

UNICE TASK FORCE ON ENLARGEMENT

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A. Executive Summary

Hungary has a functioning market economy that has all the pre-conditions to cope with the competitive pressures and market forces within the European Union. EU business welcomes the revised Hungarian National Programme for the Adoption of the Acquis to reach the required level of preparation for EU-accession. Hungary has made the necessary progress on the way to EU Membership and has respected clear deadlines for the adoption of the Acquis.

The Hungarian economy is already, to a large extent, integrated in the EU economy. A large number of companies have established cost-effective manufacturing facilities, which allow for cost-competitive production. Hungary has a stable macro-economic framework and a predictable economic environment. Hungarian business circles have actively co-operated with the Government in the development of EU-compatible regulations.

The Hungarian authorities have increased the administrative capacity to apply the EU Acquis. The transparency and the efficiency of the public administration system are adequately addressed in the National Programme. The Hungarian juridical system has been allocated additional resources in order to deal with EU Law interpretation.

Due to the fact that Hungary initially focused on 2002 with regard to EU accession, a number of requested transition periods are no longer needed (water quality, marketing of generic medicines). With regard to the customs procedures we have noted impressive improvements with regard to the alignment of legislation and the strengthening of implementation.

The European and the domestic business community are convinced that Hungary will be able to meet the Copenhagen criteria by 2004 if efforts are continued. The new Hungarian Government continues to fully support EU accession.

Actions recommended

- Improvement of the infrastructure – from road construction to international schools – requires additional funds and extension to the less developed Eastern regions.
- Successful alignment of Hungarian SMEs with the Acquis needs a continuation and an extension of the “Scéchenyi Plan”. State aid programmes should also assist the service sectors and newly established companies.
- Administrative capacity to apply the Acquis requires further attention. Specific concerns of the private sector include the judiciary in order to deal with EU law interpretation and consistent application of regulations at different levels of state authorisation and in different areas of the country.
- Pricing arrangement in the case of regulated enterprises like the energy and the public utility sectors have to be cleared against the EU Acquis.
- Many companies have introduced EU-compatible health, safety and environmental standards. The current infrastructure, however, requires substantial investments and a carefully thought-out adaptation programme for the implementation measures.
- More transparency and efficiency of the public administration system and a better service culture among civil servants is needed.
- Consistent application of regulations at different levels of state authorities must be ensured.

B. Introduction

With the National Programme for Adoption of the Acquis (revised version, June 2001, 393 pages), the Hungarian Government has shown its commitment and practical approach to reach the required level of preparation for EU accession. Hungary has already reached a high level of adoption of the Acquis and is well prepared to obtain full EU membership. The policy of the Hungarian Government to steer this preparation with the implementation of this National Programme has been successful.

Relations between the European Union and Hungary

Mainly due to the investments of European companies, the Hungarian economy is already - to a large extent - integrated into the EU economy. Traditional, historical links to Western Europe have eased this integration process and form a common ground for cultural understanding.

The appropriate timing for Hungarian accession to the EU is clearly a factor that has an impact on everyday business. This would include the pre-accession period, actual accession to the EU and the transition periods in a (limited) number of areas. In order to arrive at a predictable timeframe, EU industry would welcome transparency with regard to the remaining chapters under discussion.

Political Criteria

Democratic institutions are in place and are functioning well. The Hungarian Government continues to display a strong and consistent commitment to EU accession. Various industrial organisations are also in place and operating. Representatives of the Hungarian Government have developed regular communication channels with Hungarian business circles. These circles actively co-operate with the Government in the development of EU-compatible economic regulations.

Companies' experience does not reveal discrimination against minority groups - including the Roma - in their field of activity. The changes in the public procurement law will further improve transparency in this area, which is susceptible to corruption. Further transparency of the public administration system is envisaged in the National Programme for Adoption of the Acquis.

C. Economic Context and Developments / Investment Climate

Hungary has a functioning market economy that has all the pre-conditions to cope with competitive pressure and market forces within the European Union. Due to privatisation, liberalisation and deregulation, a wide range of economic sectors are now irreversibly exposed to market forces. Further attention is needed, however, for the pricing arrangements in the case of regulated enterprises like the energy and the public utility sectors. A large number of companies have established cost-effective manufacturing facilities, which allow for cost-competitive production. These plants can be easily integrated into European and global production networks. Currently Hungary has a stable macro-economic framework and a predictable economic environment.

