

Regulatory Reform in Hungary

Enhancing Market Openness through
Regulatory Reform



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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FOREWORD

Regulatory reform has emerged as an important policy area in OECD and non-OECD countries. For regulatory reforms to be beneficial, the regulatory regimes need to be transparent, coherent, and comprehensive, spanning from establishing the appropriate institutional framework to liberalising network industries, advocating and enforcing competition policy and law and opening external and internal markets to trade and investment.

This report on *Enhancing Market Openness through Regulatory Reform* analyses the institutional set-up and use of policy instruments in Hungary. It also includes the country-specific policy recommendations developed by the OECD during the review process.

The report was prepared for *The OECD Review of Regulatory Reform in Hungary* published in 2000. The Review is one of a series of country reports carried out under the OECD's Regulatory Reform Programme, in response to the 1997 mandate by OECD Ministers.

Since then, the OECD has assessed regulatory policies in 16 member countries as part of its Regulatory Reform programme. The Programme aims at assisting governments to improve regulatory quality — that is, to reform regulations to foster competition, innovation, economic growth and important social objectives. It assesses country's progresses relative to the principles endorsed by member countries in the 1997 *OECD Report on Regulatory Reform*.

The country reviews follow a multi-disciplinary approach and focus on the government's capacity to manage regulatory reform, on competition policy and enforcement, on market openness, specific sectors such as telecommunications, and on the domestic macro-economic context.

This report was prepared by Evdokia Moïsé with the assistance of Sophie Bismut, Tadatsugu Matsudaira and Magdolna Sass of the Trade Directorate of the OECD. It benefited from extensive comments provided by colleagues throughout the OECD Secretariat, as well as close consultations with a wide range of government officials, parliamentarians, business and trade union representatives, consumer groups, and academic experts in Hungary. The report was peer-reviewed by the 30 member countries of the OECD. It is published under the authority of the OECD Secretary-General.

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Executive Summary

Background Report on Enhancing Market Openness through Regulatory Reform

Does the national regulatory system allow market participants to take full advantage of competitive markets? Reducing regulatory barriers to trade and investment enables countries in an expanding global economy to benefit more fully from comparative advantage and innovation. This means that more market openness increases the benefits that consumers and producers can draw from regulatory reform. Maintaining an open world trading system requires regulatory styles and content that promote global competition and economic integration, avoid trade disputes, and improve trust and mutual confidence across borders. This report offers an assessment of the performance of Hungary from these perspectives.

Over the past ten years Hungary has gone through radical changes to open its economy to international competition and integrate in the world economy. This opening has even been among the principal instruments used by successive Hungarian governments in order to achieve rapid and sustainable growth of the economy. Changes have included guaranteeing the right to private property and free enterprise, reducing the role of the State in the economy, lifting restrictions to capital flows and liberalising FDI regulations. At present economic and regulatory reforms have succeeded in establishing a business friendly environment, turning Hungary into one of the most attractive markets for foreign investment in the region. Businesses are generally assured of benefiting from effective equality of competitive opportunities, while the regulatory process is geared to avoiding unnecessary trade restrictiveness and encouraging the reduction of technical barriers to trade. Reforms have been given additional impetus by the Hungarian endeavour to join the European Union, reflected especially in the adoption of internationally harmonised measures and the recognition of equivalence of conformity assessment performed abroad. Overall, it can be said that the steady commitment of successive Hungarian governments since 1990 to pro-competitive, market-opening reforms as a means for achieving rapid and sustainable growth of the economy is the most fundamental strength of the regulatory environment in Hungary today.

Nonetheless, important challenges still lie ahead in the Hungarian regulatory system in order to improve market openness. They concern especially the effective implementation of already adopted market oriented reforms. Time-consuming procedures, burdensome requirements and administrative inefficiencies remain frequent complaints of foreign firms operating in Hungary. Despite increasing acceptance by the Hungarian administration of transparency objectives, the regulatory process continues to offer insufficient opportunities for information, comment and dialogue. In recent years, the urge to move forward the reform agenda at a rapid pace has overridden the need to enhance the dialogue over this agenda with concerned constituencies, affecting the predictability of the regulatory system. The capacity of the public administration to effectively implement current policy directions has lagged behind the actual regulatory framework. Market operation thinking has not yet impregnated all levels of the administration so as to allow efficient regulation to translate into everyday market reality.

The most significant improvement with respect to market openness in Hungary will thus come from a better match between the formal incorporation of efficient regulation principles into regulation and their actual implementation and enforcement. In the meantime, efforts should continue to meet the challenge of keeping up momentum for reform so as to reinforce confidence in a regulatory system that is well adapted and responsive to the needs of a dynamic market economy.

1. MARKET OPENNESS AND REGULATION: THE POLICY ENVIRONMENT IN HUNGARY

Over the past ten years Hungary has gone through radical changes to open its economy to international competition and integrate in the world economy. As some reforms, even though limited, had been introduced since the late 1960s, Hungary was a relatively more open economy in the 1980s compared to other centrally planned economies. However a decisive step was taken in 1988 when Hungary undertook radical reforms to allow for the free establishment of companies, reduce the role of the State in the economy, and build the legal and regulatory framework of a market economy. The trade liberalisation process was further accelerated by the international commitments Hungary took through several important trade and co-operation agreements. A major feature of Hungary's transition process towards a market economy has been the government's active policy in favour of foreign investment. The country has indeed been a leader in the region in attracting and retaining a large volume of foreign investment over the past ten years. The inflows of foreign capital and the instillation of new managerial techniques have played a major role in the restructuring, consolidation and development of Hungary's manufacturing and services sectors.

1.1. Structural reforms, integration in regional and multilateral organisations and market openness

The opening of the Hungarian economy has been closely linked to the structural reforms undertaken since the late 1980s, and in particular to the privatisation program. Starting in 1990, Hungary engaged a wide-ranging privatisation program, which gained momentum following the new privatisation law in 1995. The privatisation process has included many small and medium size firms, but also large firms in strategic sectors including energy, telecommunications, chemicals, pharmaceuticals and banking. The number of assets still in State hands has considerably declined.¹ By the end of 1998 the private sector generated 85% of GDP, compared to 16% in 1989. The key sectors of the economy which essentially remain in state ownership are limited to the nuclear power industry, the electric transmission network, state forests and farms.²

Contrary to some other transition countries, Hungary chose to sell large and medium size firms to investors for cash rather than distribute vouchers to workers or citizens. The aim of this strategy was not only to generate revenues and improve public finances, but most importantly to allow the rapid creation of a new entrepreneurial structure with modern management practices and business culture. Foreign investors have provided most of the privatisation revenues. Out of the US\$ 11 billion yielded by the privatisation of 1 600 state-owned companies between 1988 and 1998, US\$ 9 billion were drawn from sales to foreign investors.³ Along with cash, foreign investors have brought technology and management know-how, which have resulted in higher productivity, improved infrastructures, and have helped develop a management culture. As a huge proportion of foreign direct investment has come from large multinational companies with global networks of production and marketing, the domestic business activity has been driven into these networks.

In the past ten years a huge amount of legislative activity has taken place in Hungary to remove the institutional features of a planned economy and build up the required legal conditions for the functioning of a market economy and for accession to the European Union. In 1989 the constitution was revised to guarantee the right to private property and the freedom of enterprise. A wide range of laws, which affect the operation of firms, was further adopted or modified in fields such as prices⁴ and taxes, establishment of companies, accounting, bankruptcy and competition law. Some of the reforms have directly affected the operation of foreign-owned firms. In addition to the liberalisation of FDI regulations, the Hungarian authorities have thus lifted restrictions to capital flows and established new legislation to provide for the protection of investment. In the specific field of protection of intellectual property, Hungary is a party to most of the major multilateral agreements. Following the conclusion in 1991 of the Europe Agreement, which provides for the adoption by

Hungary of the *acquis communautaire* (see below, Box 1), the authorities are now proceeding to conform Hungarian laws and regulations to EU legislation in a wide range of areas, including standards, competition policy, government procurement and property rights.

Along with structural reforms, Hungary has sought closer ties with western economies, and in particular to integrate into the European Union. The Hungarian authorities have concluded various multilateral and regional agreements, whose implementation has been a driving force in the liberalisation of the trade and investment regimes. Hungary, which joined the GATT in 1973, became a founding member of the WTO in January 1995. Accession to the OECD in 1996 and entry into NATO in 1999 were major steps in the country's integration in the "western" area. The focus is now on accession to the EU. In 1991 Hungary and the European Union concluded the Europe Agreement, the trade-related part of which provides for the establishment of free trade in industrial products between the EU and Hungary by 2001 (see Box 1). Hungary has also concluded free trade agreements with non-EU countries, notably an agreement with the European Free Trade Association (EFTA) countries and an agreement with Central European countries (the Central European Free Trade Agreement or CEFTA).⁵ On 1 July 1997 it joined the pan-European cumulation system of rules of origin, which means that Hungary is now part of a multilateral free trade area encompassing the EU, EFTA and nine other Central and East European Countries.⁶

Box 1. The EU-Hungary Europe agreement and the movement towards accession

On 16 December 1991, the Republic of Hungary and the European Union signed the Europe Agreement, which entered into force on 1 February 1994. This association agreement can be considered as the first step in the Hungarian endeavour to join the European Union. It includes a range of commitments towards the establishment of a free-trade area, as well as the promotion of political dialogue, economic, monetary and industrial co-operation, education and training, and the harmonisation of legislation. The trade-related part of the Agreement entered into force on 1 March 1992 under the form of an Interim Agreement.

In the framework of the Agreement the adaptation of the country's existing and future legislation to that of the Community (*acquis communautaire*) is considered a "major precondition for Hungary's economic integration into the Community". The Hungarian authorities have undertaken to ensure that future legislation is compatible with Community legislation as far as possible. Priority areas for the adaptation of laws include customs law, company law, intellectual property, financial services, competition policy, government procurement, taxation, state aids, sectoral policies (agriculture, telecommunications, energy, transport), consumer protection including product liability, technical rules and standards and environmental protection. The Agreement includes a commitment by the Community to provide Hungary with technical assistance for the implementation of these measures.

As far as trade in goods and services is concerned, the Europe Agreement aims to gradually establish a free trade area, with a quicker liberalisation on the EU side than on the Hungarian side. It provides for:

- Elimination of tariffs and quantitative restrictions on imports of industrial goods, by the 1/1/95 on the EU side (over 96-98 for imports of coal, steel and textiles), and by the 1/1/2001 on Hungary's side.
- Reciprocal concessions in the form of lower tariffs and less restrictive quotas on agricultural imports.
- A prohibition against introducing new charges or quantitative restrictions, supplemented with exception mechanisms, some applicable by both sides (safeguard, anti-dumping, shortage, agricultural policy, and BOP measures), and some only applicable by Hungary (infant industries, restructuring, social problems).
- Progressive liberalisation of trade in services.

The Europe Agreement incorporated a declaration of intent by Hungary to eventually join the European Union as a member. In June 1993 in Copenhagen the European Council committed that the associated countries in Central Europe that so desire “shall become members of the EU as soon as they are able to assume the obligations of membership by satisfying the economic and political conditions”. In July 1997, the Commission issued *Agenda 2000*, which established the basic framework for all subsequent discussion, preparations and pre-accession activities, both within the European Union and within the applicant countries themselves. The accession process was formally launched in March 1998 for Hungary and five other accession candidates on the basis of a set of criteria defined in Copenhagen. A considerable share of the integration and harmonisation work necessary in order to meet the accession criteria was already underway on account of the Europe Agreement commitments. The Accession Partnership between Hungary and the EU, concluded at the same time, set out the priorities for further work and the supporting financial assistance available from the EU. Financial allocations for all first-wave candidates include annually a 520 million euros special pre-accession instrument for agriculture and rural development (SAPARD), a 1.04 billion euros instrument for structural policies (ISPA) to be used on transport and environment projects, and 1.56 billion euros available under PHARE (77 million of which were allocated to Hungary in 1998).

Since 1998 the Commission has issued regular reports on progress made by Hungary to conform to the Copenhagen criteria, while Hungary has adopted a National Program for the Adoption of the Acquis (NPAA), that constitutes the blueprint of all planned regulatory and institutional reforms. In assessing the Hungarian capacity to adopt the obligations of membership, the Commission has found the rhythm of transposition satisfactory and generally accompanied by adequate institutional and financial provisions facilitating implementation. In the areas where national legislation is not compatible to EU legislation and where Hungary does not expect to achieve compatibility by the time of accession, the Commission and Hungary have undertaken negotiations on transitional arrangements.

Source: Agreement between the European Economic Community and Hungary, O.J. L347 of 31.12.1993 (available on <http://europa.eu.int/eur-lex>); EU Market Access Sectoral and Trade Barriers Database on Hungary, 1999, at <http://mkaccedb.eu.int/mkdb/chkxel.pl>; Agenda 2000, Commission Opinion on Hungary’s Application for Membership of the European Union, at <http://europa.eu.int/comm/dg1a/enlarge/agenda2000>; National Program for the Adoption of the Acquis, Hungarian Ministry of Foreign Affairs, State Secretariat for Integration, July 1999.

Foreign trade progression in Hungary

Figure 1. Share of trade in OECD Member countries’ economies

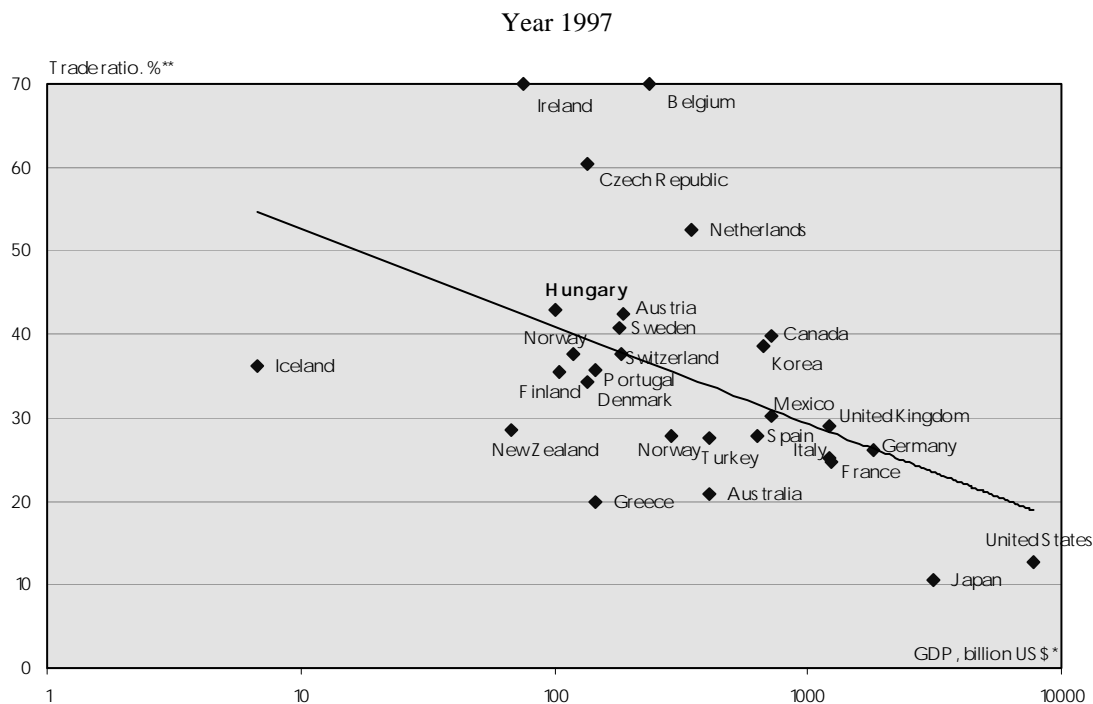
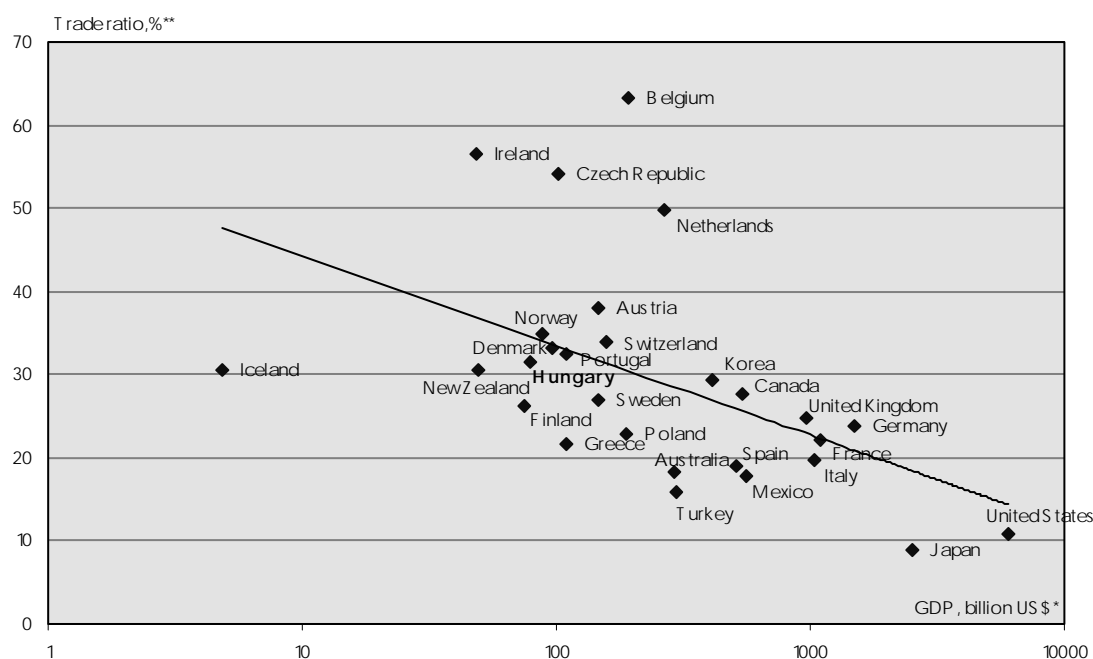


Figure 2. Share of trade in OECD Member countries' economies

Year 1992



* GDP measured at current prices and current PPPs.
 ** Average of exports and imports of goods and services relative to GDP.
 Note: Foreign trade of the Czech Republic includes trade with Slovakia.
 Source: OECD National Accounts.

