

ASSESSMENT AND RECOMMENDATIONS

Recent macroeconomic performance has been satisfactory...

The Hungarian economy has returned to a path of steady growth in recent years. Macroeconomic performance has been favourable: the GDP growth rate has held at between four and five per cent for four consecutive years, inflation has declined considerably to below 10 per cent with unemployment currently under seven per cent. Exports, expanded external markets, and increased competitiveness have fuelled the recovery, resulting in continuously progressing employment. This has made it possible to offset part of the job losses generated during the first years of the transition. While the current level of employment is 14 per cent below the level of the pre-transition period, the economy has been largely purged of redundant labour. Substantial reforms put in place by the Bokros package, a very wide liberalisation of foreign direct investment (FDI), and a new law on bankruptcy have helped to build a more competitive environment. Foreign firms have carried out microeconomic restructuring in the wake of a nearly-complete process of privatisation and an overhaul of the institutional and legal infrastructure. The concerns raised by the slow reduction of the budget deficit and the risk of overheating are often stressed, but other macroeconomic results have been satisfactory.

...but disparities throughout the country have widened...

Hungary is regaining its former position within Europe as it undergoes a profound transformation. These changes are not being felt equally in all regions of the territory however. Performances diverged and disparities were amplified when the period of growth was established. Fuelled by important waves of FDI, western Hungary, as well as the capital and its surrounding area, have been the fastest to restructure and to take advantage of cumulative effects, whereas counties in the Northeast still suffer from the difficult restructuring of heavy industries and mono-sectoral activities, and the Great Plain and the Southeast are experiencing a decline in agriculture. While northeastern regions were among the most developed

during the communist period, growth has now shifted to the West. This East-West divide, the trend towards metropolisation encouraging suburbanisation around Budapest, the rural exodus and the accompanying process of urbanisation are increasing territorial fragmentation. These trends are widening income disparities between the countryside and the main cities.

...and will probably continue to do so if territorial policies are not strengthened.

There is a risk that this skewed distribution of activities will persist and even deepen. The more advanced regions are in a better position to seize the development opportunities during a period of growth and to develop cutting-edge activities. FDI will probably continue to be attracted mostly to the western area and Budapest, particularly since the second generation of foreign investors is now focussing on value-added products and skilled manpower, while competing Central and Eastern European (CEE) countries increasingly attract low wage-based foreign investments. The strong concentration of a knowledge-based infrastructure in the capital, and of business R&D activities in the Northwest where subcontracting networks of performing small companies have emerged, will offer newcomers strong advantages. Finally, an advantageous infrastructure, dynamic entrepreneurship and good connection with western markets is likely to fuel the endogenous development in these areas. Given that GDP depends strongly on external markets and centralised industries, the existing regional gap may widen. This situation calls for the renewal of territorial policies.

Regional policy is not new in Hungary...

The Hungarian government has traditionally used regional policy to address disparities and foster local development -- its success has been mixed. The country has considerable experience in targeting public initiatives to improve structural problems and manage crisis in more backward regions. In the early stages of the transition, a Regional Development Fund was created in Hungary, whereas other CEE countries such as Poland or the Czech Republic did not devote any significant public funding to this. Policy assistance was biased towards financing infrastructure while economic objectives such as encouraging job creation investment and regional coverage became more important after 1995.

Although the funds were initially low, they tripled between 1994 and 1997 during a period of slow growth. Given the limited experience in assessing projects and the thinness of the support, however, the results of providing subsidies to firms and normative support disappointed expectations.

...but the more recent EU PHARE programme has significantly influenced policymaking while emphasising the importance of territorial development.

As early as the beginning of the transition, the EU significantly influenced policymaking in Hungary, notably through PHARE, the major EU programme that provided technical and financial support in key economic areas of CEE countries. Nearly seven per cent of the total PHARE budget dedicated to Hungary during the 1990-1999 period was directed to regional development, in particular to human resources, institution building, SME development and innovation, regional tourism and business-related infrastructure. One of PHARE's principal contributions has been to favour deconcentrated management, particularly for cross-border activities (PHARE CBC), the pilot programmes and the creation of Local Development Agencies. Another important PHARE contribution includes the new credit guarantee instruments for rural business, assistance to infrastructure funding and the introduction of modern management methods. The programme was also instrumental in urging the government to undertake institutional reforms at territorial level. PHARE procedures have drawn technical criticism, however, and many evaluation studies report mixed feelings for having ignored (until recently) the strengthening of administrative capacities, and the supply of expertise and training. PHARE's impact on banking behaviour, co-operation among SMEs, and the involvement of municipalities has been disappointing on occasion.

Still, a coherent policy framework is needed.

If the institutional experience with regional policy assisted the implementation of PHARE, the EU programme has also introduced problems and distortions. A wealth of initiatives were undertaken under its umbrella but the limited results reflect the inability of the policy framework designed, to fully articulate European assistance with domestic policy.

The structure of governance has been modified, but the division of tasks among the

Changing the structure of governance is an attempt to strengthen this policy framework. Contrary to many CEE countries, Hungary has maintained a successful balance between the pace of economic

administrative layers is not sufficiently clear...

transformation and the speed with which new institutions, new regulatory regimes, and new rules of the game have been introduced. More than a hundred acts have been passed each year and twice as many decrees have been adopted. The Act on Regional Development and Physical Planning, adopted by Parliament in 1996 and amended in 1999, created a new regional level in the territorial administration. A National Regional Development Council (NRDC) (NUTS 1), Regional Development Councils (RDCs) (NUTS 2) and County Development Councils (CDCs) (NUTS 3) draw representatives from central government, counties and the social partners. Both sub-national institutions co-ordinate functions particularly for implementing sectoral policy at the territorial level. They also have significant decision-making power for planning and selecting projects. The 1996 Act is an attempt to coordinate regional policy at different territorial levels. However it does not clearly define the power or the share of programming and planning responsibilities at each level or determine an appropriate level of sectoral co-ordination (*e.g.*, for health, education). Moreover, the 1999 amendment reduced local representation in CDCs and reinforced the RDCs' power and the participation of the central government. Furthermore the CDCs as delegated institutions hold a strong position compared to the elected county assemblies. Many advantages will accrue from reconsidering the dual system of county representation and policy implementation. The CDCs could act as specialised development agencies reporting to the elected bodies of the counties rather than to the national government. This could also open the way for a better division of tasks between counties (which could be assigned intermediate general-purpose functions mainly in education and health care) and regions (which could manage structural funds and implement large spatial and infrastructure projects).

...and collaboration among the different tiers should be improved.

The creation of a multi-stage territorial organisation with four tiers of government (central, regional, county and municipal) is an important step towards decentralisation. However, the complexity of the new organisation makes vertical and horizontal collaboration necessary to achieve cost effectiveness in the supply of public services. Moreover, given the size of municipalities and the scarcity of their resources, it is crucial that they join

forces and reach a critical mass to provide public goods. The 1990 Act on Local Governments makes it possible for municipalities to form associations on a voluntary basis, but the incentives for this purpose provided by the government are not sufficient. Some OECD countries have rewarded municipal associations and provided incentives for specific types of co-operation and this could be usefully introduced into Hungarian legislation. Such rewards could also foster vertical collaboration.

The share of local taxes has been slightly increased, but further decentralisation would require a fiscal reform to facilitate local initiatives and help to reduce disparities.

The Hungarian sub-national financial system includes high state transfers and weak local taxes. Municipal budgets represent 41 per cent of central public expenditures while local taxes amount to only 12 per cent of central tax revenues. Although the share of own taxes has slightly increased, real own resources still amount to less than 40 per cent of all local revenue. In fact, fiscal decentralisation did not keep pace with the decentralisation of the 1990s. To compensate for these discrepancies, large intergovernmental grants are steered by the central government. After a difficult period of declining revenues, inflation and lower transfers from the central government, local governments have succeeded in generating surpluses, thanks to revenues from privatisation, strictly controlled spending and contracting out services. Local governments now have more leeway in financing local initiatives, but lack of their own resources tends to limit their efforts. Furthermore, intergovernmental grants hardly reduce revenue disparities and do little to achieve national goals such as minimum standards for public services and the elimination of territorial spillovers. A reform that increases the predictability and accuracy of the fiscal system could put local governments in a better position to significantly enhance their financial planning capacities and to address their own long-term development. Increasing the share of the personal income tax going to local government, and promoting a value-based property tax could balance differences among the municipalities and equalise losses in business tax income. The reform should also lead to streamlining intergovernmental grants. In the long run, improving the present equalisation system should be considered.

While regional allocations for economic development,

Until now, government policy directed towards reducing territorial

including EU assistance, increasingly target the less developed areas focusing on crucial growth factors, more attention is also given to institution building and EU accession preparation.

disparities has relied mainly on increasing transfers to the less developed regions and using the grant system to amplify the redistribution. From the beginning of the 1990s regional allocations were concentrated in the northeastern and eastern parts of the country. Two counties -- Szabolcs-Szatmar-Bereg and Borsod-Abauj-Zemplen -- still receive the bulk of the assistance. While EU funds were previously distributed relatively evenly between regions and sectors, PHARE 2000 now mainly targets eastern regions. The budget has been doubled and two additional EU government co-financed pre-adhesion programmes for large transport and environmental infrastructure (ISPA) and for agriculture and rural development (SAPARD) are being implemented. On the whole, assistance is increasingly accession-driven either from the E.U side or from national sources (*e.g.*, through programmes launched in all seven regions). It emphasises institution building, reinforcing administrative capacities and enhancing expertise in programme management. These supplemental funds alleviate the tensions of distributing limited budget resources while the discipline of EU Structural Fund compliance helps policy efficiency.

In this context, the government should maintain and develop a long-term strategy...

The need to integrate the *acquis communautaire* and (pre-adhesion) funds, is now one of the policy makers' main tasks. Aligning priorities on EU guidelines is becoming a dominant goal, but domestic policies should continue to serve national objectives. EU cohesion policies are not meant to be substitutes for domestic strategy and structural funds are just additional programmes. The government should therefore maintain local development programmes, and even ineligible ones that are linked with long-term strategy, and avoid delaying projects until accession. In addition, the allocations devoted to direct regional development purposes (regional and rural development allocations) seem modest, given the ambitious objectives of the National Regional Development Concept. It is therefore important that the government devote sufficient budgetary means to regional development to ensure balanced domestic purpose and co-financing. In particular, special attention should be devoted to the RDCs that in practice receive significantly less funds than CDCs and Regional Development Agencies (RDAs) require appropriate staffing levels that they currently lack. Given the need to tighten fiscal

policy however additional spending on territorial development would need to be financed by cuts elsewhere in the budget.

...and consider institutional arrangements to reinforce horizontal and vertical co-ordination.

As the number of programmes and the profile of regional policy grow, the involvement of ministries in policy-making with development targets at sub-national level is critical. Many ministries finance local and regional investment to one degree or another, through special chapters in the budget. The number of allocations they channel is, in general, significantly higher than that of the Ministry of Agriculture and Regional Development (MARD), which remains the main central government actor for regional issues. The task of overall co-ordination of structural policies has been assigned to the Ministry of Economy, while a ministry without portfolio retains some responsibility with regard to the PHARE programme. Further efforts should be made to reduce the fragmentation of functions and streamline the institutional framework.

The spatial impacts of economic policies should be assessed.

Regional policies that were adopted at the beginning of the transition sought to reduce disparities and promote equalisation via direct subsidies, while economic policies pursued the traditional goal of promoting privatisation and product competition, furthering regulatory reform and enhancing competitiveness. This division of tasks no longer holds. In Hungary and in other OECD countries, the territorial dimension of economic policies is more apparent than before. Territorial policies that target regional, urban, and rural development focus increasingly on identifying the development potential of each territory and promoting the full exploitation of comparative advantage by providing services and infrastructures (efficiency policies). The Szechenyi Plan, the recent initiative from the Hungarian Ministry of Economy that emphasises the need for a balanced territorial distribution of activity, is a first step. Until now, the spatial impacts of economic policy initiatives have not been analysed in depth and much remains to be done for more coherent and mutually reinforcing policy initiatives.

FDI must spread to less advanced territories, particularly in the East.

Foreign direct investment (FDI) remains the main tool of economic development strategies. So far, Budapest, and Central and West Transdanubia have attracted large influxes of foreign investment and

internalised most of their economic benefits. Specific policy instruments and regional incentives (grants, tax exemption, industrial parks, free trade zones) notwithstanding, foreign investors, whether already implanted in Hungary or not, have only recently been attracted, in rather modest numbers; to the South or to the East. As several OECD country experiences show, it is possible to attract an important share of FDI to less wealthy regions. This requires comprehensive central policies as well as the involvement of regional development agencies, a high degree of professionalism and networking capabilities. National authorities would need to set up incentive ceilings and specific mechanisms to limit regional overbidding.

Home growth development, especially, small and medium-size enterprises, deserves more attention...

Other alternatives to FDI development strategies are required, including strengthening local firms and regional market-based industries. SMEs often form the backbone of less advanced regions, especially in rural areas. In fact, there are many small, vital firms in Hungary. While they play a decisive role in trade, construction, light industries and services, they are not very productive, the quality of their products and services is low, marketing is insufficient and management is often weak. It is generally easy to launch a venture, but the environment is not very conducive to developing small businesses because of the administrative burden, relatively high taxes and a changing fiscal regime, a high social insurance rate and difficult access to bank loans and guarantee suppliers. In 1999, the government approved a decree on steps to be taken while a bill on small and medium-sized enterprises was passed in Parliament. The new budget appropriations for SMEs include budget lines from the Ministry of Economy that focus on direct business assistance, and from the MARD (Regional Development Allocation) that emphasises indirect business support (funding investment, business infrastructure, incubators and innovation centres). It is too early to assess these initiatives, but it is important to stress that the focus on SMEs has resulted in a proliferation of programmes that often have no clear relationship. The environment for SMEs must be stabilised and their access to the banking system is crucial for this. Previous PHARE loan schemes generally failed to attract bank interest in the SME sector. Given the lack of intermediate institutions,

sectoral formulae such as a Regional Guarantee Consortium should be considered.

... and the domestic sector should be linked with foreign-owned enterprises to strengthen territorial development.

There is some fear that the economy will comprise two different spheres: a duality with, on the one side, a well-performing foreign sector, usually composed of large firms, and, on the other, a mass of small firms that find it increasingly difficult to cope within a competitive and more global environment. As SME policies will not deliver results in the short term, increasing ties between the two sectors may help to upgrade the competitiveness of small firms involved in networks with foreign enterprises and sediment technical competence at local level. At the same time, foreign firms will be more locally anchored and therefore less prone to disinvestment. Industrial FDI is more common in those sectors that manufacture parts than in assembling industries, and their exports often have a high content of imports. There are nonetheless some signs of greater competitiveness from Hungarian subcontractors as the share of domestic supply in the output of foreign-owned enterprises located in free trade zones rose in 1998. If FDI operations are switching from a low-wage mass-production paradigm to a more high-skilled innovation-based one, as some new greenfield investments suggest, there will be greater requirements for subcontracting networks and domestic supplies. Whether current economic trends favour these changes is questionable. While the decline in research and technology investment seems to have stopped, foreign firms are largely responsible for overhauling the R&D system and innovation structures. Diffusion of technology to small firms is slow and there are few enterprises engaged in new products. The government is aware of these gaps and is taking steps to correct these imbalances. It has launched the Supplier Target Programme, which has resulted in a subcontractor Charter already signed by 50 foreign-owned enterprises with 1 500 firms participating in the programme. Under the Preliminary National Development Plan (PNDP), a competitive grants scheme will be accorded for establishing networks and joint SME production while the Szechenyi Plan of the Ministry of Economy will launch a subcontracting programme. Other initiatives include support to business-related infrastructure and skills in SMEs and a regional catch-up programme for

innovation and research from the Ministry of Education. These programmes should be co-ordinated at the delivery level and RDAs should be involved. More generally, the different services provided to SMEs (training, counselling, technological assistance and experiments, networking advice) should be streamlined and clustered at the regional level so that one-stop-shops and specialisation can be introduced among Local Employment Agencies, County Development Agencies and Regional Development Agencies. A regional technological platform integrating the different supply from universities, colleges, public laboratories could be created to diffuse information, offer assistance and propose technological packages for SMEs.

Improving transport and telecommunications infrastructures remains crucial for economic growth.

Adequate infrastructure and spatial externalities as a basis for territorial development are essential for attracting FDI, ensuring that SMEs are competitive and achieving a more balanced, sustainable regional distribution of activities. New transportation links and universal telecommunication access reduce the cost of doing business in peripheral regions, making the inherently lower land and labour costs more attractive to firms.

Highways and a network of main roads should be more evenly distributed and integrated nationwide. Railway and secondary roads need to be improved.

In Hungary, the efforts to improve accessibility have significantly helped to alleviate territorial bottlenecks and improve regional wealth, but much remains to be done. The plan to expand highways and main roads has been given new momentum recently, but the plan to modernise the network remains biased in favour of the West and of Budapest. Its configuration remains radial and few significant binding elements have been added. The railway network is more evenly spread but scarce resources mean that it is insufficiently maintained and repaired. Postponing the restructuring of the National Railway Company (MAV) has already been costly to the Ministry of Finance and the new development plans proposed should foresee the rationalisation of transport services and a separation of tracks and rolling stocks. It may be necessary to envisage the closing of less profitable lines in co-ordination with road modernisation or regional or county level intermodality investment projects. This points to the need to pay greater attention to the secondary road networks including city by-pass and border

crossing. Given that the central government bears three-quarters of the financial burden even with European funding (through the ISPA programme), investment programming needs to be carefully designed and the regional impact needs to be fully assessed. Focusing too much on the TransEuropean Network corridors may broaden rather than narrow accessibility differences between central and peripheral regions.

Infrastructure planning needs to be enhanced to stop the decline of urban public transport...

In Hungary, the volume of public passenger traffic has lessened significantly because the quality of services has dropped and charges have risen to compensate for cuts in the central government subsidy. Apart from providing a reasonable subsidy given the important externalities of public transport, municipalities should improve infrastructure planning and increasingly consider the demand for multi-modal transport especially in suburban areas. The central government also has a role to play in promoting coherent land use planning, modernising city road networks and investing in traffic attenuation facilities. In Budapest and the major cities, it could help promote the co-ordination of services between railway, buses and interurban services.

...and a more open telecommunications market needs to be established to more rapidly bridge the gap with other OECD countries.

Telecommunications have experienced some degree of catching up. Hungary is now on a par with the OECD average for a digitised network and mobile services. However, telecommunication facilities are unevenly distributed across the territory, the density of telephone lines in villages is often low, and long distance calling and calls to the countryside can be of poor quality and subject to disconnection. Telecommunications are therefore a major obstacle to regional development even outranking transport or border-crossing problems. Privatising the National Company (MATAV) has been a significant leap forward, but competition remains limited, which means upward pressures on cost and price. The Hungarian unit price for internet connection is still the highest among OECD countries. A more open market should be established to improve access to advanced telecommunications services and the universal services obligation should be enforced.

Despite progress, there are still considerable environmental problems,

The sustainability of transport investment and public infrastructure in general has been a major issue in Hungary since the early

especially in the cities and the East, which call for greater involvement from sub-national authorities.

days of the transition process. At regional level, environmental cleanliness is now increasingly considered to be a comparative advantage and a potentially attractive element of the business climate for people and private investment. Although some progress has been made on pollutant emissions, Hungary still lags behind in waste management and water treatment capacity. The complete integration of the *acquis communautaire* requires time and effort. While western border regions will soon match the level of environmental protection of advanced OECD countries, a number of other areas are disappointing. New sources of air pollution have emerged around major cities. There is not enough control of discharges into rivers and especially the Danube. While financing environmental protection investment, harmonising priorities with those of the EU, and getting EU support (ISPA) are important tasks for the central government, sub-national authorities are generally best placed to offer local solutions to sustainable development problems. In Hungary, however, counties or regions still have few responsibilities. Since they have to prepare regional plans, their involvement in impact assessment studies, awareness campaigns, and citizen consultation should be better ensured.

Securing a more functional housing market can significantly improve the quality of life and the mobility of the labour force.

The quality and limited availability of housing infrastructure have hindered interregional mobility and job-generating investment. The housing market remains particularly rigid due to, among other factors, the previous policy of low give-away prices and the transfer of part of the stock to cash-deprived local governments. In addition, scarce resources and the absence of a central subsidy to municipalities have made renovation particularly difficult especially in large cities. An underdeveloped credit market (particularly the mortgage system) prevents any large turnover of housing and makes new construction affordable only for the highest income strata. The central government is now more concerned with the problem of high real estate prices in major cities and the existence of an important non-solvent demand for housing. From 2001, greater commitment is reflected in the Szechenyi Plan's priority for housing -- while the National Budget provides resources for rental housing and renovation. While the plan targets first home buying and market expansion, it also aims at enhancing the liveability of regions and cities profile and at meeting the

needs of the disadvantaged, especially the elderly. The plan will need to be carefully implemented in order to reduce existing disparities, which requires applying an equalisation formula to the allocation of subsidies to be derived from the new state fund.

Bridging the social gap with more advanced OECD countries will require more targeted policy responses.

According to official estimates, the percentage of the population living below the subsistence level rose from 10 per cent in the 80s to 25 per cent in the mid-90s. At the same time, Hungary has a negative demographic situation because of a low natural rate of increase and a high mortality rate. The under-emphasis on social issues in territorial policy-making is all the more surprising given that poor social performance is widespread and touches even the most advanced regions. During the first stage of the transition, poverty spread in many areas after unemployment surged because of agricultural streamlining and the dramatic restructuring of the manufacturing industry. The budget and scope of policy responses have been limited thus far. Welfare provisions to the poor include social assistance, family allowances (childcare) and income supplement paid to the long-term unemployed. In 1999, a workfare element was introduced in the unemployment assistance system, which is a positive step to encourage work initiatives, but the new system is strongly biased in favour of public works, increasing the dependency of lagging regions on the public sector. So far, policies have done little to correct territorial imbalances in the number of hospital beds, doctors and the amount of resources allocated to health infrastructures between the different regions. With regard to family benefits, the focus is now increasingly put on the most needy though it is still perceived as favouring the middle-classes. Overall, more efforts should be made to improve access to welfare benefits for the poorest.

Active labour market policies in lagging regions focus too much on public works.

Unemployment has been identified as the main cause of poverty and the government has taken some policy initiatives in order to meet this challenge. Many of these policy initiatives (*e.g.*, wage subsidies) are non-territorial by nature. However, the labour market fund is now focussed more on interventions in targeted regions. Furthermore, active labour market policies (ALMP) are being implemented by the Country Labour Centres (CLC) to initiate welfare to work processes. Nine Regional Labour

Development and Training Centres have also been set up to tackle structural unemployment issues but the network is not sufficiently articulated with the business environment. In addition, a major share of the CLC funds goes to public work programmes. On the whole, the policy efforts remain modest. Expenditure in less favoured regions is well below the OECD average, while several regions, including North Hungary and the Great Plain are still plagued with significant and persistent high unemployment rates.

More decentralised intervention will increase the efficiency of social policy initiatives.

Deconcentration and even the decentralisation of some social policies could help deal with the problem of poverty and exclusion more effectively. So far, local authorities have spent about 57 per cent of the social expenditure budget on social benefits, principally employment benefits, housing aid and other transitional aid, and the figure is growing. The capacity of local government to intervene depends largely on local tax revenues, and deficits concerning basic equipment are very common in settlements with populations of above 20 000 or in small villages. In this context, social grants are targeted at local governments in fiscal crisis. Intergovernmental grants and central programmes such as the social land programme and emergency aid do lend some equalisation, but special attention should be given to covering basic procurement of equipment in villages. A preventive policy for health risks could be better promoted at local level while more flexible arrangements and active public participation should be encouraged. Such arrangements between local transport, housing and health policies are critical for determining an appropriate response to ageing and social problems and can be better co-ordinated and managed in a decentralised way. At the same time, strong vertical decentralisation does not seem to provide appropriate responses for managing large health equipment and hospitals when greater responsibility given to local government is not accompanied by corresponding financial resources. Overall, clarifying the roles among administrative layers is required to avoid duplication and excess capacity.

Co-ordination of infrastructure and programmes in education should be improved.

Results of decentralisation in education are mixed. Local governments have been given significant autonomy and wide responsibilities, but decentralisation has led to fragmented curricula and has

sometimes produced problems of cost-effectiveness. Some schools suffer from scarce resources and poor teaching staff while others are overstaffed. The merger of some schools seems necessary to use available resources more efficiently while access to basic education should be ensured in backward regions. The proportion of students leaving the education system without a diploma remains high and tertiary education participation rates are low in some areas. It is important to improve regional co-ordination of infrastructure and programme content as well as to elaborate a national strategy to tackle the most disadvantaged groups. It is also crucial that education and regional development policy be more integrated to improve school-to-work transitions.

The social problems of the Roma population require specific attention.

The Roma population is another important social issue. This disadvantaged minority is characterised by a particularly low rate of educational enrolment, low average income and high vulnerability to poverty. Therefore, it deserves special attention. The Roma represent, depending on the source, between five and 10 per cent of the population and far more in the northeastern and southern regions, and their number is expected to double by 2025. They have a higher than average rate of unemployment and most of their income is derived from social benefits. To improve their inclusion in the labour market and in society at large, successive Hungarian governments have targeted policy packages that emphasise education, training, preserving cultural values, enhancing employability, experimental housing and agrarian programmes. The success of these measures is critical if the government wants to alleviate the social budget burden. It is important to have the Roma participate in their own affairs and minority self-government has been recently established to implement cultural activities, create enterprises, and to allow them to voice their views and veto some local government decisions. The Law on Minorities should nevertheless be amended to enforce more efficient anti-discrimination legislation in employment and education and to ensure the consultative power and participation in major policy initiatives of minority self-governments and their representation in parliament. Initiatives associating Roma and non-Roma citizens should be strongly encouraged and information about Roma culture and values widely

diffused.

In sum, a balanced approach to decentralisation and rural and urban development will greatly improve the sustainability of the current growth path of the Hungarian economy.

Hungary has made outstanding progress implementing institutional changes, privatising assets, creating macroeconomic policies and improving the quality of public services and infrastructure. The sustainability of the new growth trajectory is not yet established and requires policy corrections. Without these, spatial fragmentation, disparities in wealth and employment between the East and the west, the capital and the periphery, and between urban and rural areas will increase. The challenge is twofold. First, the central authorities need to partner increasingly with sub-national entities and to establish relevant institutional arrangements. This co-operation is already taking place through territorial development programmes provided for municipalities and agencies but it should be intensified in order to meet regional economic demand. Assistance from the EU and additional infusions of resources from the European Commission clearly favour the country's progress, particularly in accelerating institutional building and laying the groundwork for increasing subsidiarity in the governance of territorial policy. Furthering the process of decentralisation will require rebalancing resources in favour of the lower levels however. Second, given the present trends towards polarising activities and growing intra-regional disparities, the central government must shape territorial policies in particular through regional aid schemes for SMEs, strengthening regional infrastructure and encouraging entrepreneurship. While much attention should be paid to rural development, modernisation of agriculture and diversifying services including tourism, urban policy should not be ignored. Budapest is the only city with international functions. Its role as gateway to the world needs to be reinforced and the institutional framework for the capital and the other large cities should be stabilised. It is especially critical to encourage better agglomeration management through inter-municipal co-operation. Such shifts in policy emphasis should facilitate the transition to EU adhesion and increase the acceptance of structural change.