Annual GDP growth is about 5% whereas the unemployment rate currently is 6% (60% of the EU average). However, the inflation level has still been moving around 10% during the past two years.

The per capita income in 2000 was € 12,069 p.p.p., which corresponds to 57% of the EU average. During recent years, however, GDP growth has been above the EU average. Together with the relative appreciation of the Hungarian currency this is moving the Hungarian economy in the direction of the EU average.

A decisive factor of the structural changes in Hungary was the market-oriented privatisation practice applied and the massive penetration of foreign, mainly multinational, direct investment. By the end of 2000 official estimates put the value of FDI at USD 21 billion, i.e. USD 2,100 per capita. However, the actual volume of foreign capital active in the Hungarian economy is surely higher by around 20%, since profit re-investment is not taken into account in the above FDI value. Foreign direct investment has also brought along substantial knowledge of implementation and enforcement of EU legislation.

By the end of the 1990s Hungary ranked among the most globalised economies of the world (no. 17). In 1999 foreign-owned companies accounted for 74% of Hungarian exports and 71% of imports (as compared with 30% and 33% respectively in 1992). Hungary's deep involvement into the international specialisation and division of labour is shown by the strong presence of foreign capital not only in the manufacturing industry, but in all sectors of the Hungarian economy.

In 2000 Hungarian exports to the European Union accounted for 75% of total exports, higher than that of most EU countries with the exception of Portugal and the Netherlands. In Hungarian imports, the EU accounted for 58% of the total, the reason for this somewhat lower figure lying in the distorting effect of soaring oil and gas prices.

By the end of 1999 more than 1 million enterprises and organisations were registered in Hungary, 800,000 of them active. 96.6 % of those enterprises have fewer than 10 employees. Those with 10 to 50 employees account for 2.6%, those with 51 to 300 employees for 0.7%, the remaining 0.1% are large companies. Hungary ranks second behind the Czech Republic among candidate countries for "company density", meaning 80 enterprises per 1,000 population (the same index is 50 within the EU). In Hungary, due to the large number of self-employed people, the average number of employees is 2.9 - substantially below the CEE average (4.0).

The regional disparities between Budapest/Western Hungary and the Eastern regions with regard to FDI require specific attention. Increased infrastructure development - from road construction to international schools - is required to extend this to the less developed Eastern regions as well. The use of EU (pre-accession) funds is key in further developing depleted Hungarian infrastructure. The procedures for assessment of individual projects in this context should be organised efficiently. Further development of project management skills of Hungarian civil servants and the use of existing EU experience would be helpful in the use of EU funds.

Small and medium-sized enterprises (SMEs)

The integration of small and medium-sized enterprises (SMEs) into the EU is of crucial importance to the Hungarian economy. The further development of Hungarian SMEs in the framework of the so-called suppliers' charter deserves full support. State aid programmes for SMEs, like the Enterprise Development Programme (EDP), should not only assist manufacturing but also the service sector. Multinational companies are also contributing to the improvement of SMEs' management skills with their training and social investment programmes.

The SME chapter of the Hungary-EU accession negotiations reviewing SME-related problems and requirements has been closed already. Regarding the ways and means of fostering SMEs the member states enjoy substantial freedom. The other reason for early closing of the chapter was, naturally, the Hungarian position stating that by the time of accession Hungary will be able to align with the *Acquis communautaire* and implement it, and will ask for no transition period with regard to SMEs. Problems with SMEs arise mainly as “by-products” of other chapters such as Taxation, Company law, Environment, Competition policy, etc.

It is important to foresee additional funds for the Subcontractor Programme, by now incorporated into the “**Széchenyi Plan**” (a national development plan, a kind of New Deal) in order to widen the institutional background. Besides promoting the networking of SMEs, support for start-ups must be envisaged too. Not just the subcontractors of MNEs, but also the small enterprises offering individually marketable goods and services for the Hungarian market must be targets for and recipients of the support through specific programmes. The Széchenyi Plan is most welcome since it covers both MNE subcontractors and SMEs acting individually.

In summary, there is a need for a well-founded and well-funded development programme to help the successful alignment of Hungarian SMEs with the *Acquis*. Key elements of the programme are the assessment of the needs, organisation of the information flow, support for technical development (transfer of technology) and for market access, promotion of the knowledge base and of the linkage to SME networks, as well as creation of special ways and means of financing.

D. Progress in adoption, Implementation and Enforcement of the Acquis

The Four Freedoms

Free movement of goods

As a result of implementation of the Europe Agreement, the industrial free-trade area between Hungary and the EU was achieved on 1 January 2001 exposing the whole of the Hungarian industry to EU competition.

The switch-over from industrial free-trade area to customs union – a result of EU accession - does not in itself influence the terms and conditions of trade under the Europe Agreement. Entering the customs union will, however, effect the part of Hungarian foreign trade falling under the most favoured nation preferences in the sense that Hungarian customs tariffs will cede to the common EU tariffs. The lowering of the general customs duty level will expose local manufacturers of similar goods to additional competition from outside the free-trade partner countries. On the other hand, lower import duties will favour users of such goods in Hungary. In some cases when the implementation of EU tariffs will raise import duties for Hungarian manufacturers, it may create an adverse cost effect.

By implementing the EU anti-dumping regulation Hungary will have recourse to a new and efficient protection mechanism, whose implementation was not practicable in the pre-accession phase. Thus the protection of the Hungarian market will grow, yet the impact on market players will not be the same. Those manufacturing similar goods will be favoured by the protection, whereas importers of those goods will have to pay more and may divert their sourcing towards EU member states.

The market activity of some of Hungarian companies has become part of the Single Market. In those sectors where regulations slightly differ from those of the EU, domestic companies - mainly SMEs - have asked for state aid and assistance in the pre-accession phase.

Hungary is ready to adopt fully the EU legislation on free movement of goods, as scheduled, in the coming years. The free movement of goods between the EU and CEFTA countries will considerably increase the business efficiency of European companies operating on the CEE market by optimising their production, marketing and sourcing. There are no requests for transition periods as the Acquis will be transposed in the pre-accession period.

Free movement of services

The build-up of regulations fostering the freedom to provide services has already started under the Europe Agreement, though to a lesser extent than with the free movement of goods. Service markets have partly opened and one can see no barriers to implementation of the Acquis upon accession. Characteristic for manufacturing industry is the lack of requests for transition periods for services. Accounting standards meet EU and international requirements. Some requests for transition periods refer to the financial regulation details of investments.

It should be remembered that the immediate implementation of EU legislation pertaining to the freedom to provide services could cause a new competitive environment in some non-liberalised areas closed for liberalisation so far or else in the pre-accession period. Such problems may arise for services related to infrastructure, mainly transport, and to further liberalisation of the energy sector. Hungarian employers are interested in being granted transition periods in this part of the Acquis communautaire.

Free movement of capital

European companies have had positive experience with regard to free movement of capital. No special obstacles have been encountered with regard to free movement of capital. The rapid development of the financial and insurance sector contributed to encouraging experience with regard to the services area.

Free movement of persons

The Hungary 2001 Regular Report by the Commission puts Hungarian GDP per capita (in p.p.p.) at 52%, whereas researchers at Deutsche Bank arrived at 56% of the EU average. The 6% unemployment rate in Hungary is lower than the EU average. Average Hungarian wages in 2000 – again in p.p.p. – were one third of the EU average. Minimum wages increased in 2001 from € 96 to € 192 a month. The differences in wages and living standards are comparable with the situation in Spain, Portugal and Greece before EU accession when massive migration predictions did not prove to be right.

Both the EU and the Hungarian employers and business community advocate immediate implementation of the free movement of people along with general implementation of the Acquis. At this point free movement of enterprise and free movement of persons go hand in hand.

It is important to grant free immigration of labour into Hungary. Accordingly, the Hungarian labour legislation including social security, pension schemes, aliens policy must be aligned with EU directives and regulations in due course in order to abolish employment limitations for residence, nationality or language.

Labour health and safety protection is another crucial area of the Acquis communautaire for both the government and companies. Alignment with the minimum requirements laid down in EU directives must be ensured as part of this chapter.

Concerning the labour market in Hungary, it is expected that the improvement of economic prospects and the quality of local jobs and career opportunities will contribute to a balanced labour market, which might be compared with previous EU experience with the accession of Spain, Portugal and Greece during their EU accession process.

Hungarian accession to the EU will improve the security of European investors by further strengthening the economic conditions and decreasing the operational costs of European companies. The competitive conditions on the Hungarian market are already comparable with the EU, due to the fact that all major competitors are already present. Many companies have included Hungary's EU accession in their corporate strategy and business plans. The single market would offer further business opportunities rather than increasing competition on the Hungarian market.

Customs procedures

Impressive developments have occurred in the field of customs procedures with regard to the alignment of legislation and the strengthening of implementation. Wider and more flexible use of simplified customs procedures would be welcomed. It is expected that the practical problems with the phasing-out of the tax-free zones will be manageable. The improvement of the handling capacity at border crossings - including cargo handling at Budapest airport - needs to be continued.

Environment

Many companies have introduced EU-compatible health, safety and environmental standards in their Hungarian operations. The current infrastructure, however, requires substantial investments in order to adopt and implement the EU environmental regulations.

Hungary has made impressive progress in the area of water quality. A detailed national programme for implementation of the Acquis was established in June 2001. A derogation (i.e. special treatment with no time limit) request has been submitted by the Hungarian party for protection of and related trade with individuals of wild fauna and flora, since Hungary would want to maintain its regulation which is stronger than that of the EU.

In addition, Hungary has signalled its wish for consultation about EU regulation setting limit values on polluting substances emitted by large incinerators. There has been a Hungarian request for technical adaptation of EU legislation on packaging, management of packaging wastes, incineration of dangerous wastes, exchange of information about underground freshwater supplies, protection of wild birds, flora, fauna and habitat.

The transposition and practical implementation of EU regulations is a big challenge for not just industrial manufacturers, but also for certain services (especially transport) and agriculture (stock-breeding, plant cultivation). This will require a consistent and well determined adaptation programme following an agreed time schedule.

Agriculture

Hungarian agricultural employers advocate EU accession based upon harmony between rights and obligations, in the hope of gaining advantages earlier if they back the quickest and fullest possible alignment with the Acquis communautaire and its full-scale implementation in Hungary. They are not in favour of derogations meaning that there is no need for transition periods. Hungary requires, however, terms and conditions which will enable it to quickly and successfully fight remaining structural shortcomings. Creating these conditions calls for considerable investments and financing sources. Domestic agrarian and budgetary resources alone are not sufficient, so there is a clear need for the inflow of more EU resources in the pre-accession period.

The harmonisation of market prices for agricultural commodities will certainly raise profitability and ease the lack of capital in Hungarian agriculture. As time passes and CAP reform advances, the intervention prices of the EU will tend to drop. On the other hand, Hungarian agrarian producers' prices will increase, considering the input prices and intrinsic costs related to EU alignment (standards, more severe provisions, packaging, etc.). For sheep, pigs, poultry and oilseeds the current price gap is not substantial, for beef, milk and potatoes the Hungarian prices are 71 to 77% of EU prices, whereas for cereals and sugar beet the price gap is 35 to 50%. Opening of EU markets for Hungarian agricultural products will help bring down stocks and so increase the price level.

At the same time it is clear that the natural increase of agrarian producers' prices – whilst enhancing profitability – will trigger food price increases for consumers. This will exert pressure on wages, which in turn will lead to erosion of Hungarian wage cost advantages, hence competitiveness, and may stimulate inflation.

Justice and Home Affairs

The Hungarian judicial system has been allocated additional resources in order to deal with EU law interpretation. New measures have been introduced to improve overall efficiency. Adoption and implementation of the Acquis communautaire will have to be followed by legal enforcement. Additional resources are required for the Supreme Court where further staffing is needed.

E. Conclusions and Recommendations

The Hungarian Government has set a clear deadline for the application of the Acquis. The administrative capacity to deal with the implementation has been developed. Progress has been made in reform of the public administration system. The concerns of the private sector include:

- Service culture among civil servants, including an understanding of the responsibility of companies to their shareholders.
- Transparency and the efficiency of the public administration system, while acknowledging that progress has been made on this in recent years.
- Consistent application of regulations at different levels of state authority and in different areas of the country.
- Downsizing of the black and grey economy. It is expected that the general EU harmonisation of tax levels would reinforce discipline and transparency in the market.

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