1.2. Trade liberalisation

Since the onset of the transition process, the Hungarian economy has significantly increased its openness to foreign trade and integrated into the OECD area. Imports of goods and services, which increased by 80% in volume between 1990 and 1997, accounted for 43% of domestic demand in 1997, up from 25% in 1990. After a fall in the early 1990s, exports of goods and services picked up in 1994 and have expanded rapidly and continuously since then. The share of foreign trade has increased from 22.6% of GDP in 1994 to reach 45.3% of GDP in 1997. The outward orientation of the Hungarian economy has thus been relatively reinforced compared to other OECD Member countries' economies (see Figures 1 and 2).

A major feature of the past decade has been the shift of trade towards western countries. In 1989 trade was equally distributed between the countries of the Council for Mutual Economic Assistance (CMEA) area and western countries. Now OECD countries account for 84% of exports of goods and 80% of Hungarian imports of goods, and the EU alone for respectively 73% and 64% (Table 1). The shift of exports was initially driven by the collapse of the CMEA when Hungarian manufacturers had to redirect their sales. But since the second half of the 1990s, it has mainly come from the increase in exports of machinery and transport equipment to OECD countries by newly established or restructured industrial capacities, in particular by foreign-owned ones. Given the diversity of factors affecting this trade shift, it is difficult to verify whether the concerns expressed by some trading partners about the diversion of actual and potential Hungarian trade in favor of EU and CEFTA countries as a result of Hungary's preferential agreements are justified.

Table 1. Hungary's foreign trade in goods, 1998

	Exports		Imports	
	mUS\$	share %	mUS\$	share %
By group of countries				
OECD	19373.0	84.2	20571.0	80.0
EU (15)	16782.0	72.9	16479.0	64.1
Germany	8420.0	36.6	7249.0	28.2
EFTA	310.0	1.3	472.0	1.8
CEFTA	2039.0	8.9	1766.0	6.9
CIS	1382.0	6.0	1971.0	7.7
Total	23005.0	100.0	25706.0	100.0
By group of products				
Food, tobacco, drinks	2424.2	10.5	959.9	3.7
Raw materials	676.6	2.9	762.4	3.0
Energy	435.1	1.9	1691.0	6.6
Processed foods	7522.1	32.7	10330.2	40.2
Machinery, equipment	11947.3	51.9	11962.9	46.5
Total	23005.3	100.0	25706.4	100.0

Source: Hungarian Ministry of Economic Affairs.

The expansion of trade has come along with Hungary's efforts to reduce tariff and non-tariff trade barriers following its multilateral and regional commitments. All tariffs are now levied on an *ad valorem* basis. As a result of the Uruguay Round, the number of tariff bindings has increased to reach over 95% of total tariff lines. The MFN import duties for industrial products were cut from 13.6% on average in 1991 to 8% in 1998, and should decrease to 6.9% by 2001. MFN import duties on agricultural products have increased to 37%, as a result of the tariffication of previous quantitative restrictions under the WTO Agreement on Agriculture. It should be reduced to 27% by the end of the Uruguay Round implementation period. As a consequence of preferential agreements with the EU, EFTA and CEFTA, most trade in manufacturing products with European partners is already free from duties. Overall the average rate of duty on all imports stands at 2.5%, much lower than the average applied MFN rate of 14.3%. Hungary has also liberalised its trade regime by reducing or dismantling non-tariff measures at the border. Import licenses have been removed, except for a few products, as well as nearly all export licenses. Trade-related fees were eliminated in 1997 for WTO members.⁷ Hungary has also reduced quantitative restrictions on imports. A "Global Quota on Imports of Consumer Goods", already in place at the moment of accession to the GATT, has been gradually phased out since 1989, by raising its amount and withdrawing several categories of products. Hungary committed to eliminate the quota by 2001 for free trading partners, and extend this liberalisation to WTO members.

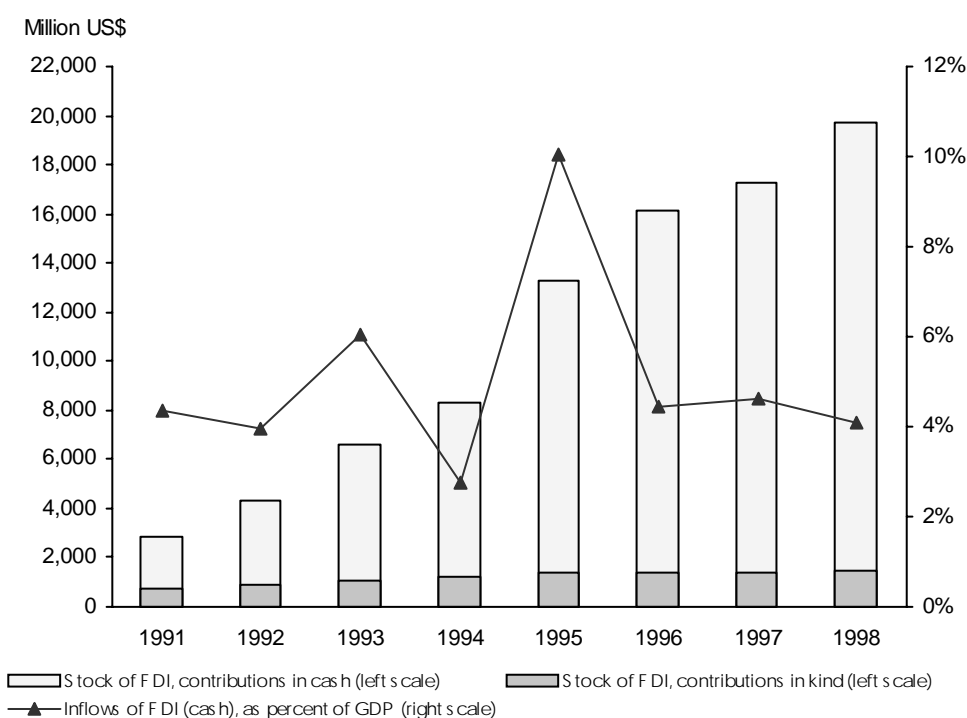
1.3. An active policy in favour of foreign investment

Foreign firms have played a key role in the transformation of the Hungarian economy. Since the transition started, Hungary has received sizeable inflows of foreign investment. Between 1990 and 1998 over US\$18 billion were invested in Hungary, and annual inflows accounted in average for 5% of GDP. By the end of 1998, the stock of FDI exceeded US\$ 19 billion⁸, nearly 40% of all capital invested in central Europe (see Figure 3). More than 30 000 foreign-owned companies, a third of which under 100% foreign control, currently operate in Hungary. They account for over 70% of the country's exports and imports, and provide 30% of the jobs. Out of the 200 largest firms in Hungary, 110 operate under foreign control. With over 25%

each of the total FDI stock, Germany and the United States are the major investors in Hungary, followed by Austria and France with 10% each. Overall EU countries account for two thirds of foreign capital invested in Hungary. Since 1995, Japanese firms have emerged as an important source of FDI, mainly in greenfield projects.

To a large extent, the trends in FDI have followed the course of the privatisation process. In 1993 and 1995, as the government sold large chunks of assets, FDI surged respectively to 2.5 billion US\$, or 6% of GDP, and to 4.4 billion US\$ or 10% of GDP (see Figure 3). Progress in privatisation has also been reflected in the sectoral breakdown of FDI. As privatisation of the industry came to an end in the 1990s, the bulk of FDI moved away from the industry to the service and energy sectors. During the 1990-94 period FDI concentrated in the manufacturing sector, mainly automobile, electronics, pharmaceutical and the food industry. However from 1995 on, the privatisation of the banking and the energy sectors resulted in an upsurge of FDI in these sectors. In 1997 80% of FDI inflows went to these services. The privatisation program is now drawing to a close. This has however not resulted in a collapse of FDI as non-privatisation investments, including greenfield projects and expansion of existing capacities, have grown significantly. The cumulated sum of greenfield industrial investments carried out by foreign capital at the end of 1997 accounted for 22% of total FDI.⁹ But in 1997 alone, roughly half of the foreign capital was invested in greenfield plants.

Figure 3. Foreign direct investment in Hungary (1991-98)



Source: Hungarian National Bank and OECD National Accounts.

The Hungarian authorities have actively encouraged foreign investment in order to meet the investment needs of the economy. They have offered a complex set of incentives to foreign investors, including tax allowances and the possibility to set up industrial free trade zones (for details on these incentives, see Box 2). These incentives combined with the relatively low wage costs and high skilled labour have contributed to the attractiveness of Hungary as a destination of FDI. Their role should however not be overstated. According to foreign investors, the various financial incentives may have influenced business

decisions, but have not been as deciding as the initial opportunity provided by the cash-based strategy chosen for privatisation and subsequently the overall political stability, market-oriented economic policy and improved infrastructure.¹⁰ As far as labour is concerned, the increase in costs has not resulted in less investment, and foreign firms do not concentrate solely on labour intensive activities, as shown by their growing exports of high-tech and high value-added products.¹¹

Inflows of FDI have indeed occurred in an open investment regime and investment-friendly environment. The Hungarian authorities' strategy to attract FDI is reflected in the legal and regulatory framework pertaining to FDI, companies, capital movements, protection of investments and intellectual property. Among the most important regulatory improvements, it is worth noting the 1988 legislation guaranteeing free and full repatriation of profits; the 1992 legislation authorising complete foreign ownership without prior agreement; and the 1998 legislation allowing the establishment of branches of foreign companies. The improvement of infrastructures, which has been boosted by the inflows of foreign capital in particular in the telecommunications sector, has reinforced Hungary's attraction for investors. Infrastructures have also been promoted by the possibility to set up industrial parks, which combine full infrastructure (road connections, services, etc) and local tax allowances from the municipality. By the end of 1998, 75 industrial parks were established, 55 of which are already under operation. Most of the parks are located in the traditional industrial regions of northern Hungary and the majority were launched as greenfield investment projects. Industrial parks host approximately 700 firms, employing 60 000 people and having a turnover of 870 billion forints. 80% of those firms are SMEs.

In recent years, investment promotion policy has been reoriented in order to divert FDI to less developed regions or specific sectors. The vast majority of foreign capitals invested in Hungary to date were indeed directed to the western part of the country because of its proximity to the important European markets. The ensuing improvement of infrastructure and attraction of skilled labour has further enhanced the appeal of western Hungary to foreign investors and left the East lagging behind.

Box 2. FDI incentives in Hungary

Investment incentives in Hungary can be divided into three categories: fiscal incentives, financial incentives and customs incentives. Their exact incidence on investment decisions is difficult to assess, not least because incentives and allowances provided by the local authorities are not included in the calculations of support intensity and seem overall to be less transparent. The objective of the incentives is not only to attract foreign investments to Hungary, but also to divert it to selected sectors, activities or regions. For instance, regional tax preferences are given to companies that are registered in a priority region (where the unemployment rate exceeded 15% in June of the preceding tax year) and/or in an enterprise zone, while corporate tax allowances are available for research and development. The incentive system initially put more emphasis on export-oriented investments rather than on regional development or other economic objectives. The Hungarian government has undertaken to transform the system taking into account WTO and EU regulations. The previously existing export performance requirement connected to some of the incentives was replaced as of 1998 by a condition of increase in sales revenues in general, while regional development elements were enhanced.

Fiscal incentives consist of tax allowances conditional on certain performance requirements. The majority of these incentives will be phased out in the coming years. They include a five-year 50% tax allowance made available since the 31st of December 1995 for investments of at least 1 billion forints aiming to establish production facilities. The same incentive is available since the 31st of December 1996 for investments of at least 1 billion forints aiming to establish hotel facilities. To qualify for these incentives, available until 2002, a specified growth in net sales is required. A ten-year 100% tax allowance is available until 2011 for companies, which establish production facilities with a value of at least 10 billion forints. To qualify for this incentive, there is not only a net sales growth requirement, but also the workforce must increase by at least 500 persons in a given year, as compared to the year preceding the beginning of the investment project. The minimum investment value required for this incentive is brought down to 3 billion forints and the workforce increases to 100 persons if the company is registered in an area where unemployment exceeds 15%. Furthermore, for companies registered in priority regions or in enterprise zones a tax allowance of 6% of the value of the investment project is available on the value of the machinery installed. The same allowance is available for companies installing an infrastructure project in these regions in the year when the project is put into operation. 20% of direct costs incurred in connection with R&D activities are deductible from the tax base.

Financial incentives to investments exist in the framework of the targeted allocation for economic development (the most important among targeted incentives, representing 15.8 billion forints in 1999), the central basic technological development programme, the targeted allocation for rural (regional) development, the labour market fund, as well as in the schemes for the development of tourism, for environmental protection and for agricultural activities. The support, available for companies registered in Hungary, is given in various forms, including preferential bank loans, refundable grants, non-refundable grants, or interest subsidies. It is granted through schemes of application, regulated by bidding rules and awarded on the basis of a competitive tendering process. These budget funds support not only (new) investments, but also the achievement of other economic goals, like the development of SMEs, the catching-up process of the less developed regions of the country, environmental protection, investments into R&D activities etc. Usually, up to 30% of the investment costs, but maximum 200 million HUF may be financed from the funds. The process of awarding financial benefits entailed a considerable amount of discretion from concerned authorities, both at the national and the local level, and has been carried out in a relatively non-transparent manner in the past as regards the applicable criteria and amounts awarded. Targeted financial incentives such as those covering R&D related investments, rural development or environmental protection programmes, and awarded through tenders and on the basis of a set of clear criteria constitute a relative improvement over such practices.

Customs incentives take the form of special regulation with respect to industrial free trade zones. The concept of industrial free trade zones in Hungary is different from the typical customs free area, such as used for instance in the EU. Basically there are no isolated geographical areas designated for this purpose; every company can set up its own zone, under license by the National Headquarters of the Customs and Finance Guard. Industrial free trade zones are considered as being outside Hungary for the purposes of customs, foreign exchange and other legal regulations. The goods and means of production (excluding building and auxiliary material) are not subject to customs liability. Currently, more than 100 companies are registered in an industrial free trade zone. In the first five months of 1999, companies in industrial free trade zones represented 42% of exports and 29% of imports. Their growing importance is underlined by the fact, that the corresponding shares were 36% and 25% in 1998, respectively. Industrial free trade zones regulation is particularly attractive to assembling companies, which only use cheap local labour, import their inputs, mostly export their outputs and are able to bring in high value equipment duty-free. However, its importance is reduced by the gradual abolition of industrial tariffs in trade with preferential partners, the introduction of the pan-European cumulation system, and the growth of local value added. After the accession of the country to the EU there are few companies for which the maintenance of the regulation could still be significant.

Foreign direct investment had an important role in enhancing economic efficiency. Foreign-owned firms displayed the most rapid increases in productivity and have been paramount in improving quality and innovation.¹² Their impact on the rest of the economic activity was less marked at the outset. Foreign investors largely remained faithful to their traditional suppliers, partly for fear that Hungarian firms would not be able to deliver goods in accordance with just-in-time constraints and market specifications. This prompted increased focus from the Hungarian authorities on promoting linkages between foreign-owned and Hungarian firms. In this context, the Ministry of Economic Affairs developed in 1997 a “Targeted Program for Subcontractors”. The program aims at creating a network of Hungarian suppliers enjoying improved credibility with foreign-owned firms, through the conclusion of co-operation agreements, the promotion of information packages, the establishment of training programs and the introduction of a “Hungarian product - supervised quality” trademark. The initial phase of the program relied primarily on more capital-intensive medium-sized companies that have already experience as subcontractors, while promoting the emergence of small and micro businesses in the subcontracting market. Anchoring the host of frail medium, small and micro businesses to the more dynamic segment of the Hungarian economy could operate against the development of a dual economy and in favour of the successful integration of Hungarian business in the global economy.

2. THE POLICY FRAMEWORK FOR MARKET OPENNESS: THE SIX “EFFICIENT REGULATION” PRINCIPLES

An important step in ensuring that regulations do not unnecessarily reduce market openness is to build the “efficient regulation” principles into the domestic regulatory process for social and economic regulations, as well as for administrative practices. “Market openness” here refers to the ability of foreign suppliers to compete in a national market without encountering discriminatory or excessively burdensome or restrictive conditions. These principles, which have been described in the 1997 OECD *Report on Regulatory Reform* and developed further in the Trade Committee, are:

- Transparency and openness of decision making.
- Non-discrimination.
- Avoidance of unnecessary trade restrictiveness.
- Use of internationally harmonised measures.
- Recognition of equivalence of other countries’ regulatory measures.
- Application of competition principles.

They have been identified by trade policy makers as key to market-oriented, trade and investment friendly regulation. They reflect the basic principles underpinning the multilateral trading system, concerning which many countries have undertaken certain obligations in the WTO and other contexts. The intention in the OECD country reviews of regulatory reform is not to judge the extent to which any country may have undertaken and lived up to international commitments relating directly or indirectly to these principles but rather to assess whether and how domestic instruments, procedures and practices give effect to the principles and successfully contribute to market openness.

This section considers whether and how Hungarian regulatory procedures and content affect the quality of market access and presence in Hungary. An important reverse scenario -- whether and how inward trade and investment affect the fulfilment of legitimate policy objectives reflected in social regulation -- is beyond the scope of the present discussion. This latter issue has been extensively debated within and beyond the OECD from a range of policy perspectives. To date, however, OECD deliberations have found no evidence to suggest that trade and investment *per se* impact negatively on the pursuit and attainment of domestic policy goals through regulation or other means.

2.1. *Transparency, openness of decision making and of appeal procedures*

In order to ensure international market openness, the process of creating, enforcing, reviewing or reforming regulations needs to be transparent and open to foreign firms and individuals seeking access to a market, or expanding activities in a given market. From an economic point of view, transparency is essential for market participants in several respects. Transparency in the sense of information availability offers market participants a clear picture of the rules on the basis of which the market operates, enabling them to base their production and investment decisions on an accurate assessment of potential costs, risks and market opportunities. It is also a safeguard in favour of equality of competitive opportunities for market participants and thus enhances the security and predictability of the market. Such transparency can be achieved through a variety of means, including systematic publication of proposed rules prior to entry into force and use of

electronic means to share information, such as the Internet. Transparency of decision making further refers to the dialogue with affected parties, which should offer well-timed opportunities for public comment, and rigorous mechanisms for ensuring that such comments are given due consideration prior to the adoption of a final regulation. Market participants wishing to voice concerns about the application of existing regulations should have appropriate access to appeal procedures. Such dialogue allows to build market forces into the process and to avoid trade frictions. This sub-section discusses the extent to which such objectives are met in Hungary and how.

2.1.1. Information dissemination

Information with respect to prospective and effective regulation is primarily provided through publication in the *Magyar Közlöny* (the Official Journal of the Republic of Hungary). In accordance with the 1987 Act on Legislation, all regulations, including Acts of Parliament, Government Decrees or Ministerial Decrees, are not valid unless promulgated in the Official Journal prior to entry into force. The date of entry into force must be determined so as to give sufficient time for preparing for the application of the legislation. The established practice is to provide for 8, 15 or 30 days between the promulgation and entry into force of lower level regulation, while in the case of laws a longer period is generally provided. In the case of tax legislation, at least 90 days must elapse between promulgation and entry into force.

Prospective legislation is brought to the attention of domestic constituencies and foreign parties through the presentation to the Parliament and the publication in the *Magyar Közlöny* of the five-year legislation program adopted by the government in accordance with the Act on Legislation. The legislation program covers the elaboration of new laws and significant government decrees as well as the revision of existing legislation. It is compiled by the Ministry of Justice after consultation with ministries, national regulatory agencies, the President of the Supreme Court, the Supreme Prosecutor, the municipalities of Budapest and of the counties, and associations representing domestic constituencies, including employers and workers associations. Along with the presentation of the new legislation program, the government reports to the Parliament on the implementation of the previous legislation program and the experiences gained through the enactment of the legislation. In addition to the legislation program, the Government compiles a work schedule for the first and the second half of every year, containing the list of regulation to be enacted or amended. This schedule is also published in the *Magyar Közlöny*. However, use of this channel is limited to publicising general indications on prospective regulation and does not extend to a detailed “notice and comment” procedure whereby the entire text of the draft regulation would be made available to interested constituencies for information and comments. Therefore, the opportunities of domestic and foreign market participants to have an advance picture of regulatory developments that goes beyond the general overview are quite limited.

Apart from the formal requirement of promulgation in the official journal, there is an extensive use of informal paths, including (often private) publications of general scope, individual journals of the Ministries, CD-ROM databases or the Internet. The most authoritative unofficial publication of legislation is the trilingual (in Hungarian, English and German) *Hatályos Jogszabályok* (Collection of Legislation in Force), which facilitates the access of foreign parties to Hungarian regulation by allowing them to overcome the linguistic barrier. Other compendia of legislation include the *Hatályos Jogszabályok Gyűjteménye* collection and the *Törvények és Rendeletek Gyűjteménye* collection. The most important pieces of regulation, together with related explanations, are also published by the individual publications of the Ministries, such as the Newsletter of the Ministry of Economic Affairs. These periodical publications are also available in a number of foreign languages.

Foreign firms that wish to obtain information about the regulatory and economic environment in Hungary may also enquire at the network of external economic attaches, which is part of the Ministry of Foreign Affairs but benefits from professional guidance of the Ministry of Economic Affairs. They can further get information from the Investment Promotion and Trade Development Agency (*Magyar Kereskedelemfejlesztési és Befektetésösztönzési Közhasznú Társaság*, or ITD Hungary) operated by the Ministry of Economic Affairs. ITD Hungary, established in 1993, runs offices in nearly 40 countries, primarily in Europe. Its main focus is to attract FDI in Hungary and to promote Hungarian exports. ITD officers provide general information on the Hungarian investment scene, seek partners and locations for firms wishing to establish in Hungary and offer consulting in the legal and financial preparation of greenfield investments and establishment of joint companies. They also design and carry out export programs to introduce local manufacturers and trading companies on foreign markets, propose logistical, financial and professional support to marketing activities of Hungarian export-oriented companies and co-ordinate their participation at foreign fairs and exhibitions.

In contrast to the process of adopting regulations, particular decisions of the executive power seem fairly opaque, despite the strong principle in favour of public access in Hungary's Constitution and laws.¹³ Administrative decisions with respect to privatisation, allocation of investment incentives and government procurement (see below) have often raised concerns about transparency, and have sometimes led to allegations of corruption. The recent adoption of legislation defining the legal status and liability of members of the government and establishing the incompatibility of private business with public service could help enhance the credibility of the executive, but an improvement of openness of administrative decision-making would also be necessary.

2.1.2. Consultation mechanisms

There are no formal mechanisms in Hungary for consulting with concerned constituencies when preparing or reviewing regulations. Nevertheless, as the Act on Legislation requires assessment of the impact of legislation on socio-economic relations, relevant parts of the administration organise informal consultations in the course of the enactment of new legislation or the amendment of existing legislation and the preparation of the drafts related to them. Such consultations are primarily addressed to existing professional associations, including the national chambers of commerce and foreign business associations. In order to enhance the representativeness and efficiency of such consultations, the Ministry of Economic Affairs has recently established the Council of Investors and the Council of Foreign Economic Operators. These councils are composed of representatives of employers, employees, scientific institutions and the administration, and meant to convey to the administration the opinion of economic operators on the practical impact of prospective regulation. Specialised consultative bodies also exist for specific policy areas, such as the Excise Goods Council, composed of representatives from the oil, tobacco, and spirits and liquors industries.

In the context of the informal consultations, foreign parties have the same opportunities as domestic constituencies to participate and make observations. Every ministry, the Prime Minister's Office, the Office of the Parliament as well as the Office of the President of the Republic have an information and complaints office, where it is possible to submit observations directly to the decision-makers through the Internet or by mail. Moreover, both the Ministry of Foreign Affairs and the Ministry of Economic Affairs run a country desk system for each major economic partner country or groups of countries. This system enables international partners to identify more easily the persons in charge and offers them the opportunity to make observations and submit recommendations in relation to draft regulations directly to the relevant authorities.

The handling of possible observations and suggestions made by foreign businesses or business associations is not dependent on whether such businesses or associations are domiciled in the territory of the Republic of Hungary or not. For example, Hungarian legislation on customs preferences afforded to individual utility vehicles, which provided a competitive advantage to specific importers, was amended on the basis of complaints voiced by a foreign partner not established in Hungary. Foreign business associations express general satisfaction on the openness of the Hungarian authorities to observations on potential effects of proposed regulation and suggestions for improvement. They regret however that the relatively short timeframe¹⁴ available for elaborating and finalising new regulation has lessened opportunities for a meaningful interaction, especially in the case of important legislation, such as tax and social legislation, which still undergoes frequent and significant changes. These regulations are paramount for business operation and their continuous and unpredictable modifications seriously obstruct strategic planning on behalf of firms. As short timeframes are mainly attributable to the extensive law-making activity of recent years, this situation is likely to improve in the future.

Consultations with trading partners on adopted regulations can take place in the WTO framework, following notification of such regulations by Hungary. However, Hungary has not always been up to date with WTO notifications, namely in the area of subsidies and countervailing measures.¹⁵ Consultations on new or amended regulations also take place in the context of the regular contacts maintained between Hungary and the European Union or countries with which Hungary has concluded free trade agreements. These consultations are organised under a fixed procedure within committees and subcommittees entrusted each with a specific subject matter. Among these bodies, specific mention should be made of the Association Council, established by the Europe Agreement, where all issues related to the association of Hungary to the European Union are raised.

2.1.3. *Appeal procedures*

Market participants wishing to voice concerns about administrative measures have the possibility to appeal in a first instance to the competent administrative authority. After exhaustion of available administrative remedies or in the absence thereof (such as when the decision emanates directly from a Minister or the Head of a regulatory agency), the appeal can be brought to the courts. On the other hand, a court appeal is excluded in a number of cases, including with respect to import and export licensing of goods, services, rights and titles. An appeal has a delaying effect on the implementation of the measure, except in the case of decisions with immediate execution, which are narrowly defined by law. In addition, complaints or objections in relation to specific measures of regulatory agencies or to the absence thereof, can be submitted to the parliamentary commissioner of citizen's rights (Ombudsman). The Ombudsman may invite the agency to motivate its decision, put forward recommendations for amendments, or call upon the agency to withdraw a decision in breach of the law.

The Act on the General Rules of Public Administrative Procedure provides that parties whose rights or interests are affected by an administrative decision or action¹⁶ can appeal this decision or action irrespective of citizenship or domicile. Hungarian and non-Hungarian parties enjoy full equality before the law in public administrative procedures and their cases must be dealt with without any discrimination or bias. Everybody may use their mother tongue whether orally or in writing in a public administrative procedure and nobody should suffer any disadvantage due to lack of knowledge of the Hungarian language. These general procedural safeguards apply *mutatis mutandis* to a number of areas which are covered by specific sectoral legislation, including the areas of foreign trade administration, tax, excise and customs administration, industrial rights protection, financial services and unfair market behaviour.

2.1.4. Transparency in government procurement

Concerns have often been raised in the past with respect to transparency of government procurement in Hungary. Some foreign firms have even taken legal action against non-transparency and procedural irregularities in government tenders in Hungary. Hungary undertook to address these concerns through the enactment of its first Act on Public Procurement (Act XL of 1995), which was designed in accordance with existing international models (World Bank Guidelines, UNCITRAL Model Law) and is generally considered to have greatly improved transparency. Hungary is not party to the WTO Government Procurement Agreement, nor does it envisage acceding to the Agreement before accession to the EU. However, Hungarian legislation is generally compatible with EU directives in this field, with the notable exception of requirements regarding utilities (energy, water, telecommunications and transport).¹⁷

In June 1999 Hungary enacted a new Public Procurement Act, with a view *inter alia* to reinforce the prohibition of breaking down procurements in order to evade the Act and to further clarify the conditions governing direct negotiation procurements. An additional amendment of the Act is scheduled for 2002, in order to make it fully compatible with the European Public Procurement Directive. The Act applies to central local and municipal government and to public undertakings, including utilities, and is enforced by the Public Procurement Council, an independent agency under the supervision of the Parliament, where the inviting authorities and the bidding firms are equally represented. Procurements coming under the scope of the Act are defined on the basis of thresholds determined yearly in the Budget Law. In 1999 the applicable threshold is 15 million forints for supplies, 30 million forints for public works and 7.5 million forints for services. Procurements of water, gas, oil and electricity, remain outside the scope of the provisions of the Act, introducing an important caveat in transparency of procurements made by public utilities.

Public procurements are attributed through open tenders, restricted tenders (tenders by invitation), or negotiated tenders. Open tenders, restricted tenders and negotiated tenders invited by publication are announced in the weekly Public Procurement Bulletin (*Közbeszerzési Értesítő*), on the Internet site of the Public Procurement Council and eventually in local newspapers. The tendering authorities can decide to publish the tender in foreign newspapers as well. Prior publication is not mandatory for negotiated procurements not invited by publication. Restricted tenders (tenders by invitation) can take place only if, due to the particular nature of the procurement, there are few bidders likely to qualify. There have to be at least five qualified bidders, based on a list drawn up upon an open competition and published by the Public Procurement Council every year. Tenders can be directly negotiated only if the other two procedures have been unsuccessful, or if, due to its particular nature, the procurement can only be carried out by a single specific contractor. In this case, the newly enacted 1999 Public Procurement Act requires notice to be given to the Chairman of the Public Procurement Council, explaining the reasons for this choice. Out of 9 827 procedures initiated from November 1995 to June 1998 open tenders represented between 69.5% (in 1996) and 62% (in 1998), tenders by invitation 6% and negotiated tenders between 24.5% (in 1996) and 33% (in 1998). In the first eight months of 1999, open tenders represented 61%, tenders by invitation 3% and negotiated tenders 36% of the total. A relatively high and yet increasing percentage of public procurement is thus allotted through procedures that are inherently less transparent.

The publicised invitation for tenders must specify the evaluation criteria used for judging the bids. Among bids satisfying these criteria the inviting authority can either prefer the least expensive bid or the most favourable bid as a whole, in which case the relative weight of the criteria must have been specified and published. Although, bids with more than 50% Hungarian content can be considered equal to majority-foreign bids that are up to 10% lower in price, this provision is seldom used because of the additional financial burden it entails for the inviting authorities. Additional criteria for deciding between bids include a preference for environmentally friendly products and for bidders with certified quality assurance systems. However, these seem to have minor importance in practice. The respect of evaluation criteria is among the elements that raised the strongest criticism from trading partners, in particular with respect to tenders by

local authorities.¹⁸ The Public Procurement Council recently observed that “*budget entities lack the trained staff needed for a professional management of public procurement. This is particularly relevant in the case of local governments and smaller budgetary institutions.*”¹⁹ For this reason, the Council organised in 1998 and 1999 training activities supported by the World Bank. Ensuring perfect transparency in the course of selecting bidders will be one of the major challenges for the new legislation on Public Procurement.

The inviting authority must take a decision promptly and the outcome made public within thirty days from the opening of the tender, or sixty days in case of construction projects. This deadline can be extended for an additional thirty days if the inviting authority can duly justify its impossibility to respect the deadline. Contract awards are published in the Public Procurement Bulletin, including in the case of negotiated tenders invited without prior publication. Unsuccessful bidders have the right to be informed of the reasons for their exclusion within another fifteen days and can lodge appeals with the Public Procurement Committee, which is independent both from the government and from the Public Procurement Council. As an example, in 1998, 318 appeals were introduced, out of which the Committee upheld 126. The contents of public procurement contracts are not publicised and it is relatively difficult to obtain related information otherwise than through the tender announcement.

In sum, despite considerable improvement with respect to the transparency of regulatory procedures in Hungary and notwithstanding the increasing receptiveness of the Hungarian administration, the regulatory process continues to offer insufficient opportunities for information, comment and dialogue. Part of the problem seems to stem from the intense pressure under which the process has operated in the past ten years and should be naturally relieved in the future. However, more could be done to ensure that complete, accurate and timely information, as well as real and deliberate opportunities for comment are offered to all market players and in all circumstances. A more systematic and formalised prior notice procedure could go a long way into bolstering confidence to a rules-based and predictable operation of the Hungarian economy. Considerable care should also be taken to ensure a more transparent operation of public procurement procedures in the future.

2.2. Measures to ensure non-discrimination

Application of non-discrimination principles aims to provide effective equality of competitive opportunities between like products and services irrespective of country of origin. Thus, the extent to which respect for two core principles of the multilateral trading system -- Most-Favoured-Nation (MFN) and National Treatment (NT) -- is actively promoted when developing and applying regulations is a helpful gauge of a country's overall efforts to promote trade and investment-friendly regulation.

2.2.1. Non-discrimination in domestic regulation

There are no overarching requirements in Hungarian legislation to incorporate non-discrimination principles into the regulatory decision-making process, other than the general prohibition of discrimination contained in article 70/A§(1) of the Hungarian Constitution, which guarantees equality of rights and obligations for all persons in the Hungarian territory. However, in the specific field of economic relations, Hungary has subscribed to the MFN and national treatment principles *inter alia* in the context of its membership to the WTO. These WTO commitments form an integral part of the Hungarian legal system by virtue of Act IX of 1998. As a consequence, in the areas covered by Hungary's international obligations any deviation from the MFN or national treatment principles should be duly substantiated by the regulatory authorities in charge. The observance of these principles is supervised by the Ministry of Economic Affairs, which can request the amendment or withdrawal of regulations incompatible with Hungary's international commitments (for a detailed discussion of the practice of intra-governmental consultations see below, Section 2.3 on unnecessary trade restrictiveness).

The reasons that may be used by a regulatory authority to justify a departure from non-discrimination principles include lack of reciprocity, countermeasures against discrimination or the pursuit of certain economic and/or social objectives by reserving selected activities or support only for particular categories of economic actors. In practice, the importance the government ascribes in creating a favourable and attractive regulatory environment for foreign investors has reduced discriminatory regulations based on nationality to a minimum. All companies established in Hungary are considered as Hungarian companies and treated equally, regardless of the nationality of the owners. Furthermore, through a law adopted in 1997, Hungary met its obligation, undertaken vis-à-vis the European Union and the OECD, to enable the operation of companies established abroad as branches in Hungary as of the 1st January 1998. Hence nationality-based discrimination concentrates in the area of professional services. For instance, foreign legal practitioners must associate with a Hungarian firm or lawyer; non-Hungarian nationals cannot be licensed as architects and engineers; audits must be conducted by Hungarian-certified accountants.

Yet, a series of distinctions was introduced (some of them still continue to exist) in favour of residents or established entities, which partake in the investment attraction strategy of the Hungarian government by conferring additional attractiveness to the establishment in Hungary. For instance, only companies registered in Hungary can obtain licences for operating telecommunications services. A “buy Hungarian” clause accompanies concession contracts for the provision of public telephone services (see below, Section 3.1). In the area of government procurement, discrimination exists in favour of bids with more than 50% Hungarian content, which are considered equal to majority-foreign bids up to 10% lower in price.

In its early days, the investment incentives strategy *per se* featured measures constituting reverse discrimination in favour of foreign market players, such as the duty-free importation of capital goods by foreign-owned companies. These measures were progressively abolished, partly in order to place domestic enterprises on an equal footing with foreign-owned competitors. However, with respect to some of these measures benefits continue for the firms that obtained them before their abolition. For instance, the 10 year tax allowance granted to economic associations with a foreign participation of at least 30% was abolished in 1993 but may still be claimed until the end of its validity (at the latest 2003 for those granted in 1993). Domestic firms are thus still in a frail position compared to foreign-owned ones, not only because they bear disproportionately the tax burden, but also because of the difficulties they experience as regards access to financing, high quality human resources, or supply networks (for more details, see Chapter 1). The Hungarian authorities try at present to better integrate these firms, mostly very small SMEs, to the dynamic network of international companies registered in Hungary. The concrete results of this endeavour remain to be seen.

2.2.2. *Preferential agreements*

While preferential agreements give more favourable treatment to specified countries and are thus inherent departures from the MFN and NT principles, the extent of a country’s participation in preferential agreements is not in itself indicative of a lack of commitment to the principle of non-discrimination. In assessing such commitment, it is relevant to consider the attitudes of participating countries towards non-members in respect of transparency and the potential for discriminatory effects. Third countries need access to information about the content and operation of preferential agreements in order to make informed assessments of any impact on their own commercial interests. In addition, substantive approaches to regulatory issues such as standards and conformity assessment can introduce potential for discriminatory treatment of third countries if, for example, standards recognised by partners in a preferential agreement would be difficult to meet by third countries.

Hungary participates in a number of preferential agreements (see above, Section 1.1) and is currently preparing for its accession in the European Union. Information with respect to these agreements is primarily provided through their publication in the *Magyar Közlöny*. As with domestic regulations, information on the content of major agreements can be found in the foreign language publications of the various government agencies, such as the Newsletter of the Ministry of Economic Affairs, and on the Internet sites of those agencies together with addresses for inquiries. With respect to bilateral treaties related to a specific subject, such as agreements on investment protection or on the avoidance of double taxation, information to third parties is provided on request by the Ministry in charge. In addition, preferential trade agreements, such as free trade agreements, are notified to the WTO for information and examination in the relevant Committee.

Hungary has recurrently proceeded to multilateralise the liberalisation commitments undertaken in the framework of its preferential agreements. For instance, the commitment undertaken in the context of the Europe Agreement to progressively abolish all remaining quantitative restrictions on industrial products has been extended to all WTO members. The same approach was followed in abolishing import-related fees. As part of its OECD accession commitments in 1996, Hungary committed to extend the benefits of the Europe Agreement to all OECD Members in respect of operations falling within the purview of the OECD Codes of Liberalisation of Capital Movements and Current Invisible Operations.²⁰ Similarly, Hungary has extended to other WTO Members under the GATS the obligation undertaken in the framework of its accession to the OECD to allow establishment in the form of branches.

Disputes between Hungary and the European Union over provisions of preferential agreements concluded by either partner with third countries can be resolved through a consultation clause provided in the framework of the Europe Agreement. This mechanism has already been used with respect to preferential treatment accorded by Hungary to fresh flowers in its free trade agreement with Israel. A similar consultation clause is provided in the framework of the free trade agreement concluded between Hungary and EFTA countries. No other specific mechanisms exist in Hungary for receiving claims from third countries affected by a preferential agreement, apart from the dispute resolution mechanism available in the framework of the WTO. In general, third countries will present such claims directly to the relevant government agency.

Discriminatory elements in the Hungarian regulatory regime are therefore limited and do not seem to create market access problems in practice. The effects of past reverse discrimination provisions favouring foreign firms appear more significant in comparison. Discrimination in favour of larger firms, combined to other difficulties facing small domestic firms have further inhibited the ability of domestic firms to successfully cope with international competition and enhanced the risks of development of a dual economy. This situation can make it more difficult to sustain good macroeconomic performance and compromise the widely shared consensus for reform. Ensuring that market opening regulatory reform benefits equally all parts of the Hungarian economy and society will be essential for building support to market openness and promoting economic development in the future.

2.3. *Measures to avoid unnecessary trade restrictiveness*

To attain a particular regulatory objective, policy makers should favour regulations that are not more trade restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create. Examples of this approach would be to use performance-based rather than design standards as the basis of a technical regulation, or to consider taxes or tradable permits in lieu of regulations to achieve the same legitimate policy goal. At the procedural level, effective adherence to this principle entails consideration of the extent to which specific provisions require or encourage regulators to avoid unnecessary trade restrictiveness and the rationale for any exceptions; how the impact of new regulations on international trade and investment is assessed; the extent to which trade policy bodies are consulted in the regulatory process and openness of consultation processes to all interested parties; and means for ensuring access by foreign parties to dispute settlement.

2.3.1. General assessment

In Hungary there are no explicit provisions requiring or encouraging regulations or administrative practices to be trade and investment friendly. Nevertheless, in order to attract capital and enhance competition in the domestic market, Hungarian policy makers made a clear commitment to dismantling unnecessary restrictions. To this end Hungary has undertaken a wide range of international obligations. In the context of the multilateral trading system this has included replacing quantitative restrictions, such as non-automatic import licensing on agricultural products, by bound *ad valorem* tariffs and increasing the share of bound tariff lines from 89% in 1995 to 95.7% in 1997. Successive Hungarian governments have largely resisted protectionist pressures²¹, and the non-tariff measures introduced with the stabilisation package in 1995 have been progressively eliminated.²² Sectors subject to NTBs include agricultural goods, textiles, some chemicals, steel and cars. Approximately 60% of NTB-affected imports are subject to quantitative restrictions in the form of non-automatic licensing and a global quota on consumer goods. NTBs in the automobile sector may be related to the protection of FDI (see below sub-section 3.3), while for some other sectors the rationale appears less clear.

In the process of preparing regulations, the impact of proposed regulations on trade and investment is not formally assessed. The 1987 Act on Legislation calls for an analysis of the expected effects of proposed regulation, the conditions of enforcement and the availability of alternative, more appropriate policy instruments for attaining the desired objective. Furthermore, since 1995 drafts submitted to the Parliament are required to include a Regulatory Impact Analysis (RIA) focussing on the expected social, economic and budgetary impacts of proposed regulation (Government resolutions 1004/1995 and 1100/1996). However, the substantial law-making activity of the past ten years has significantly accelerated the legislative process. As a result of the reduction of the average time available for elaborating new regulation, regulatory impact analysis has been carried out only to a very limited extent. With the exception of budget and tax laws, usually preceded by a general macro-economical impact analysis involving scientific research institutes, very few regulations have benefited from an impact analysis, and even those performed were very poor in terms of quality.

This shortcoming has led the Hungarian administration to include the improvement of the quality and efficiency of RIA procedures among the central objectives of the ongoing regulatory reform. The Ministry of Justice, in co-operation with the Prime Minister's Office, has elaborated RIA guidelines based on best practices in Western European countries (regulatory impact analysis issues are discussed in further detail in the background report to Chapter 2). RIA was made compulsory in May 1999, by virtue of Government Resolution 1052/1999. In the meanwhile, the Council for Deregulation, functioning under the Prime Minister's Office between 1995 and 1999, went through existing legal regulations to make sure they were still warranted. Between 1994 and 1997, the Council recommended the annulment of 480 government and lower-level decrees and resolutions, which had become obsolete or irrelevant. The Council for Deregulation was disbanded in 1999.

For want of a generalised impact assessment system, proposed regulation is circulated by the responsible Ministry to all other Ministries for information and comments in the context of the informal half-yearly legislative planning. In the case of draft laws, the approval of the whole government is requested, while in the case of draft decrees a simplified co-ordination procedure is possible, whereby comments are expected only from the Ministries whose area of responsibility is affected. Proposed regulation is thus discussed at the weekly State Secretaries sessions before it is presented in front of the plenary government sessions. In case of disagreement between involved Ministries the proposal cannot proceed. Interdepartmental co-ordination on issues affecting market openness is quite extensive and seriously abided by, but suffers from inefficiency for not being sufficiently selective. The absence of clear-cut criteria for identifying concerned Ministries results in an increased workload for the administration, which often has to comment on and give clearance to regulatory proposals only remotely related to their respective areas of responsibility.

The Ministry of Economic Affairs (MEA) is responsible in general for proposed regulation that may affect foreign economic relations and in particular for supervising the implementation of the country's obligations arising from international economic agreements. The compatibility of proposed regulation with international obligations is also appraised by the Ministry of Justice and other affected Ministries within their scope of activities. Hence, despite the absence of a formal trade impact assessment, there is in practice a wide-ranging scrutiny of trade and investment related regulations. The Ministry of Economic Affairs has the power to request the withdrawal of a regulation that violates international obligations or the redrafting of a regulation that may cause adverse trade effects. Any disagreement has to be arbitrated by the government in plenary. This procedure seems to be quite effective in ruling out most of the unnecessarily restrictive regulations, not least because of the important weight of economic affairs in government priorities. Among the cases where draft administrative measures were redesigned to avoid unnecessary trade restrictiveness, there is the example of regulations on specialised customs clearance offices for the import of products subject to excise duties. As a result of MEA intervention, the number of designated offices in the draft regulation was substantially increased to avoid burdensome internal transportation obligations and costs.

As seen earlier, there are no formal consultation mechanisms for associating chambers of commerce, professional associations, trading partners and other interest groups in the elaboration of trade and investment policies. However, the Hungarian administration is relatively open to criticisms and recommendations for changes introduced in the framework of informal consultations and contacts. Market participants may lodge complaints about trade or investment restrictions directly at the relevant regulatory agency or the MEA. They may also use the channels of the chambers of commerce or professional associations. Suggestions for improvement and complaints seem to be seriously considered, and the administration should ensure that legitimate policy objectives are effectively met in the least trade restrictive manner.

While in Hungary there is a clear policy stance against unnecessary trade restrictiveness, the assessment is more mixed as far as everyday implementation is concerned. Transforming the regulatory framework of a centrally planned economy into a market economy oriented framework is not only lengthy and complex, but also subject to trial and error. Yet, it is even more complex and time demanding to change the administrative culture and teach all levels of the administration how to operate in accordance with market economy rules. Foreign firms operating in Hungary often criticise the frequent and dramatic changes in key regulations, such as tax laws, which negatively affect the predictability of the business environment. They further complain about time-consuming procedures, burdensome requirements or administrative inefficiencies, mostly attributable to insufficient infrastructure and staffing or lack of experience of officials in the field. For instance, promptness of shipments clearance seems to be quite uneven from one customs office to the other. Judicial procedures are extremely lengthy because the courts are understaffed and lack exposure to new disciplines, such as competition law.²³ At present, there is little prospect for improvement as far as human resources are concerned, since the most qualified staff tends to leave the underpaid civil service to seek better remuneration in the private sector. In the years to come the openness of the Hungarian market will essentially depend on the capacity of the Hungarian administration to ensure the smooth and stable operation of the regulatory framework in the field, more than on additional reforms of that framework.

2.3.2. *The example of customs procedures*

Customs procedures encompass formalities and procedures in collecting, presenting, communicating and processing data requested by customs for and related to the movement of goods in international trade.²⁴ As tariff levels have declined through GATT/WTO rounds, the costs incurred by such procedures have attracted growing attention of businesses. Costs are generated by the compliance with documentary requirements (acquiring and completing the documents and paying for their processing) and by delays of cargo processing at borders. The aims of customs procedures (to collect revenue; to compile

statistics; to ensure that trade occurs in accordance with applicable regulations, such as those aiming at human safety and health protection, animal and plant life protection, environmental protection, prevention of deceptive practices; etc) should be pursued so as to ensure that the procedures do not create unnecessary obstacles to international trade. In other words, the lowering of trade barriers may not achieve the full efficiency benefits of liberalisation without harmonised, simplified, fast and secured customs procedures.

In the framework of the Europe Agreement (see Box 1), customs law was among the priority areas where Hungary undertook commitments to harmonise its legislation to current and future EU legislation. The commitment to law harmonisation has acted as a catalyst for Hungary to start reforming the customs institutions and customs regulations in order to make them more efficient and service-oriented. Despite a tight budget constraint, there was a slight increase in the number of border crossing stations, now exceeding 110. Today, Hungarian customs regulations,²⁵ which adopt the substance, structure and philosophy of the EU Common Customs Code, provide more harmonised and simplified procedures.²⁶ Newly introduced or amended procedures include a fast clearance procedure for small package delivery services; more flexibility for deferred payment and deposit; the possibility of declaration in electronic form; the possibility of a consolidated declaration based on the concept of “authorised traders”; the use of single administrative documentation; the possibility of self-assessment of the value of goods; etc.

In addition to the institutional and legislative changes, there has been a notable improvement in the attitude of the Hungarian customs authority towards the users, that is businesses and in particular foreign ones. The Hungarian customs authority has made efforts to increase the dialogue with users, which in turn has encouraged the users to make improvement proposals to the customs authorities and legislators. As a result, the business community has expressed increased satisfaction with the customs operation in Hungary, especially since 1998. A recent business survey has reported the Hungarian customs procedures to be one of the most straightforward among those in central and eastern European countries.²⁷ Nevertheless, firms stressed the need for further facilitation of such procedures and the acceleration of the law approximation process. At the same time, they expressed concern regarding the imbalance between the regulations and the administrative and infrastructural capacities, particularly with respect to the customs electronic data interchange (EDI) system.

The design and development of Hungary’s customs EDI system started in 1991 with EU financial and technical assistance, but progress has been relatively slow, notably because the program proved ill suited to local circumstances. The 1998 European Commission survey has pointed out that “*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 organisations. If it reinforces its efforts, particularly in relation to project management in the computerisation area, Hungary should be ready to fulfil the responsibilities of an EU customs administration within the next few years.*”²⁸ To date there is no fully functioning customs EDI system covering import/export procedures, although Hungary’s customs regulations do provide for the possibility to submit declarations in electronic form.²⁹ On the basis of the drawbacks observed in the first years of operation, a new system was elaborated and is currently running on a trial stage, with the participation of some private companies. As this experimental project started in May 1999 some more time may be needed for the participants to assess the new system.

Box 3. Customs EDI system: benefits and difficulties

The demand of international supply chains for timely goods deliveries has prompted the request to reduce time spent for customs clearance, increasingly viewed by businesses as a trade hindrance. Yet, customs authorities need some time to effectively carry out their duties of revenue collection and import/export control for compliance with national and international obligations. The introduction of computers in the customs offices allows partly reconciling these two objectives. However, it does not address the problem of the time spent on paper-based communication between the trader's office and customs, for data input to each computer and for corrections of frequent input errors.

The customs electronic data interchange (EDI) system allows input bottlenecks to be addressed and communication time to be cut back. The establishment of a computer network between customs offices and traders allows the latter to submit customs declarations electronically, which are then automatically processed by the customs computer. It can thus reduce trade restrictiveness while increasing accuracy and enforcement quality for the customs authority for the following reasons:

- Traders do not have to physically move for submission, thus saving time and cost.
- Customs officers do not have to input declaration data into the customs computer, which saves time and prevents possible input errors and corrections.
- The customs computer verifies and screens the declarations in an accurate and quick manner. Lower risk declarations might be cleared within a few seconds while declarations assessed as higher risk³⁰ might be targeted for an intensive physical inspection.
- Different customs offices and traders share the same software and tariff tables, allowing a more harmonised implementation of customs procedures.
- Screening of declarations is no longer subject to the discretion of individual customs officers, while all transactions are recorded, thus traceable. Therefore, the customs EDI system contributes to reducing opportunities for corrupt practices.
- The storage of data in electronic form allows trade statistics to be produced more easily, and databases for screening with a view to risk assessment to be updated timely and improved punctually.
- As most deskwork is substituted by the computer, customs can mobilise their resources into areas requesting human presence, such as physical goods inspection, accelerating inspections and reducing waiting time.

However, the establishment and maintenance of the system and the training of employees are quite expensive, while timely updates of the software are necessary upon each modification of the customs regulation. In addition, the smooth operation of the system further requires:

- The computerisation of related border controls by other agencies (such as quarantine).
- The involvement of banks to enable debit payments, deferred payments or deposit management for duty payment/collection of dutiable goods.
- The possibility to submit support documents (such as commercial invoices) in electronic form, or to file them in a deferred submission.

It should be noted that the establishment of a customs EDI system does not necessarily require a change in the customs procedures; therefore, the fundamental simplification or harmonisation of customs procedures is a different issue, which can be pursued on its own right.

Source: WTO Symposium on Trade Facilitation, 9-10 March 1998, Panel 4 "Electronic Facilities and their Importance for Facilitating International Trade", G/C/W/115; WTO Council for Trade in Goods, "Role of Electronic Reporting in Trade Facilitation" (Communication from Australia), G/C/W/152.

At present the major problems of the Hungarian regulatory system as regards trade restrictiveness seem to lie essentially in operation in the field. However, despite the relative success of existing informal procedures in averting unnecessarily trade restrictive regulation, the elaboration of an appropriate RIA procedure would greatly enhance the efficacy of trade impact scrutiny. In particular, clearer threshold criteria would reduce the risk of overburdening already over-stretched resources. Any new RIA system should include a trade impact assessment.

2.4. Measures to encourage use of internationally harmonised measures

Compliance with different standards and regulations³¹ for like products, often explained by natural and historical reasons relating to climate, geography, natural resources or production traditions, frequently presents firms wishing to engage in international trade with significant and sometimes prohibitive costs. Hence, when appropriate and feasible, reliance on internationally harmonised measures, such as international standards, as the basis of domestic regulations can facilitate trade flows. National efforts to encourage the adoption of regulations based on harmonised measures, procedures for monitoring progress in the development and adoption of international standards, and incentives for regulatory authorities to seek out and apply appropriate international standards are thus important indicators of a country's commitment to efficient regulation.

Hungarian legislative practice lays particular emphasis on harmonising domestic legislation with the country's international obligations under international treaties and agreements. More specifically, the Act on Legislation requires proposed regulations to indicate the degree of approximation with relevant European legislation and the *acquis communautaire*. In the area of technical regulations and standards too, Hungarian policy understandably aims at establishing a regulatory and standardisation system applicable in a market economy and accepted world-wide, so as to facilitate the access of Hungarian products to world markets. This policy has been shaped to a large extent by the commitments undertaken in the framework of the Europe Agreement and the preparation for accession to the European Union. By virtue of the Europe Agreement, Hungary committed to:

- Promote the use of Community technical regulations and European standards and conformity assessment procedures.
- Seek to conclude agreements on mutual recognition in these fields.
- Participate in the activities of European standard-setting bodies (CEN, CENELEC, ETSI).
- Exchange technical and methodological information in the field of quality control of production and production processes.

In order to help Hungary reach these goals the European Union committed to provide technical assistance. As part of Hungary's efforts to harmonise domestic regulation along the lines of the *acquis communautaire*, Government Resolution 2212/1998 (IX.30) provides for the adoption of European New, Global and sectoral approach directives, including the conformity assessment procedures contained therein.

Box 4. Harmonisation in the European Union³²

The New Approach and the Global Approach

The need to harmonise technical regulations when diverging rules from Member States impair the operation of the common market was recognised by the Treaty of Rome in Articles 100 to 102 on the approximation of laws. By 1985 it had become clear that relying only on the traditional harmonisation approach would not allow the achievement of the Single Market. As a matter of fact, this approach was encumbered by very detailed specifications which were difficult and time consuming to adopt at the political level, burdensome to control at the implementation level and requiring frequent updates to adapt to technical progress. The adoption of a new policy towards technical harmonisation and standardisation was thus necessary to actually ensure the free movement of goods instituted by the Single Market. The way to achieve this was opened by the European Court of Justice, which in its celebrated ruling on *Cassis de Dijon*³³ interpreted Article 30 of the EC Treaty as requiring that goods lawfully marketed in one Member State be accepted in other Member States, unless their national rules required a higher level of protection on one or more of a short list of overriding objectives. This opened the door to a policy based on mutual recognition of required levels of protection and to harmonisation focusing only on those levels, not the technical solution for meeting the level of protection.

In 1985 the Council adopted the “**New Approach**”, according to which harmonisation would no longer result in detailed technical rules, but would be limited to defining the essential health, safety and other³⁴ requirements which industrial products must meet before they can be marketed. This “**New Approach**” to harmonisation was supplemented in 1989 by the “**Global Approach**” which established conformity assessment procedures, criteria relating to the independence and quality of certification bodies, mutual recognition and accreditation. Since the New Approach calls for essential requirements to be harmonised and made mandatory by directives, this approach is appropriate only where it is genuinely possible to distinguish between essential requirements and technical specifications; where a wide range of products is sufficiently homogenous or a horizontal risk identifiable to allow common essential requirements; and where the product area or risk concerned is suitable for standardisation. Furthermore, the New Approach has not been applied to sectors where Community legislation was well advanced prior to 1985.

On the basis of the New Approach manufacturers are only bound by essential requirements, which are written with a view to being generic, not requiring updating and not implying a unique technical solution. They are free to use any technical specification they deem appropriate to meet these requirements. Products, which conform, are allowed free circulation in the European market.

For the New Approach, detailed harmonised standards are not indispensable. However, they do offer a privileged route for demonstrating compliance with the essential requirements. The elaboration at European level of technical specifications which meet those requirements is no longer the responsibility of the EU government bodies but has been entrusted to three European standardisation bodies mandated by the Commission on the basis of General Orientations agreed between them and the Commission. The CEN (European Committee for Standardisation), CENELEC (European Committee for Electrotechnical Standards) and ETSI (European Telecommunications Standards Institute) are all signatories to the WTO TBT Code of Good Practice. When harmonised standards produced by the CEN, CENELEC or ETSI are identified by the Commission as corresponding to a specific set of essential requirements, the references are published in the Official Journal. They become effective as soon as one Member State has transposed them at the national level and retracted any conflicting national standards. These standards are not mandatory. However conformity with them confers a presumption of conformity with the essential requirements set by the New Approach Directives in all Member States.

The manufacturer can always choose to demonstrate conformity with the essential requirements by other means. This is clearly necessary where harmonised European standards are not (or not yet) available. Each New Approach directive specifies the conformity assessment procedures to be used. These are chosen among the list of equivalent procedures established by the Global Approach (the so-called “modules”), and respond to different needs in specific situations. They range from the supplier’s declaration of conformity, through third party type examination, to full product quality assurance. National public authorities are responsible for identifying and notifying competent bodies, entitled to perform the conformity assessment, but do not themselves intervene in the conformity assessment. When third party intervention is required, suppliers may address any of the notified bodies within the European Union. Products which have successfully undergone the appropriate assessment procedures are then affixed the CE marking, which grants free circulation in all Member States, but also implies that the producer accepts full liability for the product.³⁵

The strength of the New Approach and the Global Approach lies in limiting legal requirements to what is essential and leaving to the producer the choice of the technical solution to meet this requirement. At the same time, by introducing EU-wide competition between notified bodies and by building confidence in their competence through accreditation, conformity assessment is distanced from national control. The standards system, rather than being a means of imposing government-decided requirements, is put at the service of industry to offer viable solutions to the need to meet essential requirements, which however are not in principle binding. The success of the New and Global Approaches in creating a more flexible and efficient harmonised standardisation process in the European Union heavily depends on the reliability of the European standardisation and certification bodies and on the actual efficiency of control by Member States. First, European standardisation and certification bodies need to have a high degree of technical competence, impartiality and independence from vested interests, as well as to be able to elaborate the standards necessary for giving concrete expression to the essential requirements in an expeditious manner. Second, each Member State has the responsibility to ensure that the CE marking is respected and that only products conforming to the essential requirements are sold on its market. If tests carried out by a notified body are cast in doubt, the supervisory authorities of the Member State concerned should follow this up.

The policy framework for standardisation activities is laid down in Law XXVIII of 1995 on national standardisation, in force since May 1996. The law introduced two major conceptual reforms along the lines of the European approach to standardisation: the ascription of a voluntary character to national standards and the transfer of standardisation activities from the public to the private domain. Technical specifications should no longer be mandatory, unless specifically stated by law, and their use should be left to the judgement of market participants, producers and consumers. The Hungarian administration has accordingly undertaken to withdraw existing mandatory technical specifications and end the previous practice of making standards mandatory by law, in order to achieve an exclusively voluntary application of standards in line with the European regulation.³⁶ The parallel with the “New Approach” philosophy is further established by the introduction in the Hungarian legal system of the EC Directives setting the essential requirements. The legislative alignment is completed in the foodstuffs and automotive sector and is progressing in the pharmaceuticals and chemical products sector.

Prior to the enactment of the 1995 law, standardisation as well as quality assurance, certification and accreditation activities were carried out by the Hungarian Office for Standardisation (MSZH), a state body with public authority operating under the supervision of the Ministry of Industry. The National Standardisation Act transferred the responsibilities of the MSZH, to the Hungarian Standards Institution (*Magyar Szabványügyi Testület* or MSZT), an independent, public interest, non-profit organisation, which has an exclusive right for issuing national standards. MSZT operates under Hungarian civil law and is financed mostly by the contributions of its members, as national standards bodies in other countries. It maintains close-working relationships with national standards and certification bodies of other countries and participates actively in the work of ISO since the foundation of the latter in 1947.³⁷ MSZT accepted the WTO TBT Code of Good Practice for the preparation, adoption and application of standards and thus committed to operate according to the principles set therein. MSZT publishes a Standardisation Gazette (*Szabványügyi Közlöny*), in which it announces draft national standards, publishes adopted national standards and responds to comments and enquiries.

As the Hungarian national standards body, MSZT is responsible for the enforcement of the Hungarian commitments under the Europe Agreement, namely the harmonisation of Hungarian standards to European standards and the participation in the activities of European standard-setting bodies. In view of the voluntary nature of national standards, there is no direct government supervision on MSZT standard-setting activities, although MSZT closely co-operates with relevant administrative agencies when it elaborates technical specifications intended to become mandatory. MSZT (and its predecessor) has been an affiliate to CEN and CENELEC since 1991 and to ETSI since 1993. It has already achieved full membership to ETSI, but has yet to reach the 80% implementation rate for existing European standards, which is required as a minimum in order to obtain full membership to CEN and CENELEC.

Since 1990, the number of purely national standards in force in Hungary has continuously decreased. At the end of 1998 the number of European and international standards transposed at the national level reached about 3000. Particular emphasis is now paid to the implementation of European standards corresponding to essential requirements laid down by the New Approach directives. As of 1st April 1999, 4207 out of the 9200 European standards had been adopted as Hungarian national standards, which means a 46% implementation rate. In order to speed up the pace of adoption of harmonised standards, slowed down by the need to convert them into Hungarian, Hungary applies the practice of endorsement notice³⁸. Standards are thus directly used in English in areas where there has been no interest to form national standards committees; the circle of users is limited; standards are subject to frequent changes; and using the English language will not cause difficulties (e.g. in the area of telecommunications).

MSZT Standardisation Activities

Figure 4. Standards published by June 1999

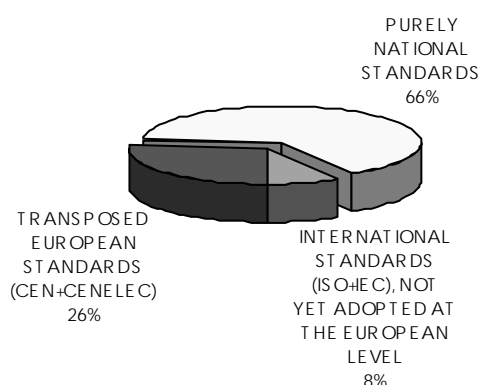
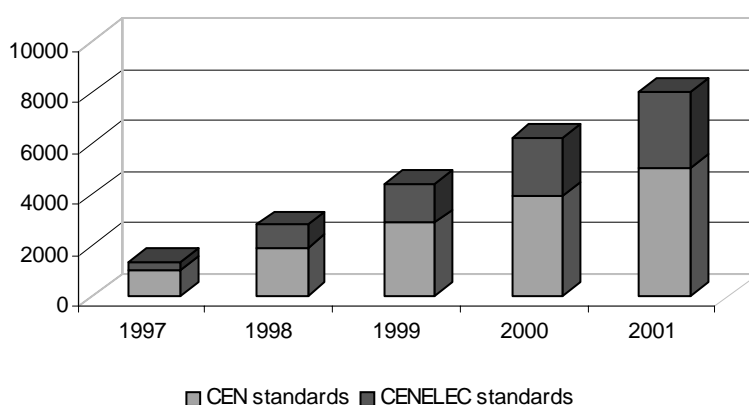


Figure 5. Schedule of implementation of European standards (in stock)



As of June 1999, 4284 European standards had been adopted, and the total number of Hungarian standards amounted to 16 466.

Source: MSZT.

Hungary has made considerable progress towards increased reliance on internationally harmonised measures. The change in the basic philosophy of standardisation was probably the most important of all positive steps. Following this fundamental change, all subsequent progress will rely more on time and availability of human and financial resources needed to adopt international standards than on any additional regulatory endeavour. The Hungarian commitment to adopt EU technical regulations and standards currently provides the necessary momentum for continuing efforts. Once member of the European Union Hungary will benefit from harmonisation efforts undertaken at the European level, since harmonised standards transposed in any of the EU members will be directly applicable in Hungary too.

2.5. *Recognition of equivalence of other countries' regulatory measures*

In cases where the harmonisation of regulatory measures is not considered feasible or necessary, the recognition of equivalence of other countries' regulatory measures in attaining the same regulatory objective may be the most appropriate avenue for reducing technical barriers related to regulatory divergence. Despite the development of global standards, there are still many areas where specific national regulations prevail, preventing manufacturers from selling their products in different countries and from enjoying full economies of scale. Additional costs are also raised by the need to demonstrate the compliance of imported products with applicable regulations in the import country through testing and certification accepted in that country. Recognising the equivalence of differing standards applicable in other markets, or of the results of conformity assessment performed elsewhere can greatly contribute in reducing these costs.

As in the area of standardisation, the major driving forces behind recognition of equivalence in Hungary are the commitments undertaken in the framework of the Europe Agreement and the Hungarian endeavour to join the European Union. In accordance to these commitments, the principle of mutual recognition applying among EU Member States³⁹ extends to Hungary in the areas where it has taken the necessary steps for approximation to the *acquis communautaire*. Furthermore, Government Resolution 2212/1998(IX.30), which stages the process of harmonisation to the *acquis communautaire* provided for the adoption of the conformity assessment procedures contained in sectoral directives and in "Global Approach" directives (see Box 4). Accordingly, in the approximated areas manufacturers who want to market their products in Hungary are no longer bound to the unique avenue of conformity certification by Hungarian government authorities but are now allowed the same range of possibilities for demonstrating conformity as within the Single European Market. This includes recognition of conformity assessment performed by notified bodies anywhere in the European Union.

Although this obviously benefits mainly EU manufacturers, the positive impact for non-EU manufacturers should not be disregarded. Indeed, the gradual opening of the Hungarian market on the basis of EU rules not only increases the transparency of the applicable regulatory environment, but also offers third partners the multiplier effect of the intra-community mutual recognition. Once a regulation transposing a given Directive enters in force in Hungary, the covered products bearing the CE marking legally applied on them by any manufacturer in the world may be freely marketed in Hungary.

In the framework of the Europe Agreement, Hungary and the European Union started in September 1997 negotiations on a Protocol regarding the mutual recognition of product certification, testing data and marks of conformity (Protocol on European Conformity Assessment, or PECA). The concept of PECAs between the European Union and Central and Eastern European countries (CEECs) has been developed in order to facilitate the implementation of the *acquis communautaire* during the pre-accession period and hence assist the gradual integration of CEECs prior to accession. As most mutual recognition agreements currently negotiated, the Protocol has a framework component covering general principles and specifies the conditions under which each party will accept the results of conformity assessment procedures produced by conformity assessment bodies in the other party. This framework section is supplemented by sectoral

annexes. In the case of Hungary, these annexes cover low voltage equipment and electromagnetic compatibility, machinery, medical devices, gas appliances, hot water boilers fired with liquid or gaseous fluids and pharmaceutical GMP and GLP.⁴⁰ The negotiations have involved Hungarian conformity assessment institutions and have benefited from consultations with concerned industries. The PECA is expected to be concluded by the end of 1999.

As recognition of equivalence cannot produce benefits for Hungarian manufacturers without the confidence of market participants in the Hungarian certification system, Hungary has undertaken to enhance the institutional framework for quality control, certification and accreditation. This covers the activities of the testing and certification bodies, the inspection authorities and the accreditation institutions. At present, serious shortcomings exist in the area of conformity assessment where a satisfactory network of testing laboratories and supervisory bodies still needs to be developed. However, Hungary set out to develop such a network in the context of the implementation of the PECA.

The Hungarian Standards Institution (MSZT) is one of the institutions in charge of quality control and certification activities, including certification of quality assurance systems and products. It is the only national system-certification institution in Hungary for ISO9000 and ISO14000. In June 1998 MSZT became a full member of the IQNet (International Network of Quality System Certifiers), which provides for the mutual recognition of quality certificates issued by any of the 29 participating national certification bodies in the world. The operation of the MSZT in the area of quality control seems generally satisfactory. Other institutions active in the area of certification in Hungary include the Commercial Quality Control Institute (KERMI) and the National Institute for Food Hygiene and Nutrition (OETI). Foreign partner satisfaction with respect to these bodies seems lower and several complaints have been expressed about high fees and slow processing to obtain approvals. Other European testing and certification bodies, notified by national authorities in the context of the Global Approach will be able to operate in the Hungarian market once the PECA is implemented. The introduction of competition in this area where bodies like KERMI and OETI currently enjoy a monopoly position may greatly contribute to enhancing the quality of service.

Domestic or foreign bodies wishing to perform testing, quality control and certification for the Hungarian market with respect to product sectors covered in the EU by New Approach Directives can obtain an accreditation from the National Accreditation Board. As soon as the PECA enters in force, this accreditation will confer those bodies the status of a “notified body” in the sense of the Global Approach. The National Accreditation Board operates under the supervision of the Ministry of Economic Affairs. Hungary is a full member of the International Laboratories Accreditation Committee (ILAC)⁴¹ and of the International Accreditation Federation (IAF)⁴². It is also an affiliated member of the European Co-operation for Accreditation (EA).⁴³

2.6. *Application of competition principles from an international perspective*

The benefits of market access may be reduced by regulatory action condoning anti-competitive behaviour or by failure to correct anti-competitive private actions that have the same effect. It is therefore important that regulatory institutions make it possible for both domestic and foreign firms affected by anti-competitive practices to present their positions effectively. The existence of procedures for hearing and deciding complaints about regulatory or private actions that impair market access and effective competition by foreign firms, the nature of the institutions that hear such complaints, and adherence to deadlines (if they exist) are thus key issues from an international market openness perspective. These issues will be the focus in this sub-section, while a more detailed discussion of the application of competition principles in the context of regulatory reform can be found in the background report to Chapter 3.

Under the Hungarian Competition Act, the basic decisions and actions are taken by the Hungarian Competition Office (HCO), which has the power to clear notified conduct, grant exemptions, issue merger authorisations, initiate investigations *ex officio* and hear complaints. Firms wishing to advance complaints against alleged anticompetitive regulatory or private actions can take their complaints to the HCO provided that the provisions of the Competition Act cover the objected market behaviour. There is no legal provision for an independent private suit under the Competition Act. The HCO must decide whether to open an investigation within 30 days after receiving a complaint and communicate this decision to the complainant. The complainant can appeal a decision not to pursue an investigation to the Competition Council, which is part of the HCO, and a negative decision of the Competition Council in court. After the Competition Council finds a violation complainants may obtain relief in court, although no such claims have been filed to date, perhaps because of the perceived slowness of the judicial system.

The Competition Act gives foreign firms national treatment. Foreign firms have the same rights as domestic firms to advance complaints. However, to date no complaints have been directly submitted to the HCO by foreign-based undertakings. Rather, they have been filed by Hungarian subsidiaries of multinational companies or foreign-based companies through Hungarian law firms or foreign law firms registered in Hungary. The treatment of these complaints confirms that foreign and domestic firms are given equal opportunities for legal action.

The 1996 amendments of the Competition Act made it possible for the HCO to take action against market conduct outside of Hungary. To judge the restrictive behaviour of a company in dominant/monopoly position, it is irrelevant whether the restrictive effects are felt in the same market where such behaviour occurred or in a different market. Domestic as well as foreign firms can thus seek relief under the Hungarian competition law in cases where firms with market power in Hungary impair competition in other markets. However, such action is possible only to the extent that the incriminated market conduct has a noticeable effect on the Hungarian market. No complaint of this kind has been made yet since these amendments entered in force (1st January 1997). The investigations undertaken with respect to a number of foreign mergers did not call for action. As a result, there is no experience of extra-territorial enforcement action. In cases where the incriminated market conduct occurs within a regulated sector (such as electricity or telecommunications) the possibilities for action may be limited by authorisations or exceptions granted by regulations specific to these sectors.

On balance, Hungarian regulatory procedures for initiating and advancing complaints about alleged anticompetitive regulatory or private actions are broadly satisfactory from the perspective of international market openness. The equality of opportunities for action between foreign and domestic firms and the independence of competition policy authorities offer considerable guarantees for an application of competition principles which is supportive of a market open to global competition.

3. ASSESSING RESULTS IN SELECTED SECTORS

This section examines the implications for international market openness arising from current Hungarian regulations in four sectors: telecommunications services; telecommunications equipment; automobiles and components; and electricity. For each sector, an attempt has been made to draw out the effects of sector-specific regulations on international trade and investment and the extent to which the six efficient regulation principles are explicitly or implicitly applied. Particular attention is paid to product standards and conformity assessment procedures, where relevant. Issues addressed here include efforts to adopt internationally harmonised product standards, use of voluntary product standards by regulatory authorities, and openness and flexibility of conformity assessment systems. Electricity and telecommunications are reviewed in greater detail in the background reports to Chapters 5 and 6 respectively.

3.1. Telecommunications services

From the outset of the transition period, the exposure of the Hungarian economy to foreign competition very quickly resulted in a surge of demand for modern business communications. The Hungarian government recognised the importance of rapid and efficient development of telecommunications as a prerequisite for furthering the opening of the market and enhancing investment inflows. Hence, it has adopted a strategy of infrastructure development and network expansion largely based on a significant privatisation program. Concession contracts were thus concluded with telecommunications operators in exchange for a series of quantitative and qualitative improvement obligations, such as a specified minimum annual growth in telephone lines and the introduction of quality of service improvement standards. As a result, considerable inflows of foreign direct investment enabled the rapid modernisation of the telecommunications sector. Fixed-line connections rose from 9.6 per 100 inhabitants in 1990 to more than 35 by December 1998, while over 76% of the network was digitised by 1998. The expansion and modernisation of the sector has in turn considerably increased the attractiveness of Hungary as a destination of foreign direct investment by improving the working conditions of business in Hungary.

Until 1989, telecommunications services, together with radio and television broadcasting and postal services, were supplied and regulated by a single state-owned organisation, the Hungarian PTT. In 1989 the Hungarian PTT was split into a telecommunications operator (Matav), the Hungarian Broadcasting Corporation (Antenna Hungaria) and the Hungarian Post Office, while regulatory responsibilities were reassigned to the Ministry of Transport, Communications and Water Management. In 1993 an independent regulator was established, presently named the Communications Authority of Hungary (HIF). In the same year, 30% of Matav's shares were sold to MagyarCom, a consortium of Ameritech and Deutsche Telekom. At the same time, Matav was granted monopoly rights to provide domestic and international long distance public telephony services throughout Hungary until 2002. In return it was charged with the rapid modernisation of the telephone network. Privatisation was completed in June 1999, except for a "golden share" still held by the government, which gives it control over future mergers and acquisitions. Other concessions too elicited considerable interest from foreign operators and several of them were successful in gaining entry into the Hungarian market. Concession contracts came with the requirement for concession companies to use products and services of Hungarian origin in the provision of public telephone services.⁴⁴

Table 2. Foreign ownership of major Hungarian telecommunication operators, 1999

Matav (Including mobile subsidiaries Westel & Westel GSM)	Deutsche Telekom (Germany): 29.79%.	Purchased in Dec 1993 and Nov 1995.	National operator with monopoly in national and international telephony.
	Ameritech (US): 29.79%.	Purchased in Dec 1993 and Nov 1995.	National operator with monopoly in national and international telephony.
PanTel	KPN (Dutch):49%.	Purchased from AT&T-Unisource in June 1998.	Alternative operator specialising in business communications.
Pannon GSM	KPN (Dutch):23.22%.	March 1994.	Mobile operator GSM.
Primatel-DCS 1800	Vodafone (UK)-Airtouch (US) (50.1%); RWE Telliance: (19.9%).	The winning bidder for the 3 rd mobile DCS 1800 licence. Concession agreement signed on 7 July 1999.	Obligated to enter into partnership with Antenna Hungaria and Hungarian Post which together are to hold 30% + 1 share in Primatel.

Source: OECD (1999), *Regulatory Reform in Telecommunications in Hungary*, Paris.

The current regulatory framework is set by the Telecommunications Act of 1993, which aims at fully liberalising the market for basic telecommunications services by the year 2002. Indeed at this time most exclusive rights provided for in the concessions will expire. The time scale for introducing full competition mirrors the EU timetable for liberalising the markets of Member States with less developed or very small telephone networks. Until then public switched voice telephony, public mobile telephony service, nationwide public paging, and broadcasting will remain monopolies or oligopolies governed by concessions. Apart

from national and international long distance service, MATAV runs the concessions for local service in 39 of Hungary's 54 regions. The rest of the local market was awarded to local operating companies, which have monopoly rights over their district access network but have to interconnect with Matav for long distance and international public switched services. Concessions for mobile telephony services and national paging systems were awarded to a limited number of operators, allowing for some competition in these areas.

Hungary signed the WTO Agreement on Basic Telecommunications in September 1997. In its 1997 Schedule Hungary introduced no limitations to national treatment with respect to cross-border supply, consumption abroad and commercial presence in any of the areas covered by its schedule (the presence of natural persons being unbound). It also committed to the obligations contained in the attached "Reference Paper". However, Hungary placed limitations on market access to cover the exclusive rights granted on international long-distance and domestic services until 31 December 2002 and for local services until 31 December 2003; the allocation of licences only to companies registered in Hungary; the requirement of 25% plus one vote of Hungarian ownership in investment; and the limited competition regime for mobile telephony services and national paging systems. Hungary indicated that the reservation of mobile telephony services to the three actual suppliers will terminate by 2004.

Consequently the right of exclusive provision in the concession contracts currently prevents entry into some 80% of the Hungarian telecommunications market. The market is open only for services such as satellite transmission, public switched data transmission services, leased-line resale, value-added services or operation of closed-loop networks. However, the presence of several operators, including foreign ones, in the different segments of the market suggests increased competition after the expiry of exclusive rights. Foreign operators seem to have generally enjoyed equality of competitive opportunities in the tendering of concession contracts, although some tenders imposed a Hungarian ownership of at least 25% plus one vote, including ownership by municipalities.

3.2. *Telecommunications equipment*

Hungary has a long tradition in the production of telecommunications equipment. Before the Second World War, Hungarian R+D activity in the telecommunications equipment sector produced some of the basic inventions, later applied world-wide, namely in radar techniques, in telephony and the invention of the hologram. The sector lost its head-start position during the period of planned economy, and at the end of the 1980s production had fallen below the pre-world-war level both from a technical and a quality viewpoint. At the same time the volume of production increased because, as part of central planning in the CMEA, Hungary became the main supplier of some telecommunications equipment for socialist countries. With the collapse of the CMEA and the decrease in domestic demand at the onset of the reform process, the output in 1992 was half of its level in 1989. The inflow of foreign direct investments, together with the ensuing restructuring of companies and the gradual restoration of domestic demand, allowed a progressive recovery of the sector. Among others, Ericsson, Siemens, Samsung, Philips, Matsushita, IBM, Sony, TDK and Nokia bought shares in existing companies or made greenfield investments. In 1997 the sector accounted for nearly 5% of total industrial output, more than 8% of manufacturing exports and 3.6% of total employment in industry. In the same year, telecommunications equipment was the fastest growing manufacturing sector in Hungary, both in terms of output, export and employment.

Bound tariffs are relatively high for that product group, in the range of 10 to 32.5% and for some products (such as other radio broadcast receivers) tariffs are unbound. However, applied MFN rates (1996 data) are considerably lower compared to the bound rates but still high, in the range of 6 to 15%. Due to the relatively high applied rates and because in the trade between Hungary and the European Union tariffs are set to zero, trade-diversion may be quite noticeable for Hungarian trade with third countries, in this particular sector. However, as a considerable amount of these products is directed to customs free zones for further processing and are thus not subject to customs duties, the importance of this issue should not be overstated.

Technical regulations for telecommunications equipment in Hungary are set by Ministerial Decree. Hungary is a member of the European Telecommunications Standards Institute (ETSI) and generally adopts European Telecommunications Standards (ETS). In accordance with EU practice, all equipment connected to the Hungarian telecommunications network must receive type approval by the Communications Authority of Hungary (HIF). Under this procedure HIF certifies that a representative product sample meets the requirements of applicable regulation on the basis of a review of joint documentation and a series of tests on the product sample. Type approval can take from one to six months depending on the product. However, if the product has already been type-approved in the European Union, type approval procedures in Hungary can be based on available EU test results.

3.3. *Automobiles and components*

Concerns about market openness and domestic regulation of automotive industries around the world are not new. Due to the historic dynamism of global economic activity in the sector and traditionally interventionist policies of some governments aimed at protecting domestic automotive industries, trade tensions related to domestic regulatory issues in general, and to standards and certification procedures in particular, have long figured on bilateral and regional trade agendas. This reflects the fact that automobiles remain among the most highly regulated products in the world, primarily for reasons relating to safety, energy conservation and the environment. Divergent national approaches to the achievement of legitimate domestic objectives in these key policy areas are therefore likely to remain a significant source of trade tensions as global demand for automobiles continues to rise.

Before 1990, Hungary had no automobile industry, other than limited spare parts and components manufacturing activities supplying factories in the Soviet Union and Poland. After 1992, due to the inflow of foreign direct investments, the automobile industry developed rapidly and became one of the fastest growing industries in Hungary. The sector is presently dominated by partly or wholly foreign owned companies. The Japanese Suzuki was the first foreign company to set up an assembly plant in Hungary, followed by General Motors/Opel, and by Audi in 1998. Opel stopped car assembly activities at the end of 1998 to concentrate on gearbox manufacturing in a new plant under construction in Hungary.

Car parts and components manufacturing was taken up and expanded by a number of joint ventures and foreign owned companies such as Opel, Ford, Audi, Denso and Knorr Bremse. Through this expansion Hungary has become the largest producer of engines in the region. Although parts and components manufacturing companies supply in part the domestic assembly market, their export sales increased even more dynamically than their domestic sales and represent today four fifths of their production. By the end of 1997, the production of vehicles and components accounted for 10% of Hungarian manufacturing production, 6% of total exports and 40% of the growth of manufacturing exports. Almost two thirds of automobiles and components export is destined to the EU.

While there was virtually no car industry in Hungary in the central planning period, the country was the biggest producer of buses in the CMEA region, supplying all other CMEA countries. While the production of buses decreased significantly (from 14.000 units in peak years to 800 in 1996 and 2.000 in 1997), Ikarus, the Hungarian bus manufacturing company, is still an important exporter, especially to the markets of Russia and other transition economies. Exports are made possible by preferential export credits from the state-owned EXIMBank and by guarantees for export credit from the MEHIB (Hungarian Export Credit Insurance Corporation). On the other hand, a 1997 bill encouraged domestic sales of buses by allocating a 1.5 billion forints subsidy to domestic transport companies in order to purchase new buses. The phasing out of these kinds of support and the limited market opening towards transition economies considerably affects the company. At present the Hungarian and Russian owners look for a foreign (EU) investor to recapitalise the company and provide access to new markets.

In the pre-transition period, Hungary also supplied the CMEA with trucks. The successful restructuring of the manufacturing company Raba promoted it among the five largest heavy truck axle manufacturers of the world, producing axles and components as well as heavy equipment for trucks and buses. The company has successfully gained new markets in Western Europe and Northern America, especially in the United States.

3.3.1. *Foreign direct investment in the automotive sector*

Foreign investment in the automotive sector was either directed to existing component-producing Hungarian companies (through purchases in the framework of privatisation or through joint ventures), or towards greenfield investments in new production lines. Initially new production lines exclusively focussed on assembly activities, relying principally on foreign supplies and thereby concentrating their operations in customs free zones. Gradually automobile manufacturers encouraged their traditional suppliers to follow them in Hungary, resulting in further investments and development in the sector. All these investors received substantial preferences from the state and local authorities.

The share of domestic value added is limited in most factories, fuelling government efforts to develop a network of domestic suppliers for these companies.⁴⁵ For instance, in the case of Opel and Ford investments the share of local suppliers is about 8%, while in the case of Audi it remains below 1%. The other extreme is represented by Suzuki, for which the share of local suppliers exceeds 30%.⁴⁶ This is explained by the need of the company to fulfil local content requirements⁴⁷ in order to qualify for reduced tariffs when exporting to the European Union. In fact, the geographical proximity of the EU and the easier access to EU car markets made possible by the Europe agreement have been significant factors of attraction for non-EU investors wishing to export to the EU. Other, EU-based companies mostly stick to their traditional EU suppliers, often because of concerns pertaining to the ability of Hungarian companies to meet quality and timeliness requirements. However, domestic participation has gradually increased. In 1998, 21% of the total supplies of car- and car-part-making companies operating in customs free zones were provided by Hungarian companies, compared to 15% in 1997.

The relatively cheap and skilled labour has also been a major attraction for foreign investments in the automotive sector in Hungary. Indeed, the hourly labour costs in the automotive sector in 1996 were 3.07 US\$ in Hungary, as compared to 5.86 US\$ in Turkey, 26.38 US\$ in Austria and 29.69 US\$ in Germany. Together with the special R&D incentive program of the government, this has induced foreign companies to move R&D activities to Hungary, as in the case of Audi and Knorr Bremse. Audi has established three R&D units in Hungary, while Knorr Bremse's Hungarian R&D centre will carry out research projects in co-operation with other European R&D affiliates of the company.

Another important factor of attraction for foreign direct investments in that sector is the protected market for finished passenger cars, owing to the combination of high tariffs, import quotas and prohibitions and burdensome technical regulations (see below). In 1998 Hungary was the fourth biggest market in the region according to the number of new cars sold (127 000 vehicles). However, neither of the two biggest domestic carmakers (Opel and Suzuki) has a dominant market presence.

At the beginning of the transition period domestic car registration was relatively low (166 vehicles per thousand people). Until that time only cars produced in the CMEA were available and shortages resulted in long waiting lists for new cars and disproportionately high prices on the market for used cars. With the relief of major restrictions, imports of used cars from Western Europe rose sharply. Car ownership per thousand people rose to 221 in 1998. The average age of the cars has decreased gradually (11.77 years in 1998), and the share of cars with a catalytic engine has increased (almost one quarter of the total in 1998). However, the car park is still dominated by old, technically outmoded and highly polluting CMEA-produced cars. The total stock of vehicles (including cars, buses, trucks and motorbikes) exceeded 4 million at the end of 1998.

At present there are about 10 000 car dealers in Hungary (as compared to about 100 000 car dealers in the EU), more than one-third of them associated with manufacturers' representative offices. On average, main dealers sell around 42 new cars per year, as compared to 266 in the EU. After EU accession further concentration is thus likely. The Association of Vehicle Importers includes all major importers and manufacturers in Hungary, except for Hungarian Suzuki. They are consulted on quota allocation, licensing questions, and invited to the discussion of related topics in the Economic Committee of the Parliament. However, they only have a sporadic participation in consultation mechanisms outside these issues.

3.3.2. *Tariffs, non-tariff border measures and taxes*

Finished cars face relatively high tariffs and non-tariff border measures when entering in the Hungarian market. Tariffs are unbound in Hungary's WTO schedule for that product group. Applied MFN rates are high (43%) for cars with a large engine capacity, although this market segment only represents 5% of total sales, and transportation equipment is among the most highly protected sectors by tariffs. Barriers on imports of trucksbuses and smaller cars are more moderate. Although tariffs are bound at a relatively high maximum rate of 25%, applied MFN tariffs are moderate, spread around 10%. Even lower tariffs (in the range of 6-10%) are applied to parts and components. No quota system is in place for these products.

Preferential tariffs cover more than four-fifths of Hungarian vehicle imports, resulting in considerably lower tariff barriers on imports from the countries affected. For instance, tariffs on cars in the framework of the Europe Agreement are set as a certain, decreasing percentage of the MFN rate, expected to reach zero in 2001. By the same year, tariffs will be abolished also on cars imported from CEFTA countries. MFN tariffs on automobiles will decrease considerably with the accession to the EU and tariffs on cars will be bound due to the adoption of the common trade policy.

Since 1998 importers need no licence to import cars with an engine capacity over 1 500 cc. However, imports of new and used cars of a cylinder capacity of 1 500 cc. or less are subject to the so-called global quota system. Quotas are expressed in quantitative terms and sub-quotas are maintained for preferential trading partners. Quotas are increased by 7% each year. Goods produced in customs-free zones are also subject to the quota. Hungary plans to phase out the global quota system by 2001.

The allocation of quotas is carried out twice a year by the Ministry of Economic Affairs and is published in the *Magyar Közlöny*. Monitoring of imports, including quotas, is performed by the Customs authority. New and "traditional" importers are distinguished, and the allocation process is biased towards traditional importers. While traditional importers get automatically the permission to import the same amount of cars as their actual imports in the previous six-month period, new importers get an allowance to import 33 cars in their first half-year of activity. Thus, in the next half-year they can only import 33 cars again, unless they make an appeal to receive permission for the import of a higher number of cars. Appeals are relatively rare. Anecdotal evidence suggests that there is a secondary market for quota licences, with a 5-10% premium.

The 25% general VAT, which also applies on cars, trucks and components, is calculated on the basis of the import price, including excise taxes and the customs fee. Although light commercial vehicles (less than 3.5 tons) are subject to much lower tariffs and benefit from the possibility of VAT reclaim, the distinction between this product group and cars for personal use remains ambiguous. Hungary charges an excise tax on purchases of new or less than 4-year-old passenger cars that are imported privately or commercially. The tax is paid at the border and is collected by the customs agency. The rate ranges from 10 to 32%, depending on the size of the engine and whether it is equipped with a catalytic converter. Because domestically made cars have smaller engine capacities, the excise duty has a higher incidence on imported cars. All in all, Hungarian taxes on new cars lie between the two EU extremes (Germany 15% - Denmark 200%).

Hungary prohibited the import of used cars, older than 4 years. The main justification given for this measure was the fact that the average age of the car park was still 11.8 years at the end of 1998 and that 60% of the cars are more than 10 years old. However, the measure effectively hampered the renewal of very old used cars owned by people who could not afford the purchase of a first-hand vehicle. Actually, this prohibition as well as the quota system seemed to a considerable extent explained by balance of payments reasons. Taking into account complaints expressed with respect to this measure, the Hungarian government suppressed the import prohibition with effect from January 2000. The environmental aim of excluding dangerous and polluting vehicles from the Hungarian car park will be pursued through the introduction of very strict traffic safety and environmental performance controls. Used car imports exceeded 100 000 per year before the government introduced tighter measures in 1995. In 1998, one third of the growth of consumer product imports consisted of passenger car imports. In 1998, import licences were allocated for up to 68 000 new and 63 000 used cars, however, these quotas were not fully used. In 1999, the quota for new cars seems to be slightly lower than the amount requested by the market. Importers hope that part of the quota for old cars will be re-allocated to new cars.

3.3.3. *Technical regulations*

Safety, environmental and other regulations affecting the car industry are largely shaped by the preparations for EU accession. Hungary is a contracting party to the UN-ECE 1958 Agreement and signatory to 75 of the 99 UN-ECE regulations. It adopted the EU Framework Directive (Directive 70/156/EEC), which established the equivalence of several UN-ECE regulations with relevant EU technical Directives. Hungary also adopted the 54 EU technical Directives on motor vehicles relating to active and passive safety measures, lighting measures and environmental protection, focusing mainly on vehicle emissions. Automobiles and trucks not conforming to EU technical requirements may not be sold in Hungary. However, Hungary has not adopted yet the European system of type-approval of motor vehicles used for the certification of these requirements. Instead, the import of new cars is subject to a series of burdensome technical regulations entailing time consuming and costly procedures. For instance, type certificates and factory quality certificates are not sufficient and each imported car must be examined individually. The Hungarian government plans to have adopted EU regulations on type-approval by the time of accession.

The Hungarian authorities have gradually tightened regulations on emissions and noise. From January 1998, imported commercial vehicles must meet the EURO 2 emission and noise reduction UN-ECE standards. All cars undergo an annual control to ensure that they meet safety and environmental protection standards. However, to date a 'double-standard' applied as conformity certificates for old vehicles, allowing them to run for another year, were based on easier requirements. The introduction of tighter environmental and safety controls to replace the import prohibition for used cars is likely to improve this situation in the future.

In conclusion, the liberal investment regime prevailing in the automotive sector in Hungary is not matched by corresponding liberalisation of the trade regime. The combination of high tariffs, import restrictions and technical barriers effectively discourages car imports in favour of the domestic infant industry and of car-makers already established in Hungary. Accession to the EU will considerably improve this situation through the implementation by Hungary of EU bound tariffs on automobiles as a part of the common trade policy, and the enforcement of the European system of type-approval of motor vehicles.

3.4. *Electricity*

The electricity sector has been subject to the general liberalisation process undertaken in Hungary over the past ten years. At the beginning of the decade the Hungarian electricity sector was a monopoly controlled by the State-owned power supplier, MVM Rt. It suffered from inefficiencies, with obsolete infrastructures, high environmental damages due to emissions from old coal-fired generating plants, and inadequate tariffs. Hungary imported a large part of its electricity consumption, up to one third, mainly from Ukraine. In 1994 the Hungarian Parliament adopted a new law to allow for the restructuring and privatisation of the sector. The Act gave the Hungarian Energy Office (HEO), an agency now under the supervision of the Ministry of Economic Affairs, the responsibility for issuing operation licenses, proposing price changes and protecting consumers. A new legislation is currently under preparation to adapt Hungarian legislation to the EU Electricity Directive⁴⁸ in view of Hungary's accession to the European Union.

The privatisation of the electricity sector has resulted in a high foreign presence. Following the unbundling of the electricity sector into different companies for generation, transmission and distribution, privatisation was undertaken by selling shares of existing state-owned companies and by launching tenders for the creation of new capacities. As for the rest of the economy, the Hungarian government put state-owned power companies for sale for cash, with a view to attracting foreign investors, thereby helping reduce Hungary's foreign debt and bringing the technical, financial and management resources needed to modernise the sector. Majority shares in the six regional distribution companies were sold to German and French electricity companies in 1995. Six generation companies were sold (mainly to US, Belgian and German companies) in two waves of privatisation in 1995 and 1997. There were subsequent bids for tender for the establishment of new capacity. Currently 30% of the generating companies and 70% of the distribution companies belong to foreign-owned companies (see tables in the background report to Chapter 5).

Even though the Hungarian electricity sector has been considerably liberalised in comparison to the pre-transition period, the State still plays a major role. Public institutions (State, municipalities and the state-owned MVM) hold shares in generation and distribution companies (including the exclusive ownership of Paks, a nuclear power plant, by MVM). The Hungarian State retains a "golden share" in privatised companies, which gives it control over future mergers and acquisitions in the sector. MVM is responsible for the transmission of electricity, including international connections. In addition, MVM acts as a "Single Buyer": generation companies cannot sell directly to retail distribution companies but must sell to MVM, and only MVM can import and export electricity. MVM can also restrict entry by new generators. Prices are still under the control of the government. HEO makes proposals according to rules set by law, but the final decision is in the hands of the Minister of Economic Affairs.

As in other sectors, the past ten years have seen a drastic change in the pattern of trade. In the early 1990s, imports from Ukraine collapsed, due to the combined slump in domestic demand and shortages in Ukraine. The national transmission grid, which had been connected eastward, is now connected to western international power transmission systems. As trade between asynchronous systems⁴⁹ is very costly, Hungary no longer imports significant amounts of electricity from Ukraine. For the time being, connections with other neighbouring countries are still underdeveloped, which limits Hungary's capacity to trade electricity westwards. Imports, mainly from Slovakia, currently account for about 1.6% of total gross consumption.

Within the new unbundled structure, any firm, regardless of nationality, can apply for the establishment of generation capacities. Sales of power to MVM are based on long-term power sales agreements, concluded through tendering procedures that are open to foreign firms. There is little doubt over the basic non-discriminatory nature of bidding tenders, as attracting foreign investors has been a clear objective of the government throughout the restructuring process. However, the decision to expand capacity is initiated by MVM, which holds major stakes in existing generation companies, and not by an independent

regulator. Moreover, some controversy has emerged over the discretionary management of price regulations, as shown in the first half of 1999 when the Hungarian Ministry of Economic Affairs refused to endorse price increases proposed by the Hungarian Energy Office. The controversy relates to the general regulatory environment of the sector and the capacity of the country to attract foreign investors through transparent and predictable rules.

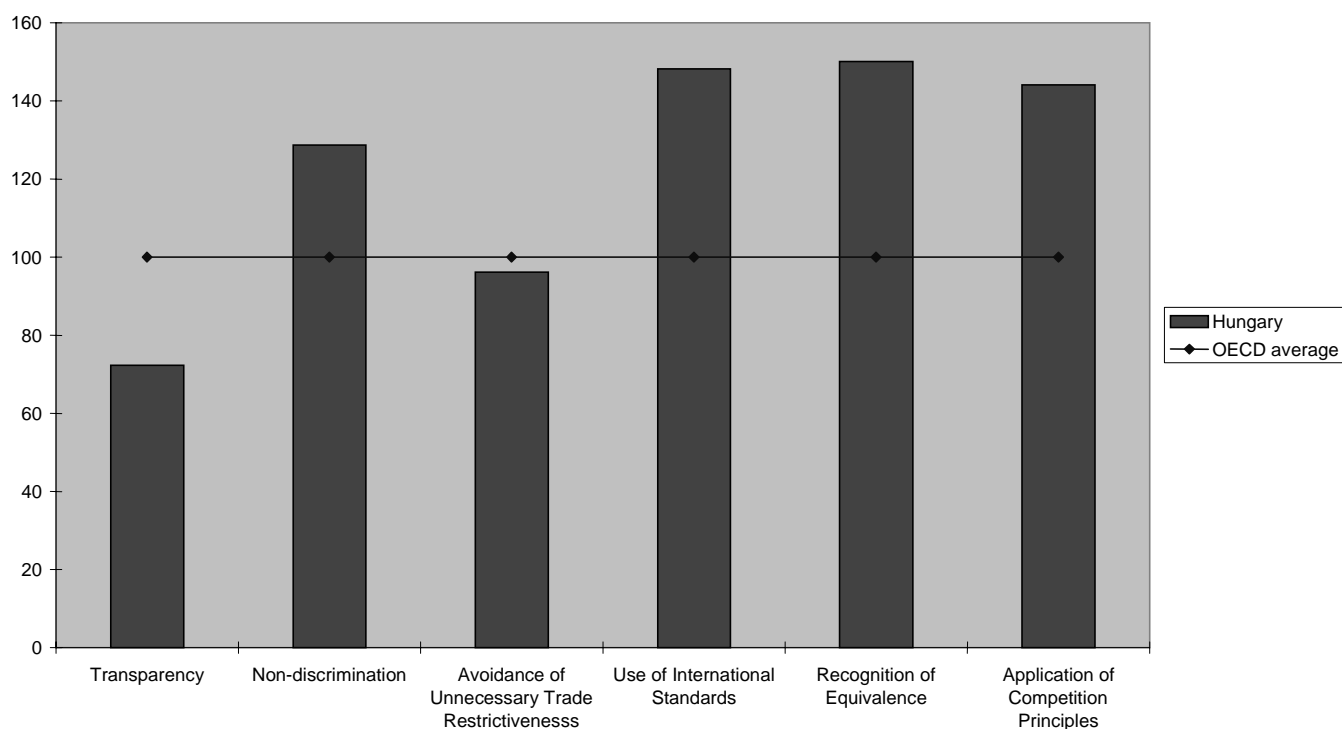
It remains to be seen whether future steps in liberalisation will lead to further international opening of the Hungarian electricity sector, and thereby to increased competition. The conditions set by the EU Electricity Directive, for example in bidding procedures, are likely to reinforce the application of transparency and non-discrimination principles in regulatory procedures. By granting some third party access, the EU Directive also provides the opportunity to increase competition. Under the new legislation, large end-users or distribution companies should be given some possibility to contract with producers offering better prices. However MVM will keep a key role in the market, and the capacity to buy directly from abroad may remain limited. In addition, as long as MVM keeps control over the operation and expansion of international connections, the potential of imports to act as a credible threat to provide and promote efficiency in the domestic electricity market will remain relatively limited.

4. CONCLUSIONS AND POLICY OPTIONS FOR REFORM

4.1. *General assessment of current strengths and weaknesses*

Over the past ten years Hungary accomplished remarkable progress towards enhancing market openness through regulatory reform. Today Hungarian regulatory procedures compare well to OECD standards. An analysis of the OECD indicators on market openness, undertaken as part of the OECD Project on Regulatory Reform, found Hungary to be ahead of the OECD average with respect to all but two of the efficient regulation principles (see Figure 6 below). OECD indicators are based on self-evaluation by member countries of their domestic application of the efficient regulation principles. However, the results concerning Hungary corroborate to a large extent the results obtained through the Secretariat country review. It should be recalled that the indicators on regulatory reform have a natural bias towards dynamic assessment, which obviously gives more weight to relative improvement rather than regulatory quality in absolute terms.

Figure 6. Hungary's trade friendly index by principle



Source: OECD (1998), Responses to the Indicator Questionnaire on Regulatory Reform, Paris.

Not all of the six efficient regulation principles examined in this review are expressly codified in Hungarian administrative and regulatory oversight procedures to the same degree. While non-discrimination, harmonisation and recognition of equivalence or application of competition principles occupy a central position in the post-transition regulatory environment in Hungary, transparency or avoidance of trade restrictiveness has not been translated into formal requirements as regards the development of domestic regulation. However, the weight of available evidence suggests that they are increasingly given expression in practice. The strongest impetus towards pro-competitive reform and regulatory streamlining efforts has been provided by the Hungarian endeavour to join the European Union and this may partly explain the focus on these areas that had priority for integration in the Single Market. The attainment of this objective should allow Hungary to reallocate efforts towards less developed areas.

Opening its market to international competition and integrating into the world economy has been and still is one of the principal objectives of successive Hungarian governments. From a market openness perspective, this is precisely the most fundamental strength of the regulatory environment in Hungary. Irrespective of political orientation, Hungarian governments since 1990 have been equally convinced of the need for pro-competitive, market-opening reforms, and of the role such reforms could play in achieving a rapid and sustainable growth of the economy. Their steady commitment in connecting themselves to European integration efforts has to be viewed in this light. This primary objective is not only the underlying motivation for the trade and investment friendly character of substantive Hungarian regulation, but also provides a certain assurance against piecemeal approaches and temptations to backtrack.

Economic reforms have thus been reliably oriented towards establishing a business friendly environment. Regulation today largely gives to foreign players equality of competitive opportunities in the Hungarian market through observance of non-discrimination and avoidance of trade restrictiveness. The potential for foreign products to encounter non-tariff barriers in the form of diverging technical regulations

or duplicative regulatory requirements is consistently reduced through coherent harmonisation and mutual recognition efforts. On top of that, a sound and influential competition policy prevents market access benefits from being reduced by private anti-competitive behaviour. This overall positive assessment is shared by foreign businesses, which establish economic activities in Hungary and express increasing satisfaction with the regulatory environment they face.

However, this regulatory environment is still far from offering sufficient opportunities for information, comment and dialogue. In the past ten years the urge to move forward the reform agenda at a rapid pace has overridden the need to enhance the dialogue with concerned constituencies over this agenda. Given the amount of reforms needed to transform Hungary into a market economy, the importance of the task may explain to some extent this choice. Yet, in this transition process, ensuring full involvement of all stakeholders is not less important than achieving basic institutional reforms. Insufficient participation of stakeholders in the reform process is not only detrimental to the predictability necessary for business planning purposes but also compromises the assent of domestic constituencies in favour of reform. The introduction of substantial improvement with respect to the openness of decision-making will be critical in order to enable further strengthening and smooth implementation of what has already been accomplished.

In any event, market openness in Hungary may be further enhanced by finding ways to ensure that awareness of and respect for the efficient regulation principles are firmly embedded across all levels of regulatory activity. In particular, the everyday implementation of applicable regulation does not always seem to match the avowed Hungarian policy against trade restrictiveness. The process of establishing, staffing and making operational all the necessary administrative structures is lagging behind the legislative process itself. Hungary will have to pay particular attention to the enhancement of administrative infrastructure and staffing in order to ensure smooth implementation. At the same time, the evolution of administrative culture in the direction of market rules operation will be paramount in ensuring effective openness of the market.

4.2. *The dynamic view: the pace and direction of change*

Globalisation has dramatically altered the world paradigm for the conduct of international trade and investment, creating new competitive pressures in Hungary and elsewhere. At the same time, the progressive dismantling or lowering of traditional barriers to trade and increased relevance of “behind the border” measures to effective market access and presence has exposed national regulatory regimes to a degree of unprecedented international scrutiny by trade and investment partners. Regulation is no longer, if ever it was, a purely “domestic” affair. Trade and investment policy communities world-wide have generally kept pace with these twin phenomena, even if they are still to become fully familiar with regulatory issues. In order to effectively play their market openness advocacy role within the domestic regulatory process, trade policy makers have to overcome systemic inertia and foster a new regulatory culture. Concrete steps to increase awareness of and effective adherence to the efficient regulation principles and deepen international co-operation on regulatory issues are encouraging trends in this context.

In the case of Hungary, international scrutiny of the domestic regulatory regime was topped by the assessment of Hungarian regulations undertaken by the European Commission with a view to the Hungarian accession to the European Union. The Hungarian administration has by now acquired some experience of lending itself to challenge. The latest EBRD report⁵⁰ commended the Hungarian commitment to and progress in institutional reform as a counterpart to privatisation and liberalisation, which enabled Hungary to maintain impressive stability and growth in the face of global stresses. Yet, however formidable the progress may have been in the past, the challenge is far from over today. In the future Hungary will need to commit itself as seriously to consolidating its accomplishments.

The early dismantling of central economic planning and the privatisation of public enterprises in Hungary has already yielded significant opportunities for foreign traders and investors, though there remains potential for much further progress in major sectors such as telecommunications and electricity. The decision to anchor liberalisation of the Hungarian economy to the European integration endeavour generates prospects for achieving a relatively high level of openness in many respects. At the same time it represents new challenges for Hungary, for instance in the area of customs control, where Hungary will have to apply border controls on goods from outside the EU on behalf of the EU as a whole. At present the main focus from a regulatory point of view should be on improving implementation quality by upgrading the current judicial and administrative capacity and in particular on restoring a speedier access to justice.

Apart from privatisation, the private sector has also grown dramatically through the creation of new, mostly small and very small enterprises, indicating that there are no significant administrative hurdles to the launching of new activities. The difficulties for these enterprises rather lie in the lack of maturity of market economy features, such as the financial system and its weaknesses as regards access to lending. The development of business support services that could help these enterprises overcome current difficulties would also be a significant step towards an effective operation of the market economy.

4.3. *Potential benefits and costs of further regulatory reform*

Market-opening regulation promises to promote the flow of goods, services, investment and technology between Hungary and its trading partners. Such expanded trade and investment flows generate important consumer benefits in terms of greater choice and lower prices, raise the standards of performance of domestic firms through the impetus of greater competition and boost GDP. All three phenomena have been observed in the past ten years when Hungary opened its market through regulatory reform. GDP increased by 4.6% in 1997 and by 5% in 1998. The increase in consumer prices fell from 18.3% in 1997 to 14.3% in 1998, while the increase in private consumption rose from 2% in 1997 to 3.5% in 1998. Inflation dropped from 23.6% in 1996 to 10.3% by the end of 1998. During 1997 productivity in the manufacturing sector as a whole increased by 14.4% and unit labour costs by 6.3%. In the particular sector of machine manufacturing, productivity increased by nearly 50% with unit labour costs falling by almost 15%.

In 1998 foreign direct investment represented 4.6% of Hungarian GDP. Companies with foreign participation operating in Hungary produced about 33% of GDP, 49% of manufacturing value-added and 78% of industrial exports and employed 30% of private sector workers. Changes in the product composition of Hungarian foreign trade also provide some interesting indications about the relative competitiveness of various sectors. The export basket has diversified with a notable shift towards high value-added products. In the first quarter of 1999, 92% of all exports was made up of industrial manufactures. Machine and equipment exports accounted for 57% of total exports. Motor vehicles recorded 55% export growth, while office machines and data processing equipment 42% export growth. The share of unskilled labour intensive products in export has fallen, so has the share of environmentally dirty products.

Box 5. Foreign investors' strategy: the case of Nokia

In 1995, Nokia established in Hungary by buying a bankrupt computer monitor assembly company from the Italian group Hantarex. The acquisition was part of the Finnish firm's strategy to transfer its labour intensive activities to countries with lower labour costs. All its computer monitors are now assembled in its Pecs plant. Nokia is going to transfer additional assembly activities to Hungary. It has recently decided to invest in a greenfield project in Komárom, a city close to the Slovakian border, where it will locate the assembly of its mobile phones.

Nokia has rapidly observed that the attractiveness of the Hungarian labour market is not limited to low skilled activities, but concerns equally high skilled activities. The large supply of highly qualified engineers⁵¹ and their relatively lower costs compared to Western European countries persuaded the company to develop new research and development activities in Hungary. The decision was also encouraged by the special incentive program developed by the Hungarian government to promote research activities in Hungary (for details, see Box 2). Nokia has now established two research units in Hungary, employing over 500 people. One unit is specialised in applied R-D and is charged with the development of mobile switching software, while the other one concentrates on basic research in telecommunications.

After the necessary lead-time for attracted investment and trade flows to have an impact on the economy, Hungary has steadily reaped the benefits of its market opening reforms. The pursuit of reform efforts aimed at further enhancing the market orientation of the national regulatory system will allow it not only to maintain its head start among post-transition economies but to progressively catch up with developed economies.

The need for all governments to address market failures through sound regulatory action is an undisputed sovereign prerogative. Nonetheless, ill-conceived, excessively restrictive or burdensome regulation exacts a heavy price on commercial activity, domestic or foreign, and places a disproportionately heavy burden on small-and medium-sized enterprises. Given the large percentage of small and micro domestic firms in the Hungarian private sector, remaining regulatory burden is likely to be even more detrimental to these firms than to the relatively larger and more robust foreign-owned enterprises. Trade and investment friendly regulations need not and should not undermine the promotion and achievement of legitimate Hungarian policy objectives. High-quality regulations can be trade-neutral or market-opening, coupling consumer gains from enhanced market openness with more efficient realisation of domestic objectives in key areas such as the environment, health and safety. However, it is doubtful that this can be achieved in the absence of purposeful, government-wide adherence to the principles of efficient regulation.

4.4. Policy options for consideration

The following recommendations are based on the assessment presented above and the policy recommendations set out in the 1997 OECD Report to Ministers on Regulatory Reform. Based on international consensus on good regulatory practices and on concrete experiences in OECD countries, they are likely to enhance the contribution of the regulatory environment in Hungary to the openness of the market.

- *Improve the transparency of prospective regulation and widen the opportunities of concerned constituencies to provide input to the decision making process*
 - Prospective regulation should be made available to concerned constituencies for information and comments. Efficient "notice-and-comment" procedures would greatly enhance the predictability of the market and enable strategic planning by the firms. It would also provide the regulators with valuable input from market players allowing them to better adapt regulations to the needs of the market.

- Consultations with respect to proposed regulation should be organised in a timely manner so as to allow meaningful interaction between concerned constituencies and the administration. Such consultations should take place sufficiently early in the decision-making process to be able to have an incidence on the proposed regulation. They should allow sufficient time for consulted groups to reflect constructively and formulate an opinion.
- Unnecessary frequent and drastic changes in key regulations, such as tax regulation, should be avoided in order to reinforce the predictability of the business environment. In terms of market operation, a delay in enacting a piece of legislation is less damaging than an early enactment followed by a substantial amendment; and a less-than-perfect regulation is preferable over annual improvements.
- *Ensure a clear understanding by prospective bidders of the criteria used for the evaluation of public procurement bids and for the selection of successful bidders*
 - The administration should ensure that the rules applicable on public procurement and in particular the evaluation criteria are clearly explained to interested firms and applied transparently by the inviting authorities. This would help convince potential bidders that have kept away from procurement procedures that they really have equal opportunities to obtain contracts.
- *Continue to promote non-discrimination in the domestic regulatory system and its enforcement*
 - No new incentives affording reverse discrimination in favour of foreign investors should be introduced in order to attract foreign capital in Hungary
- *Promote a consistent regulatory impact analysis (RIA) system for the whole range of regulations, including administrative rules; develop a consistent practice for the assessment of trade and investment effects of proposed regulations*
 - Regulatory impact analysis should be formalised for all new and amended regulation. An efficient and cost-effective analysis should include an initial screening stage whereby regulation warranting further scrutiny would be identified on the basis of predetermined criteria. The screening would free resources, which could then be used on a more efficient assessment of scrutinised regulation. RIA procedures should explicitly cover impacts of proposed regulations on trade and investment. The efficiency of trade impact assessment procedures would also be enhanced by further promoting the incorporation of market players' concerns through the improvement of consultation procedures.
- *Strengthen the administrative and judicial capacity for the enforcement of applicable regulation*
 - The staffing of services in everyday contact with users should be enhanced both in terms of quantity and of quality. Allowing for increased staffing for certain services without further expanding the public sector may entail a serious rethinking of the overall distribution of human resources across the administration. Appropriate training, including in the framework of European civil servants training and exchange programs, should go a long way towards quality improvement. Particular attention should be paid to additional training for the judiciary, namely to enhance their exposure to new topics, such as competition law, intellectual property protection, or administrative remedies.

- *Enhance the transparency and the uniform application of customs procedures*
 - Efforts should be pursued to train customs officials to the requirements of modern customs control procedures and to upgrade the possibilities for the electronic interchange of customs data.
- *Maintain the momentum in the area of standardisation*
 - Hungary has made considerable progress towards increasing reliance on internationally harmonised measures and should keep going in the same direction. A strong commitment to an efficient and reliable standardisation system not only enhances market opportunities for Hungarian firms but also greatly contributes to the consolidation world-wide of efficient and transparent markets for industry and consumers alike.
- *Streamline conformity assessment procedures and institutions*
 - Government endeavours in the field of recognition of equivalence will have little effect without the confidence of market participants in the Hungarian conformity assessment system. This implies enhancing the reliability of conformity assessment procedures and institutions. The development of the MSZT into a dependable player in the area of international certification and quality control could serve as a model for the setting up of necessary institutions.

NOTES

1. Recently there have been isolated cases of nationalisation. In 1998, as no new investor could be found to support the failing Postabank, the Hungarian State led various re-capitalisation operations and eventually nationalised the bank.
2. However, through its golden share, the Hungarian State retains capacity to control strategic decisions, including mergers and acquisitions in some of the privatised companies not only in the banking, telecommunications and energy sectors but also in the manufacturing and food processing sectors. The Hungarian State also owns some radio and television broadcasting companies and important parts of the transportation sector.
3. Csáki, Gy (1998), "Foreign direct investment in Hungary", in *Foreign Direct Investment in the CEFTA countries. Economic Trends and Research Summaries*, No. 1, GKI Gazdaságkutató Rt. Budapest.
4. While the scope of price control was considerably reduced in the past decade, the State still regulates prices mainly in the energy sector and pharmaceutical industry.
5. Hungary's free trade agreement with the European Free Trade Association entered into force on 1 July 1993. The Central Free Trade Agreement with the Czech Republic, Poland and Slovakia entered into force on 1 January 1995, while Slovenia, Romania and Bulgaria joined the CEFTA in 1997, 1998 and 1999 respectively. The free trade agreements with Israel and Turkey entered into force in 1998. Hungary has also initiated negotiations on a free trade agreement with the three Baltic States (Estonia in 1996, Lithuania and Latvia in 1997).
6. In the context of the preferential agreements concluded by the members of the free trade area, exporters must show that the domestic content of their product reaches a pre-determined level in order to obtain a preferential status from other preferential partners. The new system however facilitates the fulfilment of this condition by classifying imports from within the cumulation region as domestic content.
7. A 3% statistical fee and a 2% customs clearance fee still apply for imports from non WTO member countries.
8. Source: Hungarian National Bank, reported by the Hungarian Ministry of Economic Affairs at www.ikm.iif.hu/english/economy/capital/foreign.htm
9. Source: Ministry of Economic Affairs at www.gm.hu/hunec/v26n4/c7.htm
10. Based on interviews at the Association of International Companies in Budapest (June 1999).
11. OECD (1999), *Economic Survey of Hungary*, Paris.
12. OECD (1999), *Economic Survey of Hungary*, Paris.
13. Under article 61 of the Hungarian Constitution "... everyone has the right to .. information of public interest..", while Act LXIII of 1992 on the Protection of Personal Data and Accessibility of Data of Public Interest requires the authorities to grant access for anyone to "any information under processing by an authority performing state or local self-government functions or other public duties, except for personal data". In a decision from November 1996 on the relationship between public funds and private business, the Ombudsman stressed that "the transparency and controllability of the privatisation process, as public interest, takes precedence over the private interest of protection of business secrets". (Case n°528/A/1996)

14. Although the Rules of Procedures of the Government [Government Resolution 1088/1994(IX.20)] indicate that a 15 to 30 days consultation period should be provided for in normal circumstances and “not less than five days in urgent cases”, consulted parties indicate that in practice they generally have five days or less for giving an opinion.
15. WTO Committee on Subsidies and Countervailing Measures, G/SCM/23, 30 July 1999.
16. Any decision or action whereby an agency of public administration establishes rights and obligations, verifies data, maintains records or performs administrative supervision is regarded as a case of public administration.
17. Agenda 2000, Commission Opinion on Hungary’s Application for Membership of the European Union.
18. Local authorities are the most important providers of public procurement contracts. In 1997, out of 291 billion forints worth of public procurement, 135 billions were awarded by municipalities, 81 billions by public service providers, 55 billions by central budget organisations and 20 billions by other authorities.
19. Hungarian Public Procurement Council, “Brief Review of the Status of Public Procurement in Hungary”, June 1998.
20. OECD Document C(96)73/FINAL.
21. An assessment largely shared by WTO Members, as expressed in the 1998 WTO Trade Policy Review of Hungary.
22. In early 1995, the Hungarian economy presented a very important debt burden. In 1994, the budget deficit had reached 8.4% of GDP, the current account deficit rose to over 9%, gross government debt was in the range of 85-90% of GDP and external debt was around 46% of GDP. This situation prompted the Hungarian Government to introduce a major stabilisation package in March 1995. The package included cuts in government consumption, wage restraint, particularly in the public sector, a 9% devaluation of the forint along with the institution of a crawling peg exchange rate regime, and a temporary import surcharge of 8%. The package has been successful in restoring macroeconomic balance. The surcharge was notified and subsequently reviewed in the WTO. It has been removed in July 1997.
23. During the transition period, the intensification of economic activity together with the enactment of 98 new laws in areas not previously regulated resulted in increasing the workload (and subsequent backlog) of the courts from 1 039 389 cases pending in 1991 to 1 589 089 cases pending in 1996. The number of judges in national courts slowly increased from 2 311 in 1977 to 2 449 by the end of 1998, but administrative and support staff is still largely insufficient.
24. The commentary of the revised Kyoto Convention (Convention on the simplification and harmonisation of customs procedures) defines “Customs procedures” as including all rules concerning the specific customs treatment applicable to goods. Such rules include places of entry for means of transport; appeal procedures; use of information technology; rights and obligations of importers; as well as customs formalities and procedures in a stricter sense.
25. Hungarian Customs Law consists of Act C of 1995 on customs proceedings and customs; Government Decree No.45/1996(III.25); and decree of the Ministry of Finance No.10/1996(III.25).
26. “Hungary: Customs Regulations Guide”, Hungary Ministry of Industry and Trade.
27. “The DHL Customs Report 1999”, April 1999. The survey was conducted by interviews to 100 Western multinationals operating in Central and Eastern Europe and CIS. Hungary was ranked as the best together with Czech Republic and Poland in the survey.

28. “Agenda 2000: European Commission Opinion on Hungary’s Application for Membership of the European Union - B. Criteria for Membership, 3.8 External Policies, Customs”, European Commission, <http://www.meh.hu/kum/kumwebhr/DOK/WWW/b38.htm>.
29. Act C of 1995 on customs proceedings and customs Article 52 (2) states “*In commercial movement the central organisation of the customs may permit to present the declaration of goods in electronic way.*” Following this, Government Decree No.45/1996(III.25.) Article 75 sets the general conditions for such declarations in electronic form.
30. In the context of customs procedures, “risk assessment” refers to a technique for estimating the degree of non-compliance with customs law of each customs declaration. The purpose of risk assessment is to “*determine which persons and which goods, including means of transport, should be examined and the extent of the examination*” (extract from revised Kyoto Convention General annex Article 6.4).
31. In accordance with established terminology in the WTO TBT Agreement, mandatory technical specifications are referred to as “technical regulations”, while voluntary technical specifications are referred to as “standards”.
32. See Dennis Swann “*The Economics of the Common Market*”, Penguin Books, 1995; European Commission “*documents on the New Approach and the Global Approach*”, III/2113/96-EN; European Commission, DGIII Industry, “*Regulating Products. Practical experience with measures to eliminate barriers in the Single Market*”; ETSI “*European standards, a win-win situation*”; European Commission “*Guide to the implementation of Community harmonisation directives based on the new approach and the global approach (first version)*”, Luxembourg 1994.
33. Decision of 20 February 1979, Cassis de Dijon, Case 120/78, ECR p.649.
34. Energy-efficiency, labelling, environment, noise.
35. See the Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the liability for defective products.
36. Government resolution 2335/1996 of 6 December 1996.
37. MSZT actively takes part in more than a fourth of over 200 technical committees operating in ISO. It currently holds the secretariat of ISO/TC34 on agricultural food products and of its subcommittee 4 on cereals. To date it has contributed to the development of over 500 standards by ISO committees (counting the contribution of predecessor organisations MSZH and MSZI before 1996). MSZT also participates in the work of COPOLCO, the ISO committee on consumer protection responsible for ensuring that the development of standards in the different fields is carried out with due consumers’ participation.
38. An endorsement notice allows to introduce as a national Hungarian standard a European standard in its original English version.
39. All products lawfully manufactured in one Member State must be accepted by the others even when they have been manufactured in accordance with technical regulations which differ from those laid down by existing national legislation, provided they meet the marketing conditions in the originating Member State.
40. Good Medical Practices and Good Laboratory Practices.
41. The International Laboratories Accreditation Committee is an international co-operation between the various laboratory accreditation schemes operated throughout the world and aims, *inter alia*, at the conclusion of mutual recognition agreements between members on the basis of the ISO/IEC Guide 25 on laboratory accreditation.

42. The International Accreditation Forum is a group of accreditation bodies from various countries, including Australia, Canada, Hungary, Japan, Mexico, the Netherlands, New Zealand and the United States.
43. The European Co-operation for Accreditation regroups the nationally recognised accreditation bodies of the Member countries of the EU and EFTA. It aims at promoting the conclusion of mutual recognition agreements among its members, so as to maintain the equivalence of competence of such bodies and ensure that products “*tested or certified once are accepted everywhere*”.
44. Although concession companies are expected to prefer Hungarian products and services where such products and services are competitively priced, and are equivalent to similar non-Hungarian products and services, they incur a penalty if they do not meet an annual requirement of expenditure in products of Hungarian origin, ranging from 25% to 50%.
45. For instance, the “vehicle components manufacturing” is a priority program among SME development projects, for which the government has earmarked 500 million forints in 1999. The Hungarian Association of Vehicle Component Manufacturers (MAJOSZ) reports that there are over 250 Hungarian subcontractors of vehicle manufacturers and these employ 70 000 people.
46. Based on interviews with the Hungarian Association of Vehicle Importers and the report “Automotive part manufacturing in Hungary”, Hungarian Ministry of Economic Affairs, December 1998.
47. In order to be able to export cars free of duty to the European Union, Suzuki had to ensure a minimum of 50% Hungarian content, while another 10% can come from EU sources. The need for the company to fulfil local content requirements resulted in a very quick growth of the share of domestic suppliers. In October 1992 their share was only 8%, but evolved to above 30% by January 1995. Adding up domestic suppliers share to the local value added by the company itself and the share of EU suppliers brings the local content above the 50% which is required to qualify for the duty free export of Suzuki cars to the EU.
48. Directive 96/92/EC of 19 December 1996 concerning common rules for the internal market in electricity.
49. In order to maintain important qualities of electric power, notably frequency, generators connected to the same transmission network operate synchronously. Countries to the east of Hungary are connected into one synchronous system and Western countries into another. Asynchronous generators can only be connected through expensive converter facilities.
50. EBRD Transition report 1998.
51. Hungary has along tradition of high quality professional training.