

REGULAR REPORT

FROM THE COMMISSION

ON

HUNGARY'S

PROGRESS TOWARDS ACCESSION

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A. Introduction

a) Preface

In Agenda 2000 the Commission said it would report regularly to the European Council on progress made by each of the candidate countries of Central and Eastern Europe in preparations for membership and that it would submit its first report at the end of 1998. The European Council in Luxembourg decided that

“From the end of 1998, the Commission will make regular reports to the Council, together with any necessary recommendations for opening bilateral intergovernmental conferences, reviewing the progress of each Central and East European applicant State towards accession in the light of the Copenhagen criteria, in particular the rate at which it is adopting the Union *acquis*. Prior to those reports, implementation of the accession partnerships and progress in adopting the *acquis* will be examined with each applicant State in the Europe Agreement bodies. The Commission's reports will serve as a basis for taking, in the Council context, the necessary decisions on the conduct of the accession negotiations or their extension to other applicants. In that context, the Commission will continue to follow the method adopted by Agenda 2000 in evaluating applicant States' ability to meet the economic criteria and fulfil the obligations deriving from accession.

A dynamic approach should be maintained in assessing the progress made by applicant States in the regular reports which the Commission will submit to the Council.”

The European Council in Cardiff supported those conclusions, stating that “The Union's priority is to maintain the enlargement process for the countries covered in the Luxembourg European Council conclusions, within which they can actively pursue their candidatures and make progress towards taking on the obligations of membership, including the Copenhagen criteria. Each of these candidate countries will be judged on the basis of the same criteria and will proceed in its candidature at its own rate, depending on its degree of preparedness. Much will depend on the efforts made by the candidate countries themselves to meet the criteria. All will benefit from strengthened relations with the EU including through political dialogue and tailored strategies to help them prepared for accession.”

In accordance with the guidance provided by these Council Conclusions, the progress report on Hungary follows the same structure as the Opinion. It

- describes the relations between Hungary and the Union, particularly in the framework of the Association Agreement;
- analyses the situation in respect of the political conditions set by the European Council (democracy, rule of law, human rights, protection of minorities)
- assesses Hungary's situation and prospects in respect of the economic conditions mentioned by the European Council (functioning market economy, capacity to cope with competitive pressures and market forces within the Union)
- addresses the question of Hungary's capacity to adopt the obligations of membership, that is, the *acquis* of the Union as expressed in the Treaty, the secondary legislation and the policies of the Union

It also covers judicial and administrative capacity as requested by the Madrid European Council which underlined the necessity for the candidate countries to adapt their administrative structures so as to guarantee the harmonious implementation of Community policies after membership.

This approach ensures equal treatment for all the candidate countries. The report takes into consideration progress since the Opinion. It looks at whether intended reforms referred to in the Opinion have been carried out and examines new initiatives, including those directly related to addressing Accession Partnership priorities. The report contains a separate section which examines the extent to which Hungary has addressed the short term priorities set out in the Accession Partnerships.

While the assessment of progress in meeting the political and *acquis* criteria focuses on that which has been accomplished since the Opinion, the economic assessment is based on a longer term evaluation of Hungary's economic performance. The assessment of progress made in adopting the *acquis* has been made on the basis of adopted legislation rather than legislation which is in various stages of either preparation or Parliamentary approval. Only in this manner was it possible to objectively measure and compare concrete progress in preparation for accession.

The report draws on numerous sources of information. The candidate countries were invited to provide information on progress made in preparations for membership since the publication of the Opinion. Their presentations at the meetings held under the auspices of the Europe Agreement, their National Programmes for the Adoption of the *Acquis* and the information provided in the context of the analytical examination of the *acquis* provided were additional sources of information. Council deliberations on the Opinion and the reports and resolutions of the European Parliament on the Commission Opinions¹ and in particular the report on the application of Hungary for accession to the EU prepared by Mr. Von Habsburg were taken into account in the preparation of the reports. The Commission also used assessments made by the Member States, particularly with respect to the political criteria for membership and the work of various international organisations, and in particular the contributions of the Council of Europe, the OSCE and the IFIs as well as that of non-governmental organisations in preparation of the regular reports.

¹ European Parliament Doc. 224.339 'Report on the Communication from the Commission Agenda 2000' (Rapporteurs: A. Oostlander and E. Baron Crespo; Co-rapporteurs: M. Aelvoet, J. Donner, O. Von Habsburg, E. Caccavale, F. Kristoffersen, M. Hoff, C. Carnero Gonzales, P. Bernard-Raymond, R. Speciale, J. Wiersma, J.W. Bertens)

b) Relations Between the European Union and Hungary

The Enhanced Pre-Accession Strategy

On 30 March 1998 the accession process was formally launched by a meeting of the Ministers for Foreign Affairs of the fifteen EU Member States, the ten Central and East European applicant states and Cyprus. In advance of this meeting country specific Accession Partnerships were adopted to support the applicant countries in their preparations for membership. These documents set out the priorities for further work and the supporting financial assistance available from the EU. In March Hungary presented a first version of its National Programme for the Adoption of the *Acquis* (NPAA) which describes in more detail the actions needed to reach the objectives set out in the Accession Partnership. Following the opening of the Intergovernmental Conference, Hungary presented the main elements of its integration strategy at the opening session of the EU-Hungary accession negotiations in Brussels on 31 March. An analytical examination of the *acquis* ("screening") started on 3 April. Pre-accession aid will be increased substantially. Alongside the Phare programme, it will, as from the year 2000, comprise aid for agriculture and a structural instrument which will give priority to measures similar to those of the Cohesion Fund in environment and transport. The Phare programme will concentrate on institution building and investment in other areas.

Recent developments in bilateral relations

Hungary has continued to implement the Europe Agreement correctly and contributed to the smooth functioning of the various joint institutions.

The Association Council will meet in November 1998. An Association Committee meeting was held in January 1998. The system of subcommittees continues to function as a forum for technical discussions.

Since the issuing of the Opinion the Joint Parliamentary Committee comprising representatives of the Hungarian and European Parliament met three times, in September 1997, February and September 1998. A meeting of the Joint Consultative Committee comprising economic and social representatives from the EU's Economic and Social Committee as well as relevant Hungarian bodies was held in December 1997.

Hungary's trade with the EU has continued to increase its share of total trade. During the first five months of 1998 Hungarian exports to the EU accounted for 71% of total exports. Imports from the EU amounted to 73.6% up from 62.4% for the whole of 1997.

Under the Europe Agreement an adaptation protocol, covering in particular non processed agricultural and processed agricultural products, has been signed to take into account the results of the Uruguay Round and the accession of Austria, Finland and Sweden to the EU.

Several trade issues (e.g. the lifting of the prior import surveillance on ceramic tiles, the phasing out of the import surcharge) were resolved. Recent trade problems in the

agriculture sector include concessions on cut flowers granted to Israel which are more favourable than those granted to the EU, tax discrimination on spirits and the non-application of the principle of mutual recognition for an energy drink.

Current discussions seek to accelerate the approximation process, and to progress in areas like copyright protection and state aid. In the area of industrial standards and conformity assessment, negotiations have started on the conclusion of a Protocol on European Conformity Assessment (PECA), designed to speed up the process of aligning Hungarian horizontal and technical legislation in this area to the *acquis*.

The Europe Agreement was challenged by a submission to the Constitutional Court questioning the constitutionality of the Art. 62 (2) on competition rules. The Court did not question the constitutionality of the Europe Agreement but underlined the need to modify the Hungarian law transposing the Implementing Rules on competition adopted by the Association Council.

The 1998 Phare programme consists of a national allocation (77 MECU), based on the Accession Partnership priorities, to support in particular Justice and Home Affairs, agriculture, environment, and regional policy, as well as the participation in Community programmes and Tempus. An additional 10 MECU have been allocated for a cross-border co-operation programme.

Hungary also participates in and benefits from Phare funded multi-country and horizontal programmes such as customs, environment, small and medium sized enterprises, statistics, public administration reform and TAIEX.

The Commission continues to have a critical view on the Hungarian performance regarding the implementation of the Phare programme due to the low absorption and management capacity.

B. Criteria for membership

1. Political Criteria

Introduction

In its 1997 Opinion on Hungary's application for EU membership, the Commission concluded that:

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

Furthermore, in the Accession Partnership with Hungary “ further efforts to improve the situation of the Roma” were mentioned as a medium-term priority.

Recent developments

Following the May 1998 general elections the Socialist-Free Democrat coalition government was replaced by a coalition government led by the Federation of Young Democrats. The coalition partners of FIDESz are the Smallholder's Party and the Democratic Forum. This change of government has not resulted in any major shift in government policy over the past years as regards the European Union.

1.1 Democracy and the Rule of Law

The Parliament

The Hungarian Parliament continues to operate well. Its powers are respected and the opposition plays a full part in its activities.

As confirmed by the OSCE the general elections took place under free and fair conditions.

The elections were held under the slightly modified election system adopted by the House in October 1997. The main changes concerned the timing of elections, the rules for entering Parliament and the organisation of election campaigns.

It is regrettable that the draft law regarding the Parliamentary representation of minorities which was pending at the time of the Opinion has still not been approved.

The Executive

The institutions of the State continue to operate smoothly. Important steps have been taken to modernise public administration:

- A new Act on the legal status and liability of members of the Government and state secretaries will help to increase transparency in the operation of the Hungarian administration. The Act very clearly defines and regulates the legal responsibility of the executive.
- A new law on the ethics of public service defines the incompatibility of private business with public service and thus helps to combat corruption more efficiently.

Salaries of civil servants are still low compared with earnings in the private sector and the Government continued to improve the situation by increasing salaries over the last twelve months.

The Judiciary

Addressing a specific weakness identified in the Opinion Parliament elected two new judges to the Constitutional Court which now has its full contingent of 11 judges. It has thus met its constitutional obligation to ensure the smooth functioning of other democratic institutions.

The Hungarian authorities have undertaken efforts to address weaknesses in the judiciary. A comprehensive judicial programme aims at speeding up court procedures and consolidating the judicial branch so as to combat more efficiently corruption and organised crime.

This new legislation consolidates the separation of the judiciary from the executive. The creation of a National Judicial Council consisting of 15 members will shift control over the courts to the judiciary although the executive will still be represented through the Minister of Justice. In addition a fourth level of courts, a system of high courts of justice will be inserted between the regional courts and the Supreme Court, and will hear appeals in cases against decisions of the local or regional courts. Three of the new high courts are scheduled to come into operation in January 1999 and a further two in 2003. The new legislation also defines the rights and duties of judges, lays down the principles of the remuneration of judges on a new basis and increases the training period from two to three years. It decreases the number of cases the Supreme Court is required to hear in some cases moving them from local to county courts.

Since 1997 the number of judges has considerably increased and there are currently 2449, including the 110 Judges at the Supreme Court. This number is expected to increase gradually in the short and medium term due to the judicial reform process.

It remains to be seen if the reform will speed up judicial procedures or improve the standard of rulings. In particular the reform does not affect the internal organisation of the courts. Judges do not have adequate administrative or support staff or technical facilities.

Anti-Corruption measures

Hungary continues to be confronted with corruption problems. Stricter rules were introduced for economic crimes through modification of the penal code. Additional measures have been taken regarding the prevention of corruption, such as adoption of laws on the conduct of senior officials and practitioners in the liberal professions, and on the tender of public contracts.

