | 15 | 8 | |
| 7.Audiovisual | Hungary | 1 | 0 | 0 | |
| 1.2.3 | Number of White Paper measures | 1 | 0 | 0 | |
| 8.Environment | Hungary | 23 | 0 | 2 | |
| 1.2.4 | Number of White Paper measures | 31 | 7 | 7 | |
| 9.Telecommunication | Hungary | 8 | 5 | 0 | |
| 1.2.5 | Number of White Paper measures | 9 | 7 | 0 | |
| 10.Direct Taxation | Hungary | 0 | 0 | 0 | |
| 1.2.6 | Number of White Paper measures | 2 | 2 | 0 | |
| 11.Free movement of goods | Hungary | 0 | 0 | 0 | |
| 1.2.7 | Number of White Paper measures | 0 | 0 | 0 | |
| 12.Public Procurement | Hungary | 5 | 1 | 0 | |
| 1.2.8 | Number of White Paper measures | 5 | 1 | 0 | |
| 13.Financial services | Hungary | 12 | 8 | 0 | |
| 1.2.9 | Number of White Paper measures | 13 | 8 | 0 | |
| 14.Protection of personal data | Hungary | 0 | 2 | 0 | |
| 1.2.10 | Number of White Paper measures | 0 | 2 | 0 | |
| 15.Company Law | Hungary | 2 | 2 | 0 | |
| 1.2.11 | Number of White Paper measures | 2 | 3 | 0 | |
| 16.Accountancy | Hungary | 2 | 2 | 0 | |
| 1.2.12 | Number of White Paper measures | 3 | 2 | 0 | |
| 17.Civil law | Hungary | 1 | 1 | 0 | |
| 1.2.13 | Number of White Paper measures | 1 | 1 | 0 | |
| 18.Mutual rec. of prof. Qual. | Hungary | 2 | 13 | 0 | |
| 1.2.14 | Number of White Paper measures | 2 | 16 | 0 | |
| 19.Intellectual property | Hungary | 5 | 2 | 0 | |
| 1.2.15 | Number of White Paper measures | 5 | 3 | 0 | |
| 20.Energy | Hungary | 6 | 0 | 0 | |
| 1.2.16 | Number of White Paper measures | 10 | 2 | 3 | |
| 21.Customs law | Hungary | 0 | 0 | 14 | |
| 1.2.17 | Number of White Paper measures | 2 | 1 | 14 | |
| 22.Indirect Taxation | Hungary | 8 | 25 | 0 | |
| 1.2.18 | Number of White Paper measures | 15 | 54 | 0 | |
| 23.Consumer Protection | Hungary | 5 | 2 | 0 | |
| 1.2.19 | Number of White Paper measures | 8 | 3 | 0 | |
| Total | Hungary | 213 | 167 | 66 | |
| | Number of White Paper measures | 295 | 293 | 99 | |

Statistical Data

If not explicitly stated otherwise, data contained in this annex are collected from „ **Hungarian Central Statistical Office** (KÖZPONTI STATISZTIKAI HIVATAL)“ with whom Eurostat and Member States’ statistical offices are co-operating since several years in the framework of the Phare programme. Regular data collection and dissemination are part of this co-operation process with the aim to enable the application of EU laws and practices in statistics. The data presented below have been compiled as far as possible using EU definitions and standards which in some cases differ from national practices. This may occasionally give rise to differences between the data presented here and those shown elsewhere in the opinion, which are generally based on the individual applicant countries’ updated replies to the questionnaire sent to them in April 1996. The exact compatibility with EU standards on statistics and thus the comparability with EU figures can still not be guaranteed, particularly those statistics that have not been supplied through Eurostat, but have been delivered directly by the countries concerned.. Wherever available, methodological notes are given describing content and particularities of statistical data presented in this annex. Data correspond to the information available as of May 1997.

BASIC DATA

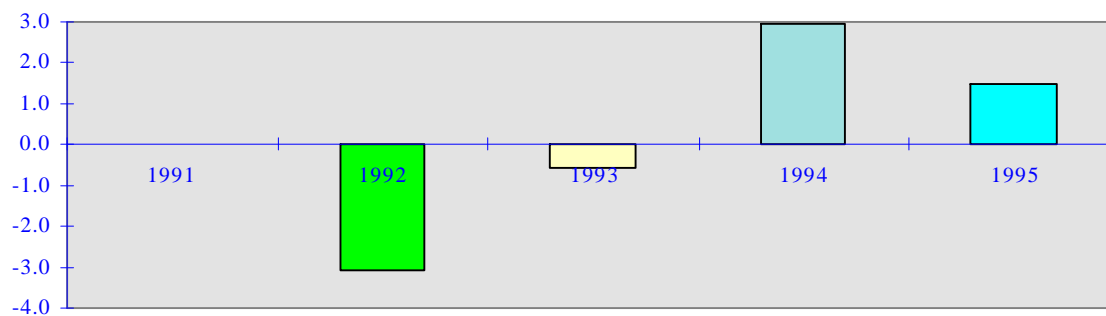
| | 1990 | 1992 | 1993 | 1994 | 1995 |
|---|---------------------------------|-------|--------|--------|--------|
| Total Area | 1000 hectares | | | | |
| | | | 9303 | 9303 | 9303 |
| Population (end of the period) | in 1000 | | | | |
| - total | | 10310 | 10277 | 10246 | 10212 |
| - Females | | | 5354.3 | 5338.2 | 5330.7 |
| - Males | | | 4922.7 | 4907.8 | 4881.3 |
| Population density | per 1 km ² | | | | |
| | | 111 | 111 | 110 | 110 |
| Urban Population | in % of total population | | | | |
| | | 43.1 | 63.2 | 63.8 | 62.6 |
| Deaths rate | per 1000 of population | | | | |
| | | 14.2 | 14.4 | 14.4 | 14.2 |
| Births rate | | 11.7 | 11.3 | 11.3 | 11 |
| Income and GDP per capita | European Currency Unit | | | | |
| -Average monthly wage and salary per employee | 167 | | | | 239 |
| -GDP per capita | 1688 | | | | 3343 |
| Structure of production: share of branch GVA | in % of Total Gross Value Added | | | | |
| -agriculture | 12.5 | | | | 6.2 |
| -industry | 27.6 | | | | 23.3 |
| -construction | 6.0 | | | | 4.4 |
| -services | 39.9 | | | | 54.0 |



NATIONAL ACCOUNTS

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|--|---|---------|---------|---------|---------|
| | in Millions of National Currency | | | | |
| Gross Domestic Product (Current Prices) | 2498319 | 2942668 | 3548262 | 4364811 | 5493800 |
| | in Billions of ECU | | | | |
| Gross Domestic Product (Current Prices) | 26.98 | 28.7 | 32.96 | 34.89 | 33.42 |
| | in Purchasing Power Standard per capita | | | | |
| Gross Domestic Product | | | 5543.6 | 5953.9 | 6311.4 |
| | % change over the previous year | | | | |
| Gross Domestic Product | | -3.1 | -0.6 | 2.9 | 1.5 |
| Final consumption expenditure | | 0.6 | 5.4 | -2.3 | -6.6 |
| -of households and NPISH | | 1.4 | 3.4 | 0.2 | -7.1 |
| -of general government | | -1.1 | 9.8 | -7.4 | -5.7 |
| Gross fixed capital formation | | -2.6 | 2.0 | 12.5 | -4.3 |
| Exports of goods and services | | 2.1 | -10.1 | 13.7 | 13.4 |
| Imports of goods and services | | 0.2 | 20.2 | 8.8 | -0.7 |
| | in % of Gross Domestic Product | | | | |
| Final consumption expenditure | 80.5 | 84.2 | 88.2 | 84.3 | 78.1 |
| -of households and NPISH | 54.8 | 57.7 | 59.7 | 58.0 | 54.0 |
| -of general government | 25.7 | 26.5 | 28.6 | 26.2 | 24.0 |
| Gross fixed capital formation | 20.9 | 19.9 | 18.9 | 20.1 | 19.1 |
| Exports of goods and services | 32.8 | 31.4 | 26.4 | 28.9 | 34.4 |
| Imports of goods and services | 33.7 | 31.7 | 34.6 | 35.4 | 36.6 |

GDP (% Change over the previous year)



MAIN ECONOMIC INDICATORS

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|--|-------|--------|--------|--------|--------|--------|
| | percentage change over the previous year | | | | | | |
| Inflation rate | 28.9 | 35 | 23 | 22.5 | 18.8 | 28.2 | 23.6 |
| | previous year = 100 | | | | | | |
| Industrial production volume indices | | | | 104 | 109.6 | 104.6 | 102.3 |
| Gross agricultural production volume indices | | | | 90.3 | 103.2 | 102.6 | |
| Unemployment rate (ILO methodology) | in % labour force | | | | | | |
| - Total | | | | 11.3 | 10.2 | 9.3 | 9.2 |
| - less then 25 years | | | | | 17.6 | 16.6 | 15.7 |
| - 25 years and more | | | | | 8.7 | 8.2 | 8.0 |
| | in Billions of USD | | | | | | |
| Gross Foreign debt | 21.37 | 23.31 | 20.51 | 22.88 | 27.20 | | |
| Balance of payments | in millions of USD | | | | | | |
| -Exports of goods | 9151 | 9688 | 10097 | 8119 | 7648 | 12864 | 14184 |
| -Imports of goods | -8617 | -9330 | -10108 | -12140 | -11364 | -15297 | -16836 |
| -Trade balance | 534 | 358 | -11 | -4021 | -3716 | -2433 | -2652 |
| -Services, net | 484 | 534 | 765 | 216 | 159 | 642 | 1498 |
| -Income, net | -1427 | -1356 | -1260 | -1190 | -1406 | -1804 | -1456 |
| -Current account balance | 379 | 403 | 352 | -4262 | -4054 | -2535 | -1689 |
| -Capital and fin. acc.(excl. reserves) | -946 | 2379 | 409 | 6112 | 3205 | 5851 | -1610 |
| -Reserve assets | 558 | -2700 | -763 | -2574 | 640 | -4614 | 1437 |

Inflation rate: Percentage change of yearly average over the previous year - all items index (data are based on national CPIs which are not strictly comparable).

Industrial production volume indices: Industrial production covers mining and quarrying, manufacturing and electricity, gas and water supply (according to the NACE Classification Sections C,D,E). Index of total industrial production and industrial sales includes the data of all industrial corporations. The indices by branches refer to corporations with more than 20 employees up to the end of 1994 and with more than 10 employees since 1995.

Gross agricultural production volume indices: Indices based on evaluation of all individual products of gross agricultural production. Constant prices refer to 1991.

Unemployment rate (by ILO methodology): Percentage of the unemployed in labour force. This rate is derived from LFSS (Labor Force Survey), observing the following ILO definitions and recommendations where:

Labor force employed and unemployed persons in the sense of the ILO definitions stated below.

The employed all persons aged 15+, who during the reference period worked at least one hour for wage or salary or other remuneration as employees, entrepreneurs, members of cooperatives or contributing family workers. Members of armed forces and women on child-care leave are included.

The unemployed all persons aged 15+, who concurrently meet all three conditions of the ILO definition for being classified as the unemployed: (i) have no work, (ii) are actively seeking a job and (iii) are ready to take up a job within a fortnight.

In Hungary, LFSS monitors only persons aged 15-74.

Gross foreign debt: Debt is extracted from the OECD's External Debt Statistics.

Balance of payments: Data is derived from IMF database, their comparability with respective EU statistics can not be guaranteed, but balance of payments is compiled mainly in accordance to IMF standards. Balance in trade of goods in accordance with balance of payments principles. Exports and imports are both in f.o.b. values. *Net income* includes direct, portfolio and other investment income, compensation of employees. Current account balance by definition of IMF 5th Manual, capital transfers are excluded. *Reserve assets:* it means changes in reserve assets during the year; (+) signifies an increase, (-) a decrease in reserve assets.

FOREIGN TRADE

| | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|----------------------|-------|-------|-------|-------|
| Imports and exports (current prices) | in millions of USD | | | | |
| - Imports | | 12645 | 14554 | 15466 | 16209 |
| - Exports | | 8918 | 10701 | 12867 | 13145 |
| - Balance of trade | | -3727 | -3853 | -2599 | -3064 |
| External trade volume indices | previous year = 100 | | | | |
| - Imports | | 120.9 | 114.5 | 96.1 | 105.5 |
| - Exports | | 86.9 | 116.6 | 108.4 | 104.6 |
| Structure of Import by SITC (current prices) | in % of total Import | | | | |
| - (0+1) food and live animals, beverage and tobacco | 5.5 | 5.6 | 6.3 | 5.3 | 5 |
| - 2 crude materials, inedible | 4 | 3.1 | 3.7 | 4.1 | 3.7 |
| - 3 mineral fuels and lubricants | 15 | 13.3 | 11.8 | 11.7 | 13.6 |
| - 4 animal and vegetable oils etc. | 0.1 | 0.2 | 0.3 | 0.3 | 0.3 |
| - 5 chemicals and related products | 12.9 | 11.9 | 12.7 | 14.2 | 13.9 |
| - 6 manufactured goods classified chiefly by material | 20.4 | 18.2 | 19.8 | 23 | 22.2 |
| - 7 machinery and transport equipment | 29.9 | 36.6 | 34.1 | 30.8 | 30.5 |
| - 8 miscellaneous manufactured articles | 12.2 | 11.1 | 11.3 | 10.6 | 10.8 |
| - 9 goods not elsewhere classified | 0 | 0 | | | |
| Structure of export by SITC (current prices) | in % of total Export | | | | |
| - (0+1) food and live animals, beverage and tobacco | 21.8 | 19.1 | 18.5 | 20.3 | 18.4 |
| - 2 crude materials, inedible | 5.5 | 5.7 | 5.2 | 4.8 | 4.5 |
| - 3 mineral fuels and lubricants | 3.4 | 4.1 | 4 | 3.2 | 4.1 |
| - 4 animal and vegetable oils etc. | 1.2 | 1 | 0.9 | 0.7 | 0.8 |
| - 5 chemicals and related products | 10.8 | 12.1 | 11.2 | 11.8 | 11.1 |
| - 6 manufactured goods classified chiefly by material | 16 | 16.1 | 16.6 | 17.4 | 17.7 |
| - 7 machinery and transport equipment | 20.8 | 24.1 | 25.6 | 25.6 | 25.5 |
| - 8 miscellaneous manufactured articles | 20.4 | 17.8 | 17.9 | 16.2 | 17.8 |
| - 9 goods not elsewhere classified | 0.1 | 0.1 | | | |
| External trade price indices | previous year = 100 | | | | |
| - Imports | 109.9 | 109.4 | 115.5 | 132.2 | 120.8 |
| - Exports | | 111.9 | 118.1 | 133.9 | 118 |

Imports and exports (current prices), External trade volume indices and Structure of external trade by SITC (current prices):

Trade data exclude direct re-exports, trade in services and trade with customs free zones as well as licenses, know-how and patents. The data are based upon the special trade system and are regularly updated.

Trade Classifications: The recording of merchandise trade occurs by two types of classification in parallel: apart from the Hungarian External Trade Classification (KTJ) also on the basis of the Harmonized Commodity Description and Coding System (HS) nomenclature.

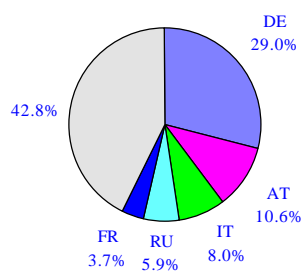
Imports are recorded on *CIF* basis and are captured in the same way as exports. **Exports** are recorded on *FOB* basis and are captured with the date on which the commodities cross the customs border. The customs statistics is utilized for monitoring of foreign trade data. Eurostat has converted National Currencies to the US dollar by applying the International Monetary Fund annual average exchange rates.

External trade price indices: Unit value index - calculation is used for measuring price changes in external trade, with the exception of heterogeneous commodity groups, where the sample method is applied for the price observation.

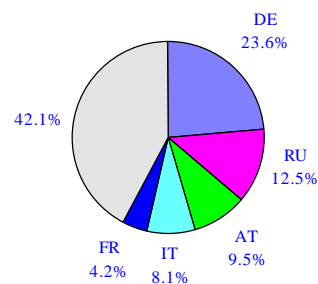
FOREIGN TRADE

| | 1992 | | 1993 | | 1994 | | 1995 | | 1996 | |
|--|-----------------------|------|-----------|------|-----------|------|-----------|------|-----------|------|
| Structure of imports by main countries (current prices) | | | | | | | | | | |
| | in % of total imports | | | | | | | | | |
| 1st partner | DE | 23.6 | DE | 22.2 | DE | 23.4 | DE | 23.4 | DE | 23.6 |
| 2nd partner | RU | 16.9 | RU | 21.6 | AT | 12 | RU | 11.8 | RU | 12.5 |
| 3rd partner | AT | 14.4 | AT | 11.6 | RU | 12 | AT | 10.7 | AT | 9.5 |
| 4th partner | IT | 6.3 | IT | 6 | IT | 7 | IT | 7.9 | IT | 8.1 |
| 5th partner | CZ | 4.3 | US | 3.9 | GB | 4 | FR | 3.9 | FR | 4.2 |
| others | | 34.5 | | 34.7 | | 41.6 | | 42.3 | | 42.1 |
| Structure of exports by main countries (current prices) | | | | | | | | | | |
| | in % of total exports | | | | | | | | | |
| 1st partner | DE | 27.7 | DE | 26.6 | DE | 28.2 | DE | 28.6 | DE | 29 |
| 2nd partner | RU | 13.1 | RU | 15.3 | AT | 10.9 | AT | 10.1 | AT | 10.6 |
| 3rd partner | AT | 10.7 | AT | 10.1 | IT | 8.5 | IT | 8.5 | IT | 8 |
| 4th partner | IT | 9.5 | IT | 8 | RU | 7.5 | RU | 6.4 | RU | 5.9 |
| 5th partner | YU | 3.5 | US | 4.2 | GB | 4.3 | FR | 4 | FR | 3.7 |
| others | | 35.5 | | 35.8 | | 40.6 | | 42.4 | | 42.8 |

**Structure of export by main partners
in 1996**



**Structure of import by main partners
in 1996**



| | | | |
|----|----------------|----|--------------------|
| AT | Austria | IT | Italy |
| CZ | Czech Republic | RU | Russian Federation |
| DE | Germany | US | United States |
| FR | France | YU | Yugoslavia |
| GB | United Kingdom | | |

SOCIAL INDICATORS

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|--------------------------|---------|---------|---------|-------|
| Population on 1 January | thousand | | | | |
| | 10354.8 | 10337.2 | 10310.2 | 10277.0 | 10246 |
| Proportion of population by age 1 January 1995 | in % of total population | | | | |
| y0_14 | | | | | 18.3 |
| y15_24 | | | | | 15.8 |
| y25_44 | | | | | 28.1 |
| y45_64 | | | | | 23.8 |
| y65_max | | | | | 14.0 |
| | total number | | | | |
| Live births | 127207 | 121724 | 117033 | 115598 | |
| Deaths | 144813 | 148781 | 150244 | 146889 | |
| Infant deaths | | | | | |
| - Less than 1 year | 1989 | 1714 | 1458 | 1335 | |
| - Still birth | 575 | 509 | 425 | 408 | |
| Marriages | 61198 | 57005 | 54099 | 54114 | |
| Divorces | 24433 | 21607 | 22350 | 23417 | |
| | per 1000 of population | | | | |
| Crude marriage rate | 5.92 | 5.52 | 5.26 | 5.26 | 5.2 |
| Crude divorce rate | 2.36 | 2.09 | 2.17 | 2.3 | 2.4 |
| Natural growth | -1.7 | -2.62 | -3.23 | -3.05 | |
| Net migration | 0 | 0 | 0 | 0 | |
| Total population growth | -1.7 | -2.62 | -3.23 | -3.05 | |
| Total fertility rate | 1.86 | 1.77 | 1.69 | 1.64 | |
| Infant mortality rate | 15.64 | 14.08 | 12.46 | 11.55 | 10.7 |
| Late foetal mortality rate | 4.5 | 4.16 | 3.62 | 3.52 | |
| Life expectancy | at birth | | | | |
| - Males | | 65 | 64.6 | 64.8 | 64.8 |
| - Females | | 73.8 | 73.7 | 74.2 | 74.2 |
| Life expectancy | at 65 years | | | | |
| - Males | | | | 12 | 12.1 |
| - Females | | | | 15.6 | 15.8 |

Net Migration: No comprehensive migration survey carried out: estimated figures.

LABOUR MARKET

| | 1993 | 1994 | 1995 | 1996 |
|---|--|------|------|------|
| Economic Activity Rate (ILO methodology) | in percent of population age +15 | | | |
| | 59.2 | 57.1 | 56.1 | 55.6 |
| Average employment | in thousand | | | |
| | 2836 | 2899 | 2744 | 2552 |
| Unemployment rate by age (ILO methodology) | in % of labour force | | | |
| - total | 11.3 | 10.2 | 9.3 | 9.2 |
| - less than 25 years | | 17.6 | 16.6 | 15.7 |
| - 25 years and more | | 8.7 | 8.2 | 8 |
| Registered unemployment (end of period) | in % of economically active population | | | |
| | 12.6 | 10.9 | 10.9 | 10.7 |

| | 1993 | 1994 | 1995 | 1996 |
|---|---------------------|-------|-------|-------|
| Average paid employment indices by NACE classes | Previous year = 100 | | | |
| - Agriculture, hunting, forestry and fishing | 73.7 | 82.7 | 90.7 | 95.3 |
| - Mining and quarrying | 65.7 | 63.8 | 82.4 | 92 |
| - Manufacturing | | 93.1 | 94.7 | 94.8 |
| - Production and distribution of electricity, gas and water | | 104.9 | 96.8 | 94.4 |
| - Construction | | 90.6 | 82.7 | 76.6 |
| - Transport, storage and communication | | 96.6 | 97.4 | 94.5 |
| Monthly nominal wages and salaries indices by NACE classes | | | | |
| - Agriculture, hunting, forestry and fishing | 125.5 | 127.8 | 121.2 | 117.4 |
| - Mining and quarrying | 130 | 118.6 | 118.5 | 118.4 |
| - Manufacturing | 124.7 | 123 | 121.3 | 121.6 |
| - Production and distribution of electricity, gas and water | 124.7 | 123.5 | 120.8 | 123.1 |
| - Construction | 120.6 | 121.9 | 116.7 | 118 |
| - Transport, storage and communication | 120 | 125.8 | 117.4 | 124.3 |
| Monthly wages and salaries indices | | | | |
| - nominal | 121.9 | 124.7 | 116.8 | 120.4 |
| - real | 96.1 | 107.0 | 87.8 | 94.6 |

Economic activity rate (ILO Methodology) Percentage of labor force in the total population aged 15+. This rate is derived of LFSS (Labor Force Survey) observing the following ILO definitions and recommendations, where:

Labor force: employed and unemployed persons in the sense of the ILO definitions stated below.

The employed: all persons aged 15+, who during the reference period worked at least one hour for wage or salary or other remuneration as employees, entrepreneurs, members of cooperatives or contributing family workers. Members of armed forces and women on child-care leave are included.

The unemployed: all persons aged 15+, who concurrently meet all three conditions of the ILO definition for being classified as the unemployed: (i) have no work, (ii) are actively seeking a job and (iii) are ready to take up a job within a fortnight.

Unemployment rate (by ILO methodology) Percentage of the unemployed in labour force. This rate is derived from LFSS (Labor Force Survey), observing the ILO definitions and recommendations (see ILO definitions above)

Registered unemployment (end of period): percentage of unemployed registered in civil economically active population, based on Labour force sample survey (LFSS). Registered unemployment data are based on the monthly administrative unemployment register. Since May 1995 the coverage scope of registered unemployed has changed because of excluding of job-seekers, who are temporarily unable to undertake work.

Average employment: Since 1994, the absolute figures for entrepreneurial sphere cover already the economic units with 10 or more employees. The data cover also all budgetary, subsidised organisations and persons with secondary job are included. Armed forces, apprentices, employees on child-care and additional child-care leaves are excluded.

Average paid employment indices by NACE classes: The data for entrepreneurial sphere cover in 1994 corporations with 20 or more employees, since 1995 with 10 or more employees. The data cover also all budgetary, subsidised organisations and persons with secondary job are included. Armed forces, apprentices, employees on child-care and additional child-care leaves are excluded.

Monthly wages and salaries indices: Monthly **real** wages and salaries indices are derived from **net** nominal wages and salaries indices divided by consumer price indices. The data for entrepreneurial sphere cover in 1994 corporations with 20 or more employees, since 1995 with 10 or more employees. The data cover also all budgetary, subsidised organisations and persons with secondary job are included. Armed forces, apprentices, employees on child-care and additional child-care leaves are excluded.

PUBLIC FINANCE

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|--|----------------------------------|------|--------|--------|--------|--------|--------|
| Government budget | in Billions of national currency | | | | | | |
| -Consolidated central government revenue | | | | | | | |
| -Grants | | | | | | | |
| -Consolidated central government expenditure | 1088.8 | | | | | | |
| -Consolidated general government expenditure | | | | | | | |
| -Consolidated central government deficit/surplus | 16.7 | | -203.7 | -253.3 | -284.8 | -275.8 | -166 |
| -General government deficit/surplus | | | -205.2 | -265.4 | -367.4 | -336.1 | -250.7 |
| Government budget | in % of Gross Domestic Product | | | | | | |
| -Consolidated central government expenditure | 52.1 | | | | | | |
| -Consolidated general government expenditure | | | | | | | |
| -Consolidated central government deficit/surplus | 0.8 | | -6.9 | -7.1 | -6.5 | -5.0 | -2.5 |
| -General government deficit/surplus | | | -7.0 | -7.5 | -8.4 | -6.1 | -3.8 |

Government budget: Data relate to central and general government as published in the IMF's *Government Finance Statistics Yearbook (1996) (GFSY)*; included also is the country's presentation in the *GFSY*.

Because the *GFSY* does not present statistics for general government, but for individual levels of government separately, the consolidated series presented here were obtained from central and local government data and adjusted in consolidation for the identified intergovernmental transfers.

Even though the statistics cover the central and local government published in *GFSY*, the coverage may not be exhaustive if some central or local government units are not included in that coverage. A measure of the exhaustiveness of the coverage can be obtained by comparing in the *GFSY* the note on the coverage of data for individual countries with the list of central and local government units provided.

It should be noted that the deficit/surplus used here is equal to revenue and grants minus expenditure, and does not take lending minus repayments into account (see further below).

The netting of inter-government transfers carried-out in the attached tables is limited to the current and capital transfers consisting of the identified grants and current and capital subsidies between the levels of government. Other types of transactions occurring between government levels, such as the payments of taxes and employers' social security contributions, and the reciprocal purchases of goods and services are not normally classified as inter-governmental transfers have not been eliminated in the consolidation process. Finally, whether the absence of data for current and capital transfers should be attributed to the absence of transfer or to lack of data is unclear; in all cases absence of information on transfers have been deemed to represent zero-transfers.

a. Government expenditure consists of general government cash expenditures on current and capital goods and services, interest payments and current and capital transfers but excludes non-cash transactions.

b. Deficit/surplus equals cash revenue and cash grants minus cash expenditure. This measure of the deficit/surplus differs from that used in GFS which equals cash revenue and cash grants, minus cash expenditure, minus net lending. This exclusion of net lending (consisting, in the *GFS* methodology, of operations in financial assets and liabilities carried out for specific policy purposes, rather than for liquidity purposes) brings the measure of the deficit/surplus presented here closer to the national accounts concept of net borrowing/net lending. Also, as a result of this exclusion, receipts from privatisation (classified as repayments in the *GFS* methodology) do not enter in the determination of the deficit/surplus presented in the attached tables (and therefore do not reduce the deficit).

Consolidated central government deficit/surplus and General government deficit/surplus data for years 1992-1996 were compiled by the Ministry of Finance on a basis that approximates the national accounts.

FINANCIAL SECTOR

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---------|---------|---------|---------|---------|---------|
| Monetary aggregates | Billions (10 ⁹) of US Dollars | | | | | | |
| - Monetary aggregate M1 | | | | 8.06 | 8.80 | 7.39 | 7.37 |
| - Quasi money | | | | 9.40 | 9.16 | 9.49 | 9.90 |
| Total reserves (gold excluded, end of period) | Millions (10 ⁶) of US Dollars | | | | | | |
| | | | | 6771 | 6810 | 12052 | 9795 |
| Average short term interest rates | % per annum | | | | | | |
| - lending rate | | | | 25.4 | 27.4 | 32.6 | |
| - deposit rate | | | | 15.7 | 20.3 | 26.1 | |
| Official discount rate (end of period) | | | | | | 28 | 23 |
| USD exchange rates | 1 USD = ...HUF | | | | | | |
| Average of period | 63.206 | 74.735 | 78.988 | 91.933 | 105.16 | 125.68 | 152.65 |
| End of period | 61.449 | 75.62 | 83.97 | 100.7 | 110.69 | 139.47 | 164.93 |
| ECU exchange rates | 1 ECU = ...HUF | | | | | | |
| Average of period | 80.488 | 92.608 | 102.535 | 107.653 | 125.090 | 164.392 | 207.909 |
| End of period | 83.773 | 101.401 | 101.679 | 112.348 | 136.153 | 183.297 | 206.656 |

Monetary Aggregates: *Money (M1):* Includes demand deposits and currency outside banks. The amount of some forint sight deposits of the household sector (that can be separated only from the beginning of 1993) has been reclassified as part of M1 instead of Quasi-money.

Quasi money (QM): Include time, savings and foreign currency deposits. In 1995 stocks of broad money (M2): the sum of currency outside banks, sight, demand, savings and time deposits of domestic money holders other than central government, extra-budgetary funds and of financial institutions, in domestic and foreign currencies.

Eurostat has converted National Currencies to the US dollar by applying the International Monetary Fund annual end of period exchange rates.

Total reserves (gold excluded, end of period): The statistics on official foreign reserves are extracted from the IMF's monthly International Financial Statistics (IFS).

Total reserves (gold excluded) are defined as the sum of central bank holdings of foreign currencies and other (gross) claims on non-residents; this definition excludes claims on residents denominated in foreign currency. According to the definition; official foreign reserves are calculated at market exchange rates and prices in force at the end of the period under consideration. Total reserves (gold excluded) published in IFS may differ from the figures published by the national authorities. Some factors contributing to possible differences are the valuation of the reserve position in the Fund, and a different treatment of claims in non-convertible currencies.

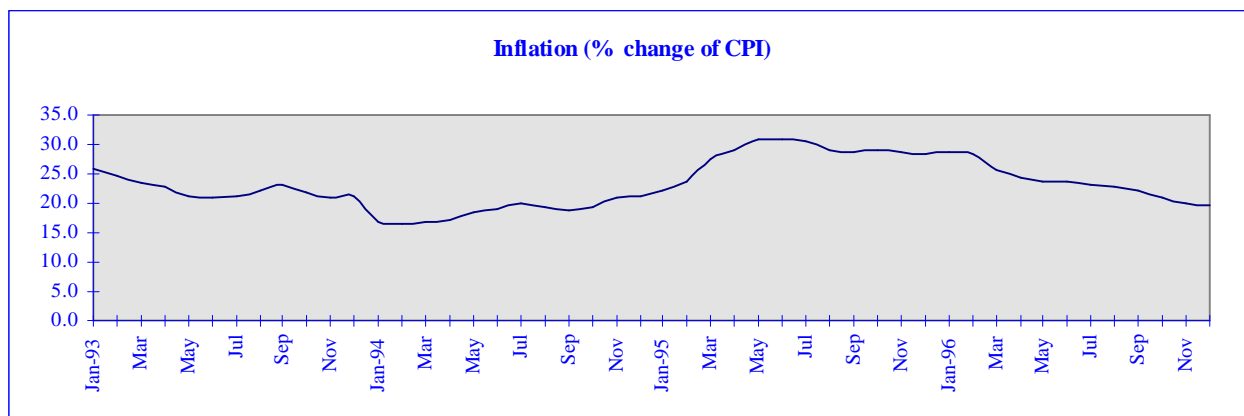
USD exchange rates: International Monetary Fund exchange rates as present in the publication: "Statistiques Financieres Internationales".

Average short term interest rates: Data are extracted from the IMF's monthly International Financial Statistics (IFS). Average short-term lending and deposit rates relate to period averages. *Lending rates* generally consist of the average interest rate charged on loans granted by reporting banks. *Deposit rates* relate to average demand and time deposit rates or average time deposit rates. These rates may not be strictly comparable across countries to the extent the representative value of the reporting banks and the weighting schemes vary.

INFLATION (12 months changes)

Percentage change of the CPIs with the current month compared with the corresponding month of the previous year (t/t-12)

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec |
|-------------|------|------|------|------|------|------|------|------|------|------|------|------|
| 1993 | 25.9 | 24.7 | 23.4 | 22.8 | 21.3 | 20.9 | 21.3 | 22.3 | 23.0 | 22.0 | 21.0 | 21.1 |
| 1994 | 17.0 | 16.6 | 16.8 | 17.3 | 18.3 | 19.2 | 20.0 | 19.5 | 18.9 | 19.5 | 21.0 | 21.2 |
| 1995 | 22.1 | 23.8 | 27.5 | 29.2 | 30.8 | 31.0 | 30.5 | 29.2 | 28.8 | 29.0 | 28.7 | 28.3 |
| 1996 | 28.9 | 28.3 | 25.6 | 24.4 | 23.9 | 23.6 | 23.0 | 22.9 | 22.2 | 21.0 | 20.1 | 19.8 |



Inflation (12 months changes): Inflation rates (12 months changes) are percentage changes of the CPIs with the current month compared with the corresponding month of the previous year. Inflation rates are based on national which are not strictly comparable between candidate countries or with those based on EU HICPs (different methods, concepts, practices in the calculation of CPIs).

INDUSTRY

| | 1993 | 1994 | 1995 | 1996 |
|---|--------------------------------|-------|-------|-------|
| Structure of GDP by economic activities (NACE, current prices) | in % of Gross Domestic Product | | | |
| - Mining and quarrying | 0.6 | 0.5 | 0.5 | |
| - Manufacturing | 21.9 | 21.6 | 23 | |
| - Production and distribution of electricity, gas and water | 3.7 | 3.2 | 3.4 | |
| Industrial production volume indices by NACE classes | previous year = 100 | | | |
| - Total | 104 | 109.6 | 104.6 | 102.3 |
| - Mining and quarrying | 99 | 82.7 | 86.7 | 102.4 |
| - Manufacturing | 103.3 | 109.3 | 105 | 102 |
| - Production and distribution of electricity, gas and water | 97.8 | 101.7 | 101.8 | 104.8 |

| | 1993Q1 | 1993Q2 | 1993Q3 | 1993Q4 | 1994Q1 | 1994Q2 | 1994Q3 | 1994Q4 |
|---|---|--------|--------|--------|--------|--------|--------|--------|
| Industrial production volume indices by NACE classes | corresponding period of the previous year = 100 | | | | | | | |
| - Total | | 105 | 108 | 103 | 109 | 106.2 | 111 | 110.4 |
| - Mining and quarrying | | 93 | 106 | 108 | 102 | 80.6 | 85.5 | 73.5 |
| - Manufacturing | | 103 | 106 | 103 | 108 | 105.4 | 110.3 | 110.9 |
| - Production and distribution of electricity, gas and water | | 98 | 99 | 99 | 100 | 97.8 | 100.4 | 102.1 |

| | 1995Q1 | 1995Q2 | 1995Q3 | 1995Q4 | 1996Q1 | 1996Q2 | 1996Q3 | 1996Q4 |
|--|---|--------|--------|--------|--------|--------|--------|--------|
| | corresponding period of the previous year = 100 | | | | | | | |
| | 109.2 | 106.9 | 103.7 | 100.1 | 101.7 | 100.5 | 102.3 | 104.3 |
| | 70.7 | 96.1 | 87.1 | 94.1 | 99.1 | 108.7 | 105.3 | 96.4 |
| | 110.6 | 107.7 | 103.6 | 100.1 | 98.7 | 102 | 103.1 | 103.7 |
| | 102.2 | 100.1 | 105.9 | 100.3 | 113 | 98.5 | 104.4 | 102.6 |

Structure of GDP by economic activities (NACE, current prices): is calculated at basic prices.

Industrial production volume indices by NACE classes: Industrial production covers mining and quarrying, manufacturing and electricity, gas and water supply (according to the NACE Classification Sections C,D,E). Index of total industrial production and industrial sales includes the data of all industrial corporations. The indices by branches refer to corporations with more than 20 employees up to the end of 1994 and with more than 10 employees since 1995.

INFRASTRUCTURE

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|--|----------------------------------|------|-------|------|------|
| Railway network | in Km per 1000 Km ² | | | | |
| | 86.8 | 86 | 83.4 | 83 | 83 |
| Railway transport | in million ton or passengers -km | | | | |
| - freight transport | | | 7708 | 7707 | 8409 |
| - passengers transport | | | 8432 | 8508 | 8441 |
| Number of telephone subscribers | in 1000 of population | | | | |
| | 194.5 | 199 | 145.6 | 173 | 208 |
| Number of inhabitants per passenger car | inhabitants | | | | |
| | 5.1 | 5 | 4.7 | 4.7 | 4.5 |

AGRICULTURE

| | 1992 | 1993 | 1994 | 1995 | 1996 |
|--|---------------------------|------|------|------|------|
| Land area by land-use categories | in 1000 Hectares | | | | |
| - total | 9303 | 9303 | 9303 | 9303 | 9303 |
| - agricultural land | 6136 | 6129 | 6122 | 6179 | |
| - forest | 1712 | 1764 | 1767 | 1763 | |
| - arable land | 4742 | 4747 | 4749 | 4806 | |
| - permanent meadows and pastures | 1164 | 1157 | 1148 | 1148 | |
| Agricultural land by legal status | in % of agricultural land | | | | |
| - state enterprise | | 20.2 | 19 | 17.6 | |
| - Cooperatives | | 53.3 | 37.7 | 30.5 | |
| - others | | 26.5 | 43.3 | 51.9 | |

| | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|--------------------------------|-------|-------|-------|-------|
| Share of GDP | in % of Gross Domestic Product | | | | |
| - Agriculture, hunting, forestry and fishing (Nace A+B) | | 6.6 | 6.7 | 7.2 | |
| | Previous year = 100 | | | | |
| Gross agricultural production volume indices | | 90.3 | 103.2 | 102.6 | 104.9 |
| Main crops by area | in 1000 Hectares | | | | |
| - Cereals | 2604 | 2657 | 2830 | 2664 | |
| - of which: wheat | 846 | 986 | 1059 | 1108 | |
| - Potatoes | 52 | 56 | 57 | 57 | |
| - Sugar beet | 108 | 95 | 105 | 124 | |
| - Fodder beet | | | | | |
| Main crops by yield | in 100 kg/Hectares | | | | |
| - Cereals | 37.9 | 31.7 | 40.7 | 41.3 | |
| - of which: wheat | 40.8 | 30.6 | 46.0 | 41.6 | |
| - Potatoes | 233.0 | 188.8 | 166.0 | 192.8 | |
| - Sugar beet | 271.1 | 229.7 | 321.0 | 338.6 | |
| - Fodder beet | | | | | |

| | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|--|-------|-------|-------|-------|
| Sales or procurement of animal for slaughter | in 1000 tons of live weight | | | | |
| - pigs | 490.2 | 420.3 | 348.6 | 375.4 | 521.5 |
| - cattle | 186.6 | 116.7 | 90.3 | 87.2 | 83.1 |
| - poultry | 243.3 | 223.3 | 218 | 293.1 | 292.2 |
| Livestock breeding intensity (end of period) | Heads per 1000 Ha of agricultural land | | | | |
| - cattle | | 163 | 149 | 150 | 147 |
| - of which: cows | | 73 | 68 | 68 | 67 |
| - sheep | | 204 | 155 | 158 | 1410 |
| | Heads per 1000 Ha of arable land | | | | |
| - pigs | | 816 | 920 | 1070 | 1120 |
| - of which: sows | | 65 | 55 | 71 | |

Share of GDP : is calculated at basic prices.

Gross agricultural production volume indices: Indices based on evaluation of all individual products of gross agricultural production. Constant prices refer to 1991.

Sales or procurement of animals for slaughter: The data refer to the procurement of principal product of agriculture.