In 1997-1998 Hungary signed the following international agreements on the fight against corruption:

- the recommendation of the Council of the OECD to Member Governments on Bribery in International Business Transactions in December 1997 (OECD anti-Bribery Pact) and
- the Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime in November 1997 (Strasbourg Convention).

Additional efforts are needed to combat corruption in the police forces, the customs service, local administration and national regulatory agencies. Furthermore, co-operation between the different anti-corruption entities should be increased.

1.2 Human Rights and the Protection of Minorities

Hungary has already acceded to most of the major institutional human rights instruments. In 1997 Hungary signed the European convention on Nationality and the European Agreement relating to persons participating in proceedings of the European Court of

Human Rights. In 1998 the Council of Europe Convention for the Protection of Minorities took effect.

The Social Charter of the Council of Europe has not been ratified. In January 1998, the government submitted 12 out of the 19 articles of that Charter to the Parliament for ratification. The new government supports the early ratification of the totality of the Charter and should therefore submit the whole text to the Parliament.

Civil and Political Rights

Basic civil and political rights continue to be respected in Hungary and important progress has been made. In particular:

- Freedom of the press continues to be respected. The Hungarian media law, adopted in 1996, has broken the monopoly of state TV and facilitated competition between commercial TV channels. In June 1997 the electronic media market was liberalised by ORTT allowing commercial TV channels to participate in tenders. The appearance of two new commercial channels provides fresh competition to a market dominated by the state-owned television and improves services in compliance with a functioning market economy. Competitive pressure is also present in the commercial radio market since the decision in November 1997 to open up this segment of the market for private ownership. Nevertheless, the number of private radio stations remains small and the public sector continues to have an important share.
- A new law regulates the functioning of NGOs in Hungary. It provides the legal basis for a functioning non-governmental sector. It is widely hoped that the law will contribute to strengthening civil society in Hungary by filling one of the largest legislative gaps in the new democracy. The EU's initiative for democracy and human rights actively supports NGOs working in this field in Hungary.
- On 1 March 1998, new comprehensive legislation on asylum entered into force. Hungary now extends refugee status to non-European refugees if they were persecuted in their homeland for religious, ethnic or political reasons and it has lifted the geographical reservation introduced in 1989 when joining the Geneva Convention. Thus it fulfils its international obligations to the Geneva Convention and meets the expectations raised in the Opinion. Minor implementation problems exist because of insufficient financial resources for the training of new staff, including judges. The Kistarcsa community shelter (a temporary first point of refuge for those seeking asylum) has closed due to its appalling conditions.
- Police behaviour and the prison situation continue to give rise to concern. It is reported that the police abuse their power, mistreat persons (there are increasing reports of abuse of minors, foreigners and Roma). While conditions within police detention centres have significantly improved, the situation in many of the prisons is still of concern.

Economic, Social and Cultural Rights

In general economic, social and cultural rights continue to be respected in Hungary. A law on the rights and equal chances of handicapped people in health care, education, employment, transport and residence was passed in March 1998 which will come into force from 1 January 1999. The law, which was one of the last legislative measures adopted by the outgoing Parliament, should put an end to discrimination against disabled persons and create the conditions for them to become equal members of society.

Minority Rights and the Protection of Minorities

Continued attention needs to be paid to the respect of the human rights of the Roma by the Hungarian authorities. The Roma are not always granted equal treatment before the law.

The government adopted a comprehensive Roma action programme in July 1997, the first since the change of regime, in response to the fact that the situation of the Roma has deteriorated over the last few years. It aims to provide medium-term solutions to improving the situation of Roma, in particular in the fields of education, employment, agricultural activities, social and health affairs and housing. The proposals are positive as they form a good basis for continued dialogue between the Roma, the government and society but there appear to be only limited funds available from the central budget.

Education is considered a main priority in improving the situation of the Roma and other minorities. The Ombudsman for National and Ethnic Minorities raised some critical points concerning the education of the minorities. The Ombudsman examined 352 petitions last year, the majority of which affected the Roma. The petitioners claimed that individual minority rights had been violated in 166 cases and collective rights in 74 cases. Another report by the Ombudsman assessing the situation of minority education in Hungary states that in contrast to other minorities Roma children suffer from discrimination through segregated classes and schools. Although the law on public education prohibits segregation, no legal sanctions can be imposed against those violating the legal provisions. The Ministry has not accepted the Ombudsman's report.

1.3 General evaluation

Developments in Hungary confirm the conclusion of the Opinion that Hungary fulfils the political Copenhagen criteria. Hungary's institutions continue to function smoothly. Elections have taken place in free and fair conditions and allowed a smooth transfer of power in 1998.

Continuing attention needs to be paid to combating corruption more effectively and to improving the situation of the Roma.

2. Economic Criteria

2.1 Introduction

In its 1997 Opinion on Hungary's application for EU membership, the Commission concluded :

“Hungary can be regarded as a functioning market economy”, “it should be well able to cope with competitive pressure and market forces within the Union in the medium term, provided the macroeconomic conditions for strong investment growth remain in place”.

In examining the economic developments in Hungary since the Opinion, the Commission's approach was guided by the conclusions of the European Council in Copenhagen in June 1993 which stated that membership of the Union requires :

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

In the analysis below the commission has followed the methodology applied in the Opinion.

2.2 Economic developments since the Commission published its Opinion

Since mid-1997, Hungary's economic prospects have continued to improve. The economy has performed better than envisaged in the reference macroeconomic framework outlined in the first “Joint Assessment of Hungary's Medium-Term Economic Policy Priorities” prepared by the Hungarian Ministry of Finance and the Commission's Directorate General for Economic and Financial Affairs in June 1997. Last year, growth accelerated, inflation fell and real personal incomes rose while the external balances improved. These trends continued into the first half of 1998 and mark a clear break with the past, largely due to the substantial modernisation of some productive sectors brought about by past foreign direct investment. The sustained strengthening of the external accounts allowed Hungary to complete successfully its precautionary stand-by agreement with the International Monetary Fund without drawing any funds. During the period

under review, the Hungarian authorities continued to operate a crawling peg exchange rate regime.

Macroeconomic developments

At the time of the publication of the Opinion, economic growth had already begun to pick up following the slowdown caused by the adjustment measures of 1995. This trend has continued: GDP growth equalled 4.4% in 1997 and was close to 5% in the first half of 1998.

Private and public consumption growth has resumed after a three-year decline. However, the speed of the recovery in household consumption is unclear since weaknesses in national account data hamper accurate measurements of the different components of domestic demand. According to the figures provided by the Central Statistics Office, the annual growth in household consumption equalled 0.9% in 1997 and rose to 2.9% in the first half of 1998.

So far, however, investment and exports have largely led the recovery. Capital expenditures on fixed assets rose by 8.8% over 1997 and accelerated further during the first half of 1998. Exports have been booming, growing at an annual rate of 26.4% in 1997 and only slightly less in the first half of 1998. However, the strengthening of domestic demand and the high import content of the most dynamic exports caused imports to grow at a similar rate, thus limiting the net contribution of exports to GDP growth.

Booming exports, however, have played a leading role in the industrial recovery underpinning the current upswing in growth. Thus, during 1997, industrial output rose by 11% as sales to export markets increased by more than 30%, counterbalancing a 1.5% fall in domestic revenues. During the first seven months of 1998, industrial growth accelerated even further as exports remained buoyant and sales growth in the domestic market resumed.

In addition, the sharp increase in exports has helped preserve the sustainability of Hungary's external balances in spite of the acceleration in growth, the resumption of domestic consumption and the timely abolition of the import surcharge by mid-1997. In ECU terms, the 1997 trade deficit in goods and services more than halved relative to 1996. The current account deficit fell from 3.8% of GDP to an estimated 2.2%. This gap was fully financed by foreign direct investment flows that continued unabated, confirming Hungary's attractiveness to foreign investors and supporting a further improvement in its debt service indicators. Similar developments took place during the first half of 1998 when the improvement in the trade balance was sustained but the current account deficit worsened slightly because of rising net income payments.

Disinflation has continued. The year-on-year inflation rate fell to 13.5% by August 1998 from 18% a year earlier. During 1997, however, the decline in inflation slowed somewhat because of a structural adjustment in the relative price of energy products, adverse seasonal trends in food prices and higher-than-planned nominal wage growth. During 1998, disinflation regained momentum thanks to smaller increases in administered prices and consumption taxes as well as positive trends in the prices for food and imported raw materials.

Wage growth, however, has remained above the guidelines fixed by the Interest Reconciliation Council (IRC), a tri-partite body comprised of unions, employers and

government representatives. During the first seven months of 1998, gross average wages grew by roughly 20% over the same period in 1997, i.e. some five percentage points higher than the average guideline set by the IRC. Strong wage growth is explained by several factors. These include a catch-up of real wages following sharp cuts in workers' purchasing power in 1995 and 1996; growth of public sector wages over and beyond that in the private sector; falling unemployment; and entrenched inflationary expectations strengthened by the authorities' recurrent failure to meet inflation targets.

The target deficit for the general government budget in both 1997 and 1998 was 4.9% of GDP. The 1997 deficit amounted to an estimated 4.6% of GDP. As in 1996, the accounts of the central budget, local governments and separate state funds all performed better than envisaged, largely due to faster than expected economic growth. This more than offset a large overshooting of the social security funds that required the drafting of a supplementary budget. During the current year, the evolution of fiscal revenues and expenditures is following a similar pattern. Higher-than-budgeted receipts by the central government are offsetting a large overshooting in the accounts of the social security funds. However, while the overspending by the Health Security Fund reflects the absence of any comprehensive reform, a radical pension reform is being implemented as of the beginning of 1998. As the number of employees switching to the new pension system is higher than expected, contributions to the Pension Fund are falling by more than budgeted and the Fund's accounts are temporarily moving into the red.

Monetary policy has continued to operate within the framework imposed by Hungary's crawling peg exchange rate regime. The National Bank of Hungary (NBH) routinely modifies official interest rates and cuts the pace at which the forint is devalued in an attempt to reduce inflationary expectations and moderate the growth of domestic demand. The timing of these decisions, however, is affected by concerns about the fragility of the external balance, on the one hand, and the pace of the recovery, on the other.

Average market lending and deposit rates have continued to decline gradually in nominal terms and the spread between the two has fallen. Adjusted for actual (as opposed to expected) inflation, deposit rates have averaged close to zero while lending rates have hovered around 3%. In the past, weaknesses in banks' balance-sheets and competition from new non-bank financial operators led to a fall in the stock of domestic credit extended by banks both in real terms and as a percentage of GDP. During 1997, however, this aggregate trend slowed down while real credit to enterprises rose at an accelerating pace for the second year in a row. On the other hand, net credit to the government and credits to household and SMEs continued to fall sharply.

The impact of the Russian crisis must be seen against the background of Hungary's high level of integration with the world economy. As a result of past trade reorientation, some 70% of Hungarian exports now go to the EU and roughly 4% to Russia. On an aggregate level, therefore, real and direct effects from the crisis are likely to be limited. The exposure of the banking sectors also appears to be rather small. Due to its positive economic performance, however, Hungary had been attracting a relatively large share of the funds allocated by international investors to emerging markets. It has been particularly affected by investors' flight from emerging market assets. The stock exchange index has recorded sharp falls. For the first time since the establishment of the current exchange rate regime in 1995, the NBH intervened to stop the forint from depreciating faster than the monthly rate of crawl and eventually was forced to raise interest rates.

Structural reforms

At the time of the publication of the Commission's Opinion, structural reforms were already relatively well advanced. The process of privatisation, in particular, had gone quite far. During 1997, mass privatisation was completed and sales for cash continued. Revenues from privatisation amounted to some 350 billion forint, more than half in foreign currency. As previously, they were mostly used to finance the reduction of public foreign debt. According to the amendments to the Privatisation Act introduced in 1997, the State Property Agency (APV) will retain a permanent stake in 116 companies. Among them are 26 agricultural companies, which use some 14% of all agricultural land and generate more than a quarter of total agricultural sale revenues. It remains to be seen if the new ruling coalition will modify remaining privatisation plans.

In the banking sector, the process of privatisation was completed, except for the sale of remaining minority interests. Controlling stakes in both K&H and Mezőbank were sold to foreign investors, bringing the share of foreign ownership in total registered banking capital to about 60% by the end of 1997. The State will limit its participation in the largest commercial bank (OTP) to a single golden share. During 1998, however, the trend towards decreasing public shareholding was reversed as a result of the developments affecting Postabanka. In March 1997, a run on the deposits of what was Hungary's second largest retail bank took place. The authorities intervened promptly to support the bank and investors' confidence in the relatively healthy Hungarian banking system was not shaken. As time passed, however, the problematic nature of Postabanka accounts became increasingly clear along with underlying failures in regulatory supervision. The inability to find a strategic investor coupled with various re-capitalisation operations to support the bank and acquire the majority stake needed to remove management eventually led to its nationalisation. Following the election of a new Board in August 1998, massive accumulated losses have been disclosed and the authorities are in the process of formulating a strategy for the effective restructuring of the bank.

Apart from bank privatisation, a number of measures implemented during 1997 and 1998 will help the development of Hungarian financial markets. These include the entry into force of regulations for mortgage lending and home savings institutions that began operation in 1997. Moreover, since the beginning of 1998, branches of foreign credit institutions are allowed to operate in the Hungarian banking sector, subject to a licence from the State Financial and Capital Markets Commission. This government agency was created in 1997 by merging the two supervisory institutions that were previously responsible for the banking sector and the security and exchange markets. Finally, a new pension system was introduced in January 1998. It is based on three pillars: a scaled-back version of the existing pay-as-you-go scheme, a fully-funded mandatory privately-operated tier and a third voluntary fully funded tier. In the long term, this regime will lead to a sharp increase in the share of national savings intermediated by the local financial sector, thus strongly supporting its development.

Pension reform also marked a first important step towards the overhaul of the social security system. Further measures were taken by the new administration with abolishment of the two quasi-independent commissions overseeing the health and pension systems.

In the area of trade policy, Hungary eliminated all trade-related charges, except tariffs, and continued to reduce the proportion of goods affected by non-tariff border measures. Among these, the global quota on consumer goods remains restrictive according to the

WTO. The authorities, however, plan to phase them out by 2001. Moreover, several items were removed from the list of products subject to quantitative restrictions at the beginning of 1998.

2.3 Assessment in terms of the Copenhagen criteria

The existence of a functioning market economy

The existence of a functioning market economy requires that prices, as well as trade are liberalised and that an enforceable legal system, including property rights, is in place. Macroeconomic stability and consensus about economic policy enhance the performance of a market economy. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy.

Since the publication of the Opinion, the market economy has been strengthened by further sales of financial and non-financial enterprises and by increasing the role of private agents in the pension system. Thanks to extensive liberalisation and privatisation, a wide spectrum of economic sectors is now exposed to market forces in a largely irreversible way, enhancing the credibility of the Hungarian reform process.

The depth and breadth of the privatisation process carried out so far has been considerable. However, the State is planning to keep a permanent stake in a fairly high number of enterprises operating in a wide range of sectors. In some cases, public participation will be reduced to a single golden share, but this entails a rather large range of powers that need to be exercised properly. Moreover, the nationalisation of Postabanka has reversed the trend towards reduced state ownership in the banking sector, presumably only temporarily.

Hungary has largely put into place the institutional machinery required to harness market forces whenever appropriate. The functioning of the economy needs to be supported by a proper enforcement of the 1996 Competition Act and by the conduct of a coherent and credible regulatory policy. Experience has shown that the regulatory environment needs to be improved further to foster the efficiency gains accruing from private ownership while sharing them with consumers. From this point of view, regulated enterprises are not being granted sufficient freedom in fixing prices for different kind of users and products. This leads to an unbalanced tariff structure that sends distorted signals to users. Finally, the implementation of regulatory policy has, at times, lacked consistency generating unnecessary uncertainty. Sometimes, for instance, the authorities have disregarded the price recommendations of the energy industry regulator, giving rise to concerns that price setting might be driven by inappropriate considerations (such as electoral issues or a desire to influence the short-term evolution of the inflation rate).

The capacity of the financial sector to channel savings towards productive investment has strengthened. More than 90% of total loans in 1997 were qualified as problem-free. Lending to the enterprises is picking up in real terms and access to credit is arguably being extended to a wider spectrum of enterprises. Banks are beginning to focus on the credit market for smaller enterprises and on retailing, while intermediation spreads are falling. Increasing competition between banks and other emerging sources of finance is likely to lead to further consolidation. This market-driven process needs to be supported by a high quality of supervision. While this is already relatively advanced, the Postabanka affair has revealed worrying failings, suggesting there is still considerable

scope for improving both regulatory laws and their implementation. The formal independence of the supervisory institution has not always been synonymous of effective capacity to enforce the regulatory framework in a timely and impartial manner.

Financial intermediation outside the traditional banking channels is expanding fast but non-bank corporate borrowing instruments still play only a marginal role. An important boost to the medium-term development of the financial system will be provided by the new pension system as long as reform implementation is accompanied by careful supervision and on-going refinement of the new framework.

With the implementation of the policy package of 1995, the previous government had proved its commitment to macroeconomic adjustment and structural reform. This allowed it to set out medium term goals for macroeconomic policies in a credible manner. It is likely that the new administration will manage to do the same since consensus about the essentials of economic policy remains broadly based. Against this background, a revision of the “Joint Assessment of Hungary's Medium-Term Economic Policy Priorities” and its reference macroeconomic framework is planned for late 1998.

Hungary remains a functioning market economy. Sustained macroeconomic stability, further privatisation, and pension reform have strengthened the workings of market mechanisms. However, there is still a need to consolidate the institutional and legal framework of a market economy, especially with regard to regulated monopolies and financial markets. Some events, most notably the case of Postabanka, indicate that regulations are not always enforced in a prompt and impartial fashion. Strengthening the regulatory mechanisms which enable a market economy to function effectively is a necessary condition to keep reaping the full benefits of all the reforms already implemented.

The Capacity to Cope with Competitive Pressure and Market Forces

Hungary's ability to fulfil this criterion depends on the existence of a market economy and a stable macroeconomic framework, allowing economic agents to make decisions in a climate of predictability. It also requires a sufficient amount of human and physical capital, including infrastructure. State enterprises need to be restructured and all enterprises need to invest to improve their efficiency. Furthermore, the more access enterprises have to outside finance and the more successful they are at restructuring and innovating, the greater will be their capacity to adapt. Overall, an economy will be better able to take on the obligations of membership the higher the degree of economic integration it achieves with the Union prior to accession. Evidence of this is provided by both the volume and the range of products traded by Hungary with EU Member States.

At the time of the publication of the Opinion, fast productivity growth, rapid increases in trade integration with the EU and large FDI flows had already characterised Hungarian economic developments for several years. This suggested that restructuring had reached a relatively advanced stage and that a core of Hungarian enterprises was already quite competitive in the EU markets.

Events occurring since then have confirmed this assessment. Export growth accelerated strongly during 1997. The share of goods going to the EU markets has increased further, especially in technology sectors such as machine manufacturing. Moreover, intra-industry trade with the EU is rising, suggesting an increasing integration of the Hungarian economy with that of the EU. Sustained increases in productivity and moderate rises in unit labour cost are making Hungarian products more competitive.

During 1997, productivity in the manufacturing sector as a whole increased by 14.4%, unit labour costs by 6.3%. In machine manufacturing, productivity increased by nearly 50% with unit labour cost falling by almost 15%.

A large part of these developments are due to the supply improvements brought about by past investment of a few multinational enterprises engaged in machine manufacturing and producing for export markets. The share of this industrial sector in total exports rose from 37% in 1996 to 45% in 1997. More generally, FDI flows have played a leading role in the restructuring of the economy and Hungary's integration into the global production system. In 1997, companies with foreign stakes above 10% were responsible for 72% of all exports and 71% of all imports.

Restructuring and competitiveness gains are taking place across a broad section of the economy, but not at the very rapid pace of the leading sectors. In some sectors, such as food processing, steel and textiles, restructuring has lagged behind. Yet, recent rises in the domestic sales of local firms producing investment and intermediate goods suggest that export-oriented foreign ventures may have begun to buy key inputs locally, rather than abroad. In this way, the benefits of FDI spread to other sectors and the amount of value added produced locally increases. In order to facilitate more widespread restructuring, the authorities are implementing policies aimed at enhancing the functioning of the labour market, improving infrastructures, promoting SMEs, supporting R&D activities and fostering regional development.

Hungary's non-wage labour costs remain high, negatively affecting enterprise competitiveness and employment. Further fiscal consolidation, and in particular the reform of the public sector and of the health care system, is needed to lay the basis for a reduction of these costs.

Macroeconomic stability has been crucial in maintaining high investment growth. It needs to be strengthened further, taking advantage of the current upswing which gives the authorities an opportunity to pursue fiscal consolidation and disinflation against the background of solid growth. Hungary needs foreign revenues to remunerate its rising stock of foreign capital and remains dependent on foreign investments to finance its transition process. Accordingly, fiscal policy need to increase further the availability of domestic savings to finance private investment and counter-balance the effect of rising household spending on the current account balance.

Hungary should be well able to cope with competitive pressure and market forces within the Union in the medium term, provided the conditions supporting trade integration and ongoing enterprise restructuring are preserved. Efforts to foster restructuring in the sectors where it has lagged behind need to be strengthened. The macroeconomic policy stance must remain sustainable and respond to changing internal and external conditions. Fiscal consolidation needs to be pursued while the continued overshooting of the accounts of the health system points to an urgent need for reform.

2.4 General evaluation

Hungary can be regarded as a functioning market economy. It should be well able to cope with competitive pressure and market forces within the Union in the medium term, provided that it maintains the conditions for trade integration and ongoing enterprise restructuring.

Since the Opinion, further progress has been achieved on privatisation, restructuring and pension reform. The regulatory framework has been strengthened, macroeconomic stability has been maintained and economic growth has accelerated.

Priority should now be given to the improved to the implementation and enforcement of the legal framework, especially with regard to regulated enterprises and to the financial sector. The sharp acceleration in growth poses a potential, if not immediate, risk for the soundness of Hungary's external accounts. At the same time, it offers an opportunity for tackling inflation and consolidating the fiscal accounts in a more forceful manner. The continued overshooting of the accounts of the health sector demonstrates an urgent need for reform.

3. Ability to Assume the Obligations of Membership

This section aims to up-date the Commission's Opinion of 1997 as concerns Hungary's ability to assume the obligations of membership - that is, the legal and institutional framework, known as the *acquis*, by means of which the Union puts into effect its objectives.

In the 1997 Commission's Opinion on Hungary's application for EU-membership, the Commission concluded that

“If Hungary continues its efforts on transposition of the *acquis* relating particularly to the single market, and intensifies its work on its implementation, Hungary should become capable in the medium term of applying it fully. In addition, particular efforts will be needed to meet the *acquis* in sectors such as environment, customs control and agriculture”.

The presentation below of the different subject matters follows the same structure as the 1997 Opinion, but the general descriptions of each sector have been omitted. Instead, the report focuses on the progress made since July 1997. Under each heading legislative decisions-and progress in implementing and enforcing legislation is reported.

3.1 Internal Market Without Frontiers

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

Effective implementation and enforcement of these four freedoms requires not only compliance with such important principles as, for example, non-discrimination or mutual recognition of national legislations but also the effective application of common rules, such as those designed for safety, environmental or consumer protection, and effective means of redress. The same principles apply to certain common rules, for example in the areas of public procurement, intellectual property and data protection, which are important in shaping the general framework within which the economies operate.

General Framework

Hungary has already adopted the basic principles of the *acquis* related to public procurement rules and the current legislation is being applied in a transparent manner. There was an increase in the number of tenders advertised as well as a decrease in the total value of contracts awarded through negotiated procedure. However, further alignment with the *acquis* is needed, notably with regard to regulations within the utilities sector and with regard to local preference clauses.

Legislation on company law and accounting has been further brought into line with the *acquis* through new laws on Companies and on the Company Registration. However, some adjustments are still needed concerning the scope of the nullity provision, the rules applied to groups of companies and publicity requirements in case of mergers.

A law on Branches and Commercial Agencies set up by Foreign Companies aligns Hungarian legislation with the relevant provisions of the Europe Agreement and with Hungary's Treaty of accession to the OECD. This law made the establishment of branches of foreign companies possible from 1 January 1998.

A new law on auditing activities and the Chamber of Hungarian Auditors harmonises Hungarian legislation with the 8th EC Accounting Directive, with regard both to professional requirements and chamber membership. The newly established Chamber of Auditors is developing training and retraining programmes to address the current shortage of qualified auditors. However, further efforts are needed.

Further progress has been achieved in the area of industrial property. Hungary's law on the Protection of Trademarks and Geographical Indications largely complies with the *acquis*. Hungary became party to the Protocol relating to the Madrid Agreement concerning International Registration of Trademarks in October 1997.

No developments have taken place in the area of copyright. Efforts are still required notably with regard to rental and lending rights, terms of protection (retro-active protection for sound recordings fallen into public domain before 1974) and cable and satellite.

The accession of Hungary in October 1997 to the Council of Europe Convention n° 108 confirms that a satisfactory level on data protection has been reached. Still some further alignments with Community norms are necessary.

The Four Freedoms

Free Movement of Goods

The general principles of the New and Global Approach are already adopted. The adoption of European Harmonised Standards is quite advanced in the sectors where Hungary has transposed New Approach Directives. Nevertheless Hungary must accelerate the transposition of the remaining standards in order to reach the 80%

transposition rate which is a precondition for a full membership of the European Standards Bodies (CEN, CENELEC).

Further progress has also been made regarding the designation of the conformity assessment bodies in the fields covered by the New Approach Directives.

A number of measures leading to alignment with the *acquis* in the area of the free movement and safety of industrial products were adopted.

Progress can be noted in the fields covered by the low voltage, toys, machinery, appliances burning gaseous fuels, non-automatic weighing instruments, construction products and pre-packaging directives.

The Hungarian legislation in the field of motor vehicles has been amended in line with the *acquis* on type approval.

Further progress has also been achieved in the field of chemicals, textiles and footwear.

A new law on pharmaceutical products for medicinal use is due to enter into force in 1999. This legislation supplements the law on civil liability for defective pharmaceutical products but further amendments as regards its scope will still be necessary to ensure full compliance with the *acquis*.

Free Movement of Capital

As already pointed out in the Opinion significant progress had already been achieved in the liberalisation of capital movements.

Since mid-1997 Hungary has proceeded further along this track. The law on Foreign Exchange was amended in January 1998. Remaining restrictions of medium and long term capital market transactions were lifted (except outward financial credits and certain operations on collective investment undertakings). Also in the field of short-term capital transactions, some progress has been made. From 15 May 1998 the ceilings on exporting foreign and Hungarian currency without a permit have been raised and authorised resident foreign exchange banks have received the full right to operate on non-resident accounts. Establishment of branches of foreign enterprises was also permitted in January 1998.

There still remain, however, restrictions on short-term capital market and money market transactions. For instance, issuing and trade in foreign securities on domestic money market is restricted as are those of domestic instruments on foreign money markets. Most residents are not allowed to hold deposit accounts abroad. In addition, restrictions on the *acquisition* of real estate by non-residents remain, albeit limited to arable land, as well as purchases of real estate abroad by residents.

The remaining restrictions on capital market operations and on the *acquisition* of real estate abroad by residents still have to be abolished. Hungary plans to remove all remaining restrictions by the year 2000.

Free Movement of Services

In the banking sector, an amendment to the law on Credit Institutions and Financial Undertakings provides foreign financial institutions with the possibility to operate as

branches, as well as to create the conditions for universal banking. Efforts to implement the real time gross settlements system should be continued.

The provisions of the Capital Adequacy Directive, which was the only major missing piece of Community banking *acquis*, have been incorporated into the Banking Law which will enter into force on 1 January 1999. Despite this progress, some technical amendments will be necessary in the banking sector to achieve full approximation. Concerning money laundering there is still a need for further alignment with the *acquis*. The continuing existence of anonymous banking accounts remains a matter of concern.

The supervisory body is the Hungarian Banking and Capital Market Supervisory Authority, which will need to be further strengthened before accession, since its duties will considerably increase after the full adoption of the *acquis*.

As regards securities, branches of foreign companies may be established since January 1998. The amended law on the Introduction of Securities, Provision of Investment Services and on Securities Exchange now ensures proper conditions for the establishment of branches of foreign credit institutions and investment firms. The provisions of the Capital Adequacy Directive will apply to investment firms as of 1 January 1999. Some of the provisions of the Investment Services Directive allowing credit institutions to provide a full range of investment services will be in place by then.

The life and non-life insurance directives are already largely implemented. As of January 1998 foreign insurers were allowed to establish branches on a national treatment basis.

Characteristic Features of Reporting and Book-keeping Obligations of Insurers have been adopted in 1997. However, insurance accounting is an area which is not yet fully harmonised.

Free Movement of Persons

(a) Free Movement of persons, freedom of establishment and mutual recognition of diplomas and qualifications

With regard to mutual recognition of professional qualifications and diplomas, Hungary is largely in line with the *acquis*, although some further adjustments are needed. Professional structures (such as professional chambers or associations) are in place for most professions, but need to be reinforced. The formal and effective implementation of the *acquis* in general and in particular in the field of architecture is quite good. A law on architects allowed further approximation on the General System Directives. In March 1998, the Hungarian Equivalence and Information Centre, which is in charge of recognition of diplomas, became an independent central agency.

By adopting new law on Branches and Commercial Representation of Foreign-Registered Enterprises Hungary has fulfilled its international obligations including those of the EA.

(b) Abolition of checks on persons at internal frontiers

No particular developments can be reported.

Competition

As already indicated in the Opinion Hungary satisfies to a large extent the requirements in the field of anti-trust. In the meantime national regulations on block exemptions have been adopted, covering insurance, exclusive distribution and exclusive purchase (April 1997) as well as franchising and motor vehicle distribution and servicing agreements (January 1998). These exemptions incorporate the main principles of the relevant *acquis* into Hungarian law.

As regards state aid the Minister of Finance was given responsibility for ensuring state aid compatibility with the *acquis* after the amendment of the Act on Public Finance at the end of 1997. Currently, state aid control is done by the State Aid Monitoring Authority within the framework of an interministerial co-ordination procedure. These reforms do not however allow the monitoring authority full access to the relevant information to assess all proposed state aid and furthermore not all funds and schemes were brought into line with the state aid regime. Moreover insufficient attention was made to institution building. This points to the need for further reform.

A centralised monitoring and data processing system for aid awards has been set up. The Annual Report on State Aid granted in Hungary in 1995-1996 was submitted to the Commission in May 1998 as required under Article 62/4 (b) of the Europe Agreement. The report broadly follows the methodology and the presentation of the Commission's survey on State aid in the Union.

Hungary abolished export related tax concessions in January 1998 which were considered by the Commission as export aids

In June 1998 the Constitutional Court ruled that three provisions of the Hungarian legislation promulgating the decision of the Association Council on the Implementing

Rules regarding the competition provisions of the Europe Agreement applicable to undertakings are unconstitutional. However, the legal effect of the ruling is suspended until 31 December 1999.

Conclusion

Steps have been made towards meeting the short-term priorities of the Accession Partnership, notably with regard to the further alignment of company law and approximation in the area of certification.

However, further progress especially in the area of standardisation, copyright, public procurement and company law is needed to meet both the provisions of the Europe Agreement and the short-term priorities of the Accession Partnership.

There is also a need for further developing institutional capacity to ensure smooth implementation of legislation in the field of free movement of goods, in particular in the field of standardisation.

In the area of free movement of services further progress should be achieved in liberalising the service sector and strengthening the supervisory authorities.

Alignment with anti-trust legislation has further progressed. The consequences of the recent ruling of the Constitutional Court need to be examined urgently to ensure the application of the related provisions of the Europe Agreement.

In the field of state aids, efforts to create full transparency in the granting of aid should be pursued resulting in the establishment of a comprehensive and updated State aid inventory. The legal framework for the granting of State aid needs further alignment to Community law. Finally, the State Aid Monitoring Authority should be given the powers necessary to control existing and future aid measures on a systematic basis. Operating rules for funds and aid schemes compatible with the *acquis* should be adopted together with the relevant institution building steps.

3.2. Innovation

Information Society

Hungary participates in the joint High-Level Committee on Information Society and actively supports the development of the information society.

The telecommunications infrastructure should be upgraded in order to take full advantage of the possibilities offered by the information society. An “Intelligent cities/regions” programme launched in 1997 aims to upgrade information infrastructure in bigger cities and regions.

Education, Training and Youth

Hungarian participation in Community programmes such as Socrates, Leonardo da Vinci, Youth for Europe began in September 1997.

Vocational training in Hungary has been gradually oriented towards the EU practices and objectives. The successful participation of Hungary in the Leonardo da Vinci programme proves that the essential elements for a sound management of vocational training are in place. No major legislative developments have occurred since July 1997. At the institutional level, vocational training has been placed under the umbrella of the Ministry of Education, in an attempt to better coordinate educational policies and to more rationally use available material and human resources.

There have been a number of initiatives to strengthen the European dimension in education. Twelve European Study Centres were set up in early 1998 in Hungary's Higher Education Establishments to develop European studies. As regards mutual recognition of professional qualifications and diplomas Hungary is generally in line with the *acquis*.

Research and Technological Development

Hungary asked to start the negotiations for full association with the 5th Framework Programme in November 1997. Three rounds of exploratory talks aiming at preparing the negotiations have already taken place.

Research is mentioned as a priority in the National Programme for the Adoption of the *Acquis*. Tax deductions can be obtained for Research and Development activities and to support innovations. Since 16 March 1998, a new law on Risk Capital Investment, Risk Capital Companies and Risk Capital Funds encourages risk capital investments for high tech firms. In order to make R&D more effective, a number of scientific research institutes are being restructured and merged.

Telecommunications

Significant progress has been made in the approximation of telecommunications regulation. However, liberalisation cannot be effective unless fair competition in the telecommunications markets is well monitored. Hungary joined the WTO agreement on telecommunication services in October 1997 thereby facilitating access to its telecom market but has maintained a monopoly in telephone services until 31 December 2001 (for international long-distance calls) and a year longer for local calls. The government's target of achieving cost-based rates by the end of year 2000 seems realistic. Both the Ministry of Transport, Communication and Water Management and the National Communications Authority are ensuring control functions, but their roles need to be clarified and there are doubts about the independence and efficiency of the Communications Authorities.

Hungary has made substantial progress in liberalising the telecommunications sector. The harmonisation measures still to be adopted include the development of an authorisation and licensing regime, the introduction of non-discriminatory, proportional, and transparent interconnection terms, and in particular cost-oriented interconnection tariffs supported by transparent cost-accounting systems.

In the postal sector, new rules have been introduced on the maximum rates for postal services, but further progress is still needed on the gradual liberalisation of the market and the guarantee of the universal postal service in accordance with the EU directives.

Audio-visual

Progress has been made in Hungary with respect to the adoption of the Television without Frontiers Directive, in particular through the adoption, in October 1998, of a law implementing the Council of Europe Convention on Transfrontier Television. Efforts, however, will be necessary in order for Hungary to ensure actual implementation and enforcement of the provisions of the convention, notably as regards satellite broadcasting.

An outstanding issue relates to the alignment of existing telecommunication licences to the provisions of the Convention.

Conclusion

Hungary has paid continued attention to information society, education and training and research and technological development. In the area of telecommunications liberalisation has to progress together with the monitoring of fair competition. Hungary has requested a transition period until 31.12.2002 for the full liberalisation of public networks voice telephony. Hungary needs to enhance efforts to align with the audio-visual *acquis*.

3.3. Economic and Fiscal Affairs

Economic and Monetary Union

Hungary has made little additional progress in its preparations for joining Economic and Monetary Union.

Since mid 1977, the National Bank of Hungary has maintained the crawling peg exchange rate regime as one of its main instruments for reducing inflation. The NBH has continued to reduce the rate of crawl while leaving unchanged the width of the band. The forint came under pressure in August in the aftermath of global financial turmoil forcing the NBH to intervene for the first time since the introduction of the crawling peg in 1995 and also to raise interest rates.

As far as central bank legislation is concerned, the Hungarian authorities will have to introduce the remaining legal provisions concerning the independence of the NBH. Contrary to what has happened following previous general elections, the Governor of the NBH as not replaced following the May 1998 elections.

Taxation

Since 1997 Hungary has continued the approximation of its VAT legislation to that of the *acquis*. The latest amendments to the Hungarian VAT legislation are the introduction of a rate for second hand goods and objects of arts and a reversed charge mechanism. From

January 1998, tropical fruits (including oranges) became subject to the reduced rate of 12% instead of the standard rate of 25% thus eliminating differentiation between fruits.

The law on Excise duties which entered into force in January 1998 addresses the problems of the domestic excise system and of a tax warehouse system, the procedure for tax suspension together with the accompanying administrative documentation and, the excise payment certificate. The law is broadly in line with the Community system even if some minor incompatibilities still exist. These measures together with the adoption of Community provisions on cigarettes and tobacco and structures and rates on alcohol and mineral oils address weaknesses identified in the Opinion. The major remaining problem relates to differential duty levels on domestic and imported spirits.

As regards direct taxation and corporation tax in particular, a new law on foreign companies setting up branches and commercial agencies, partially transposed the Community provisions on taxation of parent companies and subsidiaries.

Efforts are needed in the area of indirect taxation on raising capital and also on the provision of mutual assistance in the field of direct taxation. Several outstanding issues such as the effect of the law on Foreign Investments on the freedom to provide services need to be addressed.

The overall efficiency of tax collection in 1997 improved resulting in increased revenue.

Conclusion

Over the last year, Hungary has further progressed in taxation. While the Hungarian authorities have put in place the rudimentary elements of an excise tax structure aligned with the *acquis*, further efforts are still required in particular as regards VAT (scope of the application of the reduced VAT rate, special scheme for farmers, preparation for the Community's transitional VAT regime). Administrative capacity as well arrangements for administrative co-operation and mutual assistance need also to be further improved.

Statistics

Hungarian legislation is, with a few exceptions, compatible with the current standards applied within the European Union. Substantial progress has been made in the relations between the Hungarian Statistical Office and other ministries or institutions providing statistics or administrative data, but the co-ordinating role of the Hungarian Statistical Office still needs to be strengthened. The professional independence of the statistical units of the agencies belonging to the Statistical Office need to be defined in more detail as provisions on data transmission abroad and confidentiality.

There are also weaknesses in regional and geographic statistics, some business statistics such as tourism and the coverage and methods used in external trade statistics. Macroeconomic statistics are good. However improvements need to be made in Government finance and especially debt and deficit statistics. A major effort needs to be made in the area of agricultural statistics.

3.4 Sectoral Policies

Industry

The industrial policy of Hungary focuses on creating framework conditions for increased competitiveness, industrial modernisation, and improved regulation. This horizontal approach, which has been gradually implemented since 1995, includes incentives for the promotion of FDI and exports; investments (through e.g. the industrial parks programme); small businesses (through e.g. the suppliers' networks programme); and quality; the integration of environmental considerations into investment projects; and support for Research and Development and IT.

Hungarian industrial policy has been explicitly defined in the 1996 Medium-term Industrial Policy Strategy. This document has been continuously reviewed and a revised document, the Industrial Policy Action Programme, was prepared in the first half of 1998. The philosophy and general approach of Hungary's industrial policy are broadly compatible with those of the Community.

Since last year double-digit increases in output (+11%) and productivity (10%) have been recorded. The share of skill based manufacturing in total output has increased and product quality has improved. Exports increased in all industrial sectors except energy. These positive results would suggest that the government's industrial policy is succeeding in creating an appropriate market-based business environment.

Restructuring and privatisation in a number of major sectors, such as chemicals, mechanical engineering, and pharmaceuticals is nearly completed. Nevertheless, further restructuring efforts still have to be made, for example in the steel sector. Since 1990, steel production in Hungary has decreased rapidly. Public aid has been given while the industry undergoes restructuring. The restructuring process has not yet been completed and Hungary has therefore requested an extension of the grace period for another 5 years that will allow it to grant subsidies to the steel industry. The Commission will examine this request when individual viability plans for each steel enterprises are received

Conclusion

Hungarian industry continues to develop its competitiveness through cooperation with Community industry, a high level of investment, including foreign investment and adoption of Community standardisation and conformity assessment rules and practices. Further efforts in strengthening industrial competitiveness should be made by restructuring the steel sector.

Agriculture

Agricultural situation

Although agricultural share in the overall economy has decreased in recent years, it still accounts for 6,6% of GDP and employs around 8% of the working population.

The arable land remains fairly stable, with cereals as the main crop, covering 60% of the arable land. However, the current Government is discussing a possible reduction of its cultivated grain area by around 10% in order to reduce overproduction.

The livestock sector declined again in 1997. Combined with a modest growth in crop output, the result was a 0,6% decrease of Gross Agricultural Output, compared to 1996. According to preliminary estimates there was no growth in 1997.

The completion of the mass privatisation process in late 1997 has not led to a break-up of farm structures in Hungary with large scale farms remaining important. However in addition to traditional very small-scale production, a new independent middle-scale agricultural sector is developing.

In 1997 total agricultural exports amounted to 2,5 billion ECU and imports amounted to 959 millions ECU. This resulted in a positive agricultural trade balance (1,5 billions ECU), compared to an overall trade deficit (-1,8 billions ECU). Recent developments in Russia may however have an impact on this situation, due to the fact that Hungary exported 20% of its agro-food production to Russia in 1996 and around 18% in 1997.

Although it varies from year to year (in 1997 it decreased if compared to 1996), Hungary still had a substantial positive trade balance with the EU in the agri-food sector amounting to 509 million ECU.

Agricultural Policy

In March 1997 the Hungarian Government adopted “The Basic Principles of the National Agricultural Programme”.

In 1998 this led to a re-balancing of agricultural spending from budgetary support (reduced from 42% to 35% of the total allocated to agriculture) towards direct subsidies (which increased from 21% to 27%). Market support is mainly provided through export refunds and, for a limited number of products, by direct price support. Direct subsidies include credit grants and support for those farming poor quality land. A new subsidy designed to encourage farm employment was introduced in 1998.

Structural policy instruments for agriculture have been developed and an agri-environmental policy is slowly emerging (implementation in 1997 of the 1995 Act on environmental Protection). However, there is not yet a fully-fledged concept of rural policy to accompany changes in agriculture.

In mid 1997 Hungary reached agreement with its WTO partners on the issue of export subsidies. Hungary obtained a waiver on its export commitments applicable until 2002. The export subsidy commitments take 1995 as a base year. Any export refunds will have to comply with the levels set out in the conditions of the waiver.

Hungary is continuing its efforts for approximating its legislation to the *acquis*. Various measures such as laws on the Protection and Handling of Animal Genetically modified organisms and on Property, have been adopted by the Hungarian Government, which are due to come into force in 1999.

A compatible cattle identification system has been drawn up and the preparations for the inspection of the veterinary border stations, as well as the assessment of requirements for their further development are well underway.

Competitiveness has improved in those companies in the food sector which have been privatised thanks to considerable resources being invested in upgrading their technical management and organisational efficiency. However, some sectors, in particular marketing of farm produce and primary processing of livestock products are lagging behind. Furthermore, although the largest food manufacturers are already applying the Community standards in the veterinary sector, most establishments still need upgrading .

Hungary has been continuing efforts in the quality control area. A new law on vineyards and wine production sets the framework for the regulation of the sector and measures were taken to develop the National Institute for Wine Qualification and National Institute for Agricultural Quality Control. However, there has been no progress concerning Hungarian recognition of EU standards in this area. Complex and costly procedures are still applied to imports of wine originating in the Community (quality and health certificates).

Conclusion

Although the current state of implementation is broadly satisfactory, considerable progress still needs to be made.

Fisheries

The law on Fishing and Fishing Activities passed in 1997 provides the legal basis for the sector. However reinforced institutional and supervising capacity, especially for import control needs to be developed as do statistics on freshwater fishing.

Energy

The positive developments as regards the adoption of principles related to the internal energy market and the competition rules already stated in the Opinion have continued. Energy prices, which are approaching market levels, have been further increased.

Oil stocks are now close to the EU target of 90 days of consumption but the legislation needs to be fine-tuned with the *acquis*.

Concerning energy efficiency, the establishment in October 1997 of the Energy-Environmental Centre and preparations for setting up regional energy centres should be noted as well as progress on harmonisation with the labelling directives (e.g. approximation with *acquis* on labelling of refrigerators, freezers and combinations thereof). However more remains to be done. Energy networks are being further developed.

In the solid fuels sector a new Government Plan is being prepared. Uranium production ceased in the autumn of 1997. State aids need to be monitored closely in view of the *acquis*.

The modernisation programme for the Paks Nuclear Power Plant is ongoing. In the framework of the Powerplan-2010, which does not exclude the nuclear options the government is organising a tender to increase electricity generating capacity

The Nuclear Law entered into force in July 1997. The Hungarian Atomic Energy Authority was created as a separate body from the Hungarian Atomic Energy Commission (working under authority of the Ministry), although certain links still exist. The Central Nuclear Financial Fund, has been in operation since January 1998. It was set up to finance waste management and decommissioning, and is funded through a levy on electricity prices. At Paks, a dry storage centre for spent fuel (50 years) is under commissioning, even if the agreement for shipment of the spent fuel to Russia is still in force (but not applied). Sites for final disposal in Hungary are being investigated. Paks is looking for alternative options for fresh fuel supply in order to diversify sources, an approach which fits into the Union's diversification policy.

Conclusion

Further work is needed to adjust monopolies, provide access to networks and on energy pricing; attention should also be paid to state intervention in the solid fuels and uranium sectors, and the development of energy efficiency and fuel quality standards.

Nuclear safety standards should continue to be tackled appropriately, for example through the modernisation programme, in order to bring the nuclear power plant to the level required. Longer term solutions for nuclear waste need attention and the independence of the nuclear safety authority should be ensured.

Transport

Hungary has continued to adopt measures to align progressively with the *acquis*.

In the area of road transport new legislation has been adopted on roadworthiness testing of motor vehicles, requirements for driving licenses, the content of driver training and requirements for access to the profession for domestic road haulage operators. However the legislation on driving licenses, implemented through a Decree on policing of road transport, is not yet fully in line with Community requirements..

As regards inland navigation/maritime a new law on water transport was adopted in 1998.

In maritime transport, Hungary has already signed up to the MARPOL (International Convention on the prevention of maritime pollution) and SOLAS (International Convention on the safety of live on sea) Conventions and has joined the international STCW (Convention on the standards of training, certification and watchkeeping) for seafarers, in line with the *acquis*. Hungary achieved also alignment with the *acquis* on piloting on the high seas.

Rules on the transport of dangerous goods (by road and rail) have been brought into line with the relevant international and Community legislation.

As regards Air transport, progress has been made concerning noise pollution around airports and the limitation of noise emissions from subsonic aircraft.

As far as transport infrastructure development and financing questions are concerned, Hungary is actively participating in the Transport Infrastructure Needs Assessment (TINA). Projects for road and railway links are underway and a number of major

motorway projects (including those using private sector financing) as the M5 (southern link) and the M3 (eastern link) have been undertaken in this period.

Conclusion

Hungary has continued to take important measures both for legal and institutional alignment. Further efforts are needed to achieve a greater harmonisation of rules on technical requirements for road vehicles, development of road safety, access to market of national road haulage, infrastructure development in inland waterways and harmonisation of legislation in civil aviation (particularly safety), rail (access rights to the rail network) and combined transport.

Small and Medium Enterprises

Domestic SME policy conforms to a large extent with the Community one and further measures are being taken to complete the policy framework

In 1998, the EU Third multiannual Programme for SMEs (1997-2000) has been opened to Hungary which will cofinance EU funds.

3.5 Economic and Social Cohesion

Employment and Social Affairs

By the end of the first half of 1998 Hungary's unemployment rate stood at 9.1%. There is growing evidence of significant long-term unemployment, and there have been particularly sharp increases in unemployment among minorities. Regional disparities are considerable. Attention will need to be paid to ensuring effective coordination between the Ministries of Economics, Social and Family Policy, Health and Education (in particular as concerns vocational training) which have recently assumed the employment responsibilities of the former Ministry of Labour and Social Affairs.

A number of laws have been adopted to more closely align Hungarian legislation with the *acquis* as regards labour law, equal opportunities, and health and safety.

Two particular points raised by the Commission Opinion have been addressed through amendments to the 1992 Acts on the Labour Code and on Civil Servants concerning employees' rights on the transfer of undertakings, and the rules on collective redundancies. However, the Hungarian authorities have provided no detailed schedule of measures to transpose the remainder of the labour law *acquis*.

Ensuring the application of equal treatment for men and women in the field of social security provision has been addressed through the enactment of a number of statutes relating to state and private pension funds, and to the state health insurance system.

Domestic legislation on social security funds, private pension funds and private funds has been extended to migrant workers and their families in accordance with Community principles.

Hungary will participate in the four available Community public health programmes and in the Fourth Community Action Programme on Equal Opportunities, as from 1998.

Conclusion

Whilst progress has been made in this area during recent months, efforts to secure adoption of legislation covering the outstanding areas of the *acquis* in the field of employment and social affairs, and of enforcement across the *acquis*, continue to be required.

Regional Policy and Cohesion

The Hungarian Parliament adopted in March 1998 the “National Concept on Regional Development” which lays down the long-term objectives for Hungary’s regional policy and constitutes a basis for the National Development Plans. This constitutes a first step towards comprehensive regional planning.

Development councils have been established on regional and county levels but cannot be considered as fully operational yet. A National Regional Development Centre has been set up to develop the institutional framework. It is responsible for co-ordination, promotion, monitoring and providing technical support to regional and county development councils. Although the law of 1996 defines institutional and control structures in detail it is less specific on implementing and monitoring systems.

Human and financial resources are lacking at all levels. This explains in part why there has been progress in the development of Country Development Plans.

Furthermore, inter-ministerial co-ordination remains problematic and the National Regional Development Council has not taken on an effective coordination role. In addition, financial resources for regional policy remain limited and are split between nine ministries. Monitoring procedures also need to be further strengthened.

One of the key tasks to be addressed over the next year will be the establishment of a National Development Programme.

Conclusion

Hungary has not adequately addressed the short-term Accession Partnership priority relating to reinforcement of institutional and administrative capacity in regional development. Despite advances made in legislation and in developing concepts and structures, concrete implementation of regional policy objectives and the accompanying structures and institutions is still weak and has led to important delays in the management and implementation of Community assistance. These problems need to be addressed before Hungary is ready to participate in the EU structural policy.

3.6 Quality of Life and Environment

Environment

Since 1997 progress in legal harmonisation was rather slow and only four major laws have been adopted which provide for full or partial compliance with EU legislation. These laws are related to chemicals, genetically modified organisms, good laboratory practice and emission limits of air pollutants from combustion plants exceeding 50 MW heat power. Progress has also been made in the area of eco-labelling.

A new law regulates the scope of activities and competence of environmental inspectorates and directorates of national parks and tackles the range of activities and powers of the National Environmental and Nature Protection Inspectorate. The institutional changes brought about by this law are expected to serve as a basis for the further modernisation of the institutional apparatus to implement and enforce Community environmental legislation.

On 16 September 1997 the Hungarian Parliament adopted the National Environmental Protection Programme for the period 1997 to 2002. This programme puts particular focus on measures and investment needed for EU accession.

On basis of this programme the 1998 Environmental Action Plan was prepared and incorporated into the 1998 National Budget. This plan deals extensively with the implementation of the *acquis*. In addition, the National Legal Harmonisation Programme establishes the required detailed transposition with a precise timetable for all chapters of the *acquis*.

Currently the main outstanding issue is the transposition of Integrated Pollution Prevention Control and Seveso Directives which are not covered by national legislation. Weaknesses also exist in relation to transposition of wastewater treatment and some air pollution directives. The transposition and implementation of the waste framework directive should be accelerated. More efforts should be made in the field of radiation protection.

The basic legislation on nuclear safety adopted in 1996 still needs to be supplemented by several other legal acts on radiation protection.

Conclusion

Hungary has not been able to address all the short-term priorities of the Accession Partnership.

The National Legal Harmonisation Programme complemented by the necessary budgetary provisions foresees full transposition of the entire environmental *acquis* for the years 2000-2001.

The implementation of the above mentioned programme involving effective enforcement and compliance, especially with parts of the *acquis* which require high levels of investment in close cooperation with International Financial Institutions and considerable administrative efforts (e.g. urban waste water treatment, waste management and some aspects of air pollution legislation), can be achieved in the long term, providing that the approximation strategy is fully complied with on schedule.

Consumer Protection

The adoption of the framework law on Consumer Protection addresses one of the weaknesses identified.

This law took effect in March 1998 and establishes the basic rights of consumers with regard to safe products. Supervisory functions are ensured by the Consumer Protection Agency.

Basic provisions on consumer credits and price indications are also contained in the law, but are not in full alignment with the *acquis*. The necessary adjustments concerning unfair contract terms have been achieved with the adoption of new legislation.

Laws on commercial advertising and on the prohibition of unfair and restrictive market practices do not fully comply with the *acquis*. New measures on the general safety of goods and services and the related market surveillance proceedings aligns Hungarian legislation with the *acquis*. The new law on Medical products for human use introduces liability for non-authorised medicines but is only partially aligned with the *acquis*.

Despite the fact that consumer protection is only a medium-term priority in the Accession Partnership, Hungary has made considerable progress in the field. Further alignment is expected to be achieved in the coming years.

3.7 Justice and Home Affairs

In its 1997 Opinion, the Commission stressed as a priority the need for efficient border controls including a visa regime increasingly close to that of the EU and an asylum policy without geographical reservations and with sufficient resources.

Immigration / Border controls

Although the needed reworking of legislation on foreign nationals has not occurred, Hungary has continued its progress with readmission agreements. Three new agreements have been concluded with Member States (France, Italy and Denmark), and the existing agreement with Austria, which entered into force in February 1998, has been revised. No information on adjustments to visa policy is available.

A major effort has been focused on the country's borders, in particular through the new law on border protection which came into force in November 1997. It covers management of border controls and the organisation of border guards (who can now deal with organised crime). In May 1998, the border guards became a civilian force. The government has adopted two decrees, one on the organisation of the border guards and one on their numbers and weapons.

Asylum

The new law on asylum entered into force in March 1998, lifting the geographical reservation introduced in 1989 when Hungary ratified the 1951 Geneva Convention. Non-Europeans can now request asylum in Hungary. In June 1998, records indicated

225 recognised refugees and 2428 “Temporarily assisted” persons (mostly ex-Yugoslavs not yet repatriated), but 2047 asylum requests (the majority from non-Europeans) were made in the first half of 1998 alone. This high figure shows that there is still much to be done in increasing staff numbers to deal with asylum requests.

Police

Reforms in pursuit of an effective fight against organised crime continued. In November 1997, the Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (Council of Europe, 8 November 1990) was signed, and it should be ratified by the end of 1998. In the second half of 1997, the parliament ratified the European Convention on the Suppression of Terrorism (Council of Europe, 27 January 1977); it entered into force in November of that year (see also legislation on weapons and explosives).

Beyond the progress on legislation, particular attention needs to be devoted to human resources to ensure that adequate pay and suitable training are provided to enable the reform to succeed.

Drugs

The national commission for coordination on drugs set up in April 1998 under the aegis of the Prime Minister's office is not yet operational. Progress still needs to be made with bolstering the implementation of a multidisciplinary strategy, including the role attributed to the national contact point for information on drugs issues. The machinery for combating money laundering needs to be made more operational.

Judicial cooperation

With regard to the civil law, Hungary has obtained the required "sponsorship" from a contracting party to the Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters (Lugano, 16 September 1988). The process of obtaining the agreement of the contracting parties is under way, and it is likely that entry into force will follow before the end of 1999. Effort is still needed to make the judicial system more efficient, particularly to enable Community law to be applied uniformly in the future.

With regard to the criminal law, the new procedural code adopted by the parliament will enter into force in January 2000. It provides for witness protection in line with the criteria laid down by the Council in its resolution of 25 November 1995.

Conclusion

Hungary has confirmed its ability to make progress in taking on the Community *acquis* by focusing on the two major deficiencies identified in the short-term priorities of the Accession Partnership: asylum legislation with no geographical limits and a better system of managing border controls. Considerable progress has been made in these areas. In the interests of meeting the medium-term objectives, the existing efforts should be expanded to include:

- a law on foreign nationals and a visa policy suited to the requirements of the EU (and covering the Commonwealth of Independent States) ;

- an increase in human resources, with adequate pay and suitable training, so that the new legislation (particularly that on asylum, police cooperation and combating drugs, organised crime and corruption) can be implemented.

3.8. External Policies

Trade and International Economic Relations

As of January 1998 trade in textiles was liberalised in accordance with the Europe Agreement protocol on textiles.

In 1997/1998 Hungary signed Free Trade Agreements with Turkey, Israel, Bulgaria, Lithuania and Estonia.

As Hungary will have to comply upon accession with the obligations of the plurilateral WTO agreements, the domestic enactment of the agreement on the World Trade Organisation and its annexes is an important step. The relevant provisions came into force on 15 March 1998. To comply fully with the *acquis* in this field, Hungary should become party to the plurilateral Agreement on Civil Aircraft, on Government Procurement and on Trade in Information Technology.

Development

Hungary has no preferential trade agreements with ACP countries, but has established trade preferences for imports coming from developing countries.

There is a foreign aid fund managed by the Ministry of Foreign Affairs through which Hungary provides development and humanitarian aid.

Customs

A new integration office was established in January 1998 to ensure co-ordination and implementation of European integration tasks. Between mid 1997 and mid 1998 five new border crossing points were opened at the Ukrainian, Romanian and Slovenian borders.

The Hungarian Customs and Finance Guard is implementing an anti-fraud system throughout Hungary, with particular emphasis on the Eastern borders.

Hungary still has 10 customs free zones and 87 industrial free zones. The exemption from customs duties of certain imported goods which are used in the free zones is incompatible with the relevant EC legislation.

Hungary still does not have a system for binding tariff information on customs levies. No progress has been made in the reform of the customs code and in developing an integrated customs tariff.

As regards computerisation the necessary data bank for all customs operations at Hungarian borders has been created. However it is not always sufficiently and appropriately used. Consequently, there are still delays at the border crossings. Better staff training is needed.

In the field of customs cooperation further progress needs to be made in order to ensure a proper application of rules of origin provisions of the Europe Agreement.

Conclusion

Further efforts are needed particularly to establish an integrated customs tariff, improve and simplify border procedures, develop a posteriori controls, more effectively use electronic equipment and develop training. Customs cooperation with Member States needs also to be further improved.

Common Foreign and Security Policy

The change of Government of May 1998 did not alter Hungary's foreign policy. Foreign policy priorities are euro-atlantic integration, good-neighbourly relations and a "nation policy" aimed at supporting ethnic Hungarians beyond the borders.

Political dialogue between the European Union and Hungary has continued. Hungary actively participated in the regular meetings of political directors, European and associate European correspondents and in the CFSP working groups. Since the Opinion, Hungary joined all the common positions, declarations and demarches, to which it was invited including the common positions which introduced sanctions against the Federal Republic of Yugoslavia and the declarations about the Indian and Pakistan nuclear tests.

On 8 July 1997, Hungary was formally invited to start accession negotiations with NATO. Negotiations were launched on 10 September 1997. On 16 December 1997 Hungary signed the Accession Protocol which is currently in the process of ratification.

There continues to be some outstanding bilateral issues with Slovakia concerning the implementation of the Basis Treaty and the Gabčíkovo dam.

Hungary continues to be actively involved in the area of Common Foreign and Security Policy.

3.9 Financial Questions

Financial Control

Since 1997, no major developments can be reported. The Government has consolidated previous measures by adopting resolutions on the establishment of monitoring committees.

The State Audit Office, the external financial control body, worked on the development of its accession strategy and on the authorisation to certify the accounts of different organisations within its sphere of competence.

The Government Control Office, the internal financial control body, is now also responsible for ex post internal controls, while ex-ante controls are left to the spending ministries and agencies.

An Administrative Cooperation Arrangement between the government control office and the Commission provides for cooperation measures on public internal control and support in accession preparations.

Conclusion

In order to adopt financial control structures in line with the *acquis* Hungary needs to further develop internal financial control policy and to create proper institutions with the necessary skilled staff (e.g. paying agency for agricultural assistance, offices of regional development Councils, monitoring committees). Particular emphasis should be given to the strengthening of internal control and internal audit of the management of the Community's assistance programmes especially in the perspective of the increased pre-accession assistance.

3.10 General Evaluation

Hungary continues to approach the approximation process in a balanced manner. The rhythm of transposition has remained steady and has generally been accompanied by adequate institutional and financial provisions facilitating implementation. A slow down in the pace of transposition in certain sectors such as the environment, has been accompanied by an increased focus on strengthening implementation structures. This suggests that the objective of effective application, rather than simply transposition, is being meaningfully pursued. Continued priority is being placed on the completion of internal market legislation. Hungary has shown determination to tackle the complex area of justice and home affairs, putting in place a strategy and adopting measures which are already beginning to show results.

While Hungary has addressed the Accession Partnership short term priorities in the economic reform area, in reinforcing veterinary and phytosanitary and financial control institutions and in justice and home affairs, insufficient attention has been paid to strengthening regional development structures and to the internal market priorities of alignment of copyright and public procurement legislation and enforcement of state aid legislation.

4. Administrative Capacity to Apply the *Acquis*

This chapter updates the information given in the Opinion. The European Council in Madrid in December 1995 referred to the need to create the conditions for the gradual, harmonious integration of the candidates, particularly through the adjustment of their administrative structures. Taking up this theme Agenda 2000 underlined the importance of incorporating Community legislation into national legislation effectively,

but the even greater importance of implementing it properly in the field, via the appropriate administrative and judicial structures. This is an essential pre-condition for creating the mutual trust indispensable for future membership.

In this year's report the Commission has worked with the candidate countries to identify an illustrative list of enforcement bodies in key areas of the *acquis*. Wherever possible information is provided on whether these bodies have sufficient legal powers to implement the *acquis*, on staffing levels and on staff qualifications and on budget availability. In some cases it is already possible to give information on the quality of decisions being taken. The Commission intends to further develop this aspect in future reports.

In its Opinion the Commission concluded that further administrative reform will be indispensable if Hungary is to have the structures to apply and enforce the *acquis* effectively.

4.1. Administrative structures and capacity

Following the modification of the Act on the Legal Status of Public Officials, public service employees are being prepared for EU membership as part of the governments medium term programme. Funding will be provided in the annual budget and HUF 2bn has already been earmarked for the training of 100, 000 officials over the next few years. A special language allowance will be integrated into the salary structure and language training of civil servants will remain a priority within the EU integration programme.

As from 1 January 1999 about 10,000 management level public service employees will be obliged to pass a special examination, also covering EU topics, within three years.

In this context the Government has also strengthened the ethical rules for the public service. On 1 January 1998 stricter rules on the economic incompatibility of certain activities of public officials came into force.

Substantial structural changes within the Hungarian Public Administration have taken place at central government level since July 1998. Following the change of government in July 1998, new ministries were created and others abolished. The coordination role of the Prime Minister's Office has been strengthened.

The number of civil servants in Hungary has increased over the last year and is currently about 104, 000 compared to 98,200 in July 1997. Out of this staff-number about 53,800 are employed in the central and territorial state administration, and about 50,000 are employed directly by local-government institutions. Although overall staff levels have increased there have been significant reductions in some sectors which may have an effect on Hungary's ability to implement the *acquis* (see below).

4.2. Administrative and judicial capacity: Key areas for implementation of the *acquis*

The uniform application of EC law: The new act on the legal status of judges defines postgraduate training as a right and a duty. Judges are obliged to attend the postgraduate

courses on EU law to which they are invited. Postgraduate training is at present in the hands of the Office of the National Council for the Judiciary set up in February 1998. (Present staff: 95)

A new regulation of December 1997 reintroduces periodic evaluation of judges' activity. After appointment for life, judges are to be evaluated twice every 6 years. There are currently 2449 judges including 110 in the Supreme Court.

Since the Opinion, important progress has been made in developing training programmes and structures and ensuring that judges keep up to date. Hungarian courts already apply community law in specific areas.

Single Market: The Hungarian National Accreditation Office is a public body called the "National Accreditation Committee" (hereinafter: Committee). The Committee consists of 55 members, representing the following bodies: ministries, Hungarian Institution for Standardisation, Hungarian Metrology Authority, chambers of trade and commerce, 14 accredited bodies, institutions of higher education and scientific organisations, consumer protection and other professional interests-representing bodies. It operates under the supervision of the Minister of Economics. It is authorised to accredit testing laboratories, calibration laboratories, certification bodies and inspectors. There are eight professional accreditation commissions (6 for testing laboratories, 1 for calibration laboratories and 1 for certification and inspection) which help the operation of the Committee. To date the Committee has accredited 212 testing laboratories (while an additional 165 applications are under process), 70 calibration laboratories (while 32 applications are under process), 3 certification bodies (while 23 applications are under process) in accordance with European standards (based on EN 45000 series standards). There are 200 qualified accreditation assessors who are responsible for accreditation activities. Hungary is full member of the International Laboratories Accreditation Committee and of the International Accreditation Federation. Hungary is also an affiliated member of the European Cooperation for Accreditation.

The Hungarian Institution for Standardisation is an accredited certification body and the only national system-certification institution for ISO 9000 and ISO 14000. Since June 1998 the Institute is a full member of the IQNet. It is a non-profit public body and legally fully independent from the Hungarian Government. The Institute currently lacks sufficient financial resources to facilitate the introduction of EU standards.

In the area of free movement of services the Hungarian Banking and Capital Market Supervisory Authority was set up as a merged supervisory body in 1997. It authorises trade in bonds, securities etc. It enjoys a certain level of independence, but is still supervised by the Finance Minister. The Supervisory Authority can be considered well-staffed with a current level of staff of 263 (former figure: 235). Nevertheless further progress is needed in strengthening the relevant financial sector supervisory bodies particularly in training. The State Insurance Supervisory Authority functions well, the staff has increased and the present figure is 38.

In the area of data protection, the duties and scope of authority of the Ombudsman are determined by the data protection law. In particular the Ombudsman observes the implementation of the law, examines the complaints lodged with him and ensures maintenance of the data protection register.

The Public Procurement Council is responsible for the implementation of the Public Procurement law. The Council consists of 21 members and is required to report to the Parliament annually. A special Public Procurement Decision-making Committee was set

up to deal with enforcement. It consists of 13 Public-Procurement Commissioners. The Committee is assisted by a four-person secretariat. This Committee is fully independent of the Government and of the Council.

With regard to intellectual property law and patents, the administrative implementation bodies, such as the Hungarian Patent Office seem to work satisfactorily, but improvement in human and financial resources and training is still required in the area of police, judicial and customs enforcement

Competition: The Office of Economic Competition (OEC) is the central authority for competition matters. With 106 members, the Office of Economic Competition can be considered as well-staffed. The operation of the OEC is governed by the law on the prohibition of unfair and restrictive market practices, which entered into force in January 1997.

Over the past year the Office adopted 61 decisions, 40% of which were related to misleading consumers and 30% to abuse of dominant position. The value of fines increased. However the enforcement capacity of the Office of Economic Competition could be further improved, in particular in regulated sectors and with respect to professional skills.

As far as the State Aid monitoring authority is concerned, Community requirements have not yet been met. According to the latest modification of the law on Public Finance, the Minister of Finance should provide for the alignment of Hungarian state aid practice. However the relevant legislative measures have not yet been prepared.

Telecommunications: The Ministry of Transport, Telecommunications and Water Management (staff number: 302) is responsible for the adoption of policy and regulations. The National Communications Authority deals with the application of the regulations and the exercise of control functions such as approvals, frequency allocations and monitoring. The Communication Authority employs 500 people. There are seven regional offices.

In April 1998, the Hungarian Government adopted a decree on co-operation between the telecommunication organisations and authorities entitled to carefully intercept messages or telecommunications networks. To assure a smooth implementation of this decree, the capacity of the relevant government authorities should be strengthened.

Customs and indirect taxation: A new Office was set up in January 1998 for the co-ordination and implementation of European integration tasks. An EU support division deals with the management of EU programmes and an Integration Division is responsible for the adaptation of customs regulations and indirect taxation linked to the *acquis* and with the preparation of an administrative strategy.

From 1998 the Hungarian Customs & Finance Guard was given the mandate to handle indirect taxation matters and is authorised to levy and collect excise duties. This strengthens the authority and responsibility of the Hungarian Customs and, at the same time, it separates and decentralises the implementation of the taxation legislation which is in line with the *acquis*.

The total staff of the Customs and Finance Guard remained unchanged since 1997 and amounts to 6000.

Agriculture: The Ministry of Agriculture and Regional Development is now responsible for rural and regional development. The establishment of the Agricultural Market Intervention Centre has been an important step in the direction of implementing and enforcing the policy instruments of the CAP. The Centre has currently 26 staff.

The Institute of Geodesy Cartography and Remote Sensing has set up a modern production forecast service based on remote sensing. In 1997, a regional database was set up and the Centre for Information Development in Cartography was also established. The Institute currently counts 150 persons.

Concerning administrative capacity in respect of veterinary and phytosanitary controls, Hungary has a good basic infrastructure. As regards staffing, there are 20 Animal Health and Food Control Stations, employing 2,880 staff of which 1100 veterinarians, and a National Institute for Agricultural Quality Control employing 660 staff (ie a reduction of 50 compared to the number given in the Opinion). Priority should be given to the extension of the network of Veterinary and phytosanitary control stations to the future borders.

Transport: In the recent government re-structuring, some minor responsibilities in the field of water management were transferred to the Ministry of Agriculture and Rural Development. The number of staff in the Ministry of Transport, Telecommunications and Water management is currently 302 (a reduction of 40 persons since July 1997).

Employment and Social Policy: Two separate institutions are responsible for the enforcement of health and safety legislation in Hungary, namely the National Service for Public Health Care and the Labour Inspectorate. While each appears to have a clear grip in its own fields of responsibility, there is a need for regular and organised co-operation between the two bodies for rationalisation and reinforcement.

The National Service for Public Health Care is a nation-wide network of services in charge of health protection and prevention, professional control and co-ordination of public health care, examination of diseases, epidemics. The services include the National Service for Public Health Care comprising 20 regional offices and 136 city offices the National Centre for Epidemics and the National Centre for Public Health Care.

The number of total staff is 6,881.

The National Inspectorate for Labour Safety and Labour Affairs deals with safety at work. The number of staff is 67.

Regional Policy and Cohesion: Following the change of government in May 1998 the portfolio of regional development and planning was transferred from the Ministry of Environmental Protection to the Ministry of Agriculture and Regional Development.

At the regional level, development councils have been established, but still lack permanent staff. To develop the institutional framework a National Regional Development Centre has been set up to back up the regions. The centre is managed by

the Ministry of Agriculture and Regional Development and is the secretariat of the National Regional Development Council. The current staff is 12.

Hungary has had difficulties in making use of EU funds (Phare) for regional development. These illustrate the need for strengthening of project development and management capacity to be able to absorb increased pre-accession aid and to prepare for Hungary's participation in the Structural Funds. Hungary has not adequately addressed the short term Accession Partnership priority relating to regional development.

Environment: The Ministry of Environmental Protection has been most affected by the government restructuring since the large portfolio of regional development and planning was transferred to the Ministry of Agriculture and Regional Development.

The Chief Environmental Inspectorate, the Regional Environmental Inspectorates and the Nature Conservation Directorates carry out environmental protection. In a modification of the scope of their tasks and responsibilities, first instance jurisdiction in environmental and nature conservation matters was given to the inspectorates and directorates.

There is a clear need to increase the number of staff in the regional inspectorates as they will be responsible for the licensing under the Integrated Pollution Prevention Control Directive. There is also a need for training of staff.

The number of staff in Ministry is 472 (March, 1998) including regional development staff.

The number of staff in regional instance is: 1171 (March, 1998)

Consumer Protection: With the entry into force of the Act on Consumer Protection in March 1998, the authority of the Consumer Protection Agency (CPA) has been extended. It will be entitled to launch investigations into any complaints and to impose unlimited consumer protection fines. The Consumer Protection Agency and civil organisations will be able to apply to the courts to protect consumers in cases when damage does not affect a particular person. All companies providing public services must have consumer services. The law also sets up conciliatory bodies connected to regional economic chambers which are independent institutions responsible for mediating in cases dealt with by the CPA before they go to court. In addition, an unlimited consumer protection fine will be introduced replacing the current limit of HUF 30,000 (ECU 30). The CPA is well staffed with 144 persons.

Justice and Home Affairs: After the adoption of the new law on border protection in November 1997 border guards are authorised to carry out investigations in the area of organised crime.

Technical skills of the Border Guards need to be upgraded. In addition, steps need to be taken to strengthen border management, upgrade border equipment, IT systems, and to strengthen institutional capacity and training.

As regards asylum in order to handle the increased number of asylum seekers, there is a need to increase staffing, technical facilities and appropriate housing facilities in both community shelters and refugee centres. The law on Asylum which entered into force in March 1998 gave the responsibility for asylum proceedings and for non-European asylum seekers to the Office for Migration and Refugee Affairs. Further training of officials in this

office as well as court judges specialised in asylum cases is needed. Appeals on asylum judgements can be made to the courts. Responsibilities in immigration cases were transferred from the police to the regional public administration offices

The staff in the Ministry of Interior was substantially increased since July 1997. The current number is 676 whereas it was only 549 in last year.

Financial Control: The State Audit Office, the external financial control body performing independent review and audit of public finance is well staffed (383 staff). The Internal financial control body, the Government Control Office, has a staff of 57. Hungary needs to further develop internal financial control policy and to create adequate control functions with skilled staff in institutions such as the Regional Development Councils and monitoring committees.

4.3 Twinning

In order to help candidate countries meet the challenge of strengthening their administrative capacity and adapting their administrations to implement the *acquis* the Commission and the Member States are developing a process of twinning under the Phare programme. In the EU the *acquis* is implemented in the Member States by national administrations (at central, regional and local level) and by agencies, professional bodies and the private sector. This vast body of administrative and technical expertise is now being made available to the candidate countries. Initially twinning will cover four sectors – agriculture, environment, finance and justice and home affairs but will gradually be extended to the whole of the *acquis*.

Hungary is participating actively in twinning.

4.4. General evaluation

Hungary has continued to make progress in building up its administrative capacity to apply the *acquis*. In so doing it has addressed one of the short term priorities of the accession partnership. The emphasis on training in European affairs throughout the civil service and the judiciary is a positive development which reflects the seriousness of Hungary's preparations for membership. However, administrative capacity in certain key areas such as standardisation, state aid control and regional development is weak and a concerted effort will be needed to strengthen institutions in these areas.

C. Conclusion

Hungary continues to fulfil the Copenhagen political criteria. Continuing attention needs to be paid to combating corruption more effectively and to improving the situation of the Roma.

Hungary can be regarded as a functioning market economy. It should be well able to cope with competitive pressure and market forces within the Union in the medium term, provided that it maintains the conditions for trade integration and ongoing enterprise restructuring.

Hungary's rhythm of transposition has remained steady and has generally been accompanied by adequate institutional and financial provisions facilitating

implementation. The Commission considers that Hungary's steady progress will, if sustained, enable it to take on the obligations of membership in the medium term provided the pace of transposition in environment picks up.

D. Accession Partnership and National Programme for the Adoption of the *Acquis*: Global Assessment of Implementation

The purpose of the Accession Partnership is to set out in a single framework the priority areas for further work identified in the Commission's Opinions, the financial means available to help the candidate countries implement these priorities and the conditions which will apply to this assistance. Each candidate country was invited to adopt a National Programme for the Adoption of the *Acquis* setting out how it would deal with the Accession Partnership, the timetable for implementing its priorities and outlining human and financial resource implications. Both the Accession Partnerships and the National Programme for the Adoption of the *Acquis* will be revised regularly to take account of progress made and to allow for new priorities to be set.

1. Accession Partnership: Assessment of short term priorities:

- **Economic reform:** review and update the country's medium-term economic policy priorities within the framework of the Europe agreement; advance structural reforms (particularly with regard to the health care system).
- **Reinforcement of institutional and administrative capacity:** in particular in the areas of veterinary and phytosanitary controls (particularly as regards facilities at the external borders) environment, customs policy internal financial control and regional development.
- **Internal Market:** including certification and standardisation (further alignment of legislative measures), state aids (adoption of legislative framework, definition of role and powers of monitoring authority, enforcement) and increased transparency through improvement of aid inventory. Enforcement of intellectual property rights and further alignment of company law. Complete alignment of public procurement legislation to cover fully utilities sector.
- **Justice and Home Affairs:** implementation of appropriate refugee legislation consistent with 1951 Geneva Convention, development of effective border management.
- **Environment:** continue transposition of framework legislation, establishment and commencement of implementation of detailed approximation programmes and implementation strategies related to individual acts. Planning and commencement of implementation of these programmes and strategies.

Progress concerning the short term priorities of the Accession partnership can be summarised as follows:

- **Economic reform:** progress has been made in this area. The mass privatisation scheme has been completed and a new pension system was introduced as from 1 January 1998. Since the beginning of 1998 branches of foreign credit institutions are allowed to operate in the Hungarian banking sector, subject to a license from the State Financial and Capital Market Commission. In the field of trade policy Hungary has eliminated all trade-related charges, except some customs duties which, in accordance with the EA, are due to be progressively abolished until 1.1.2001.
- **Reinforcement of institutional and administrative capacity:** as regards veterinary and phytosanitary controls, Hungary has an elaborated basic infrastructure comprising 20 Animal Health and Food Control Stations and a National Institute for Agricultural Quality Control. The office in charge of internal financial control, the State Audit Office seems to have the basic institutional and administrative capacity, although efforts to align Hungarian audit standards to those of the EU need to be maintained. This is not the case for regional development, where substantial institutional strengthening is necessary.
- **Internal Market:** progress has been made in the adoption of a new Companies act, together with the Companies Registration Act. Some progress regarding the enforcement of intellectual property rights can also be noted although some issues still have to be resolved. Legislation has been adopted on pharmaceutical and industrial products, thus confirming that the pace of adoption in these areas has been maintained. On the other hand Hungary failed to align its public procurement legislation with respect to the utilities sector. Progress continued in the area of certification and standardisation, although it was rather slow and should be accelerated. Substantial efforts are still required to strengthen the State monitoring authority.
- **Justice and Home Affairs:** a new law on asylum has extended the right of asylum to non-European refugees, lifting the geographical reservation of the Geneva Convention. Despite some positive developments border management needs further strengthening over the coming years.
- **Environment:** a National Environmental Protection Programme was adopted, but law harmonisation was rather slow and only four major laws have been adopted over the last year.

Hungary has not fully addressed all of the Accession Partnership short term priorities. While an effort was made to address priorities in the economic reform area (completion of mass privatisation, introduction of a new pension system), in the reinforcement of institutional and administrative capacity in certain sectors (veterinary and phytosanitary controls, financial control) and in justice and home affairs, Hungary did not adequately address certain priorities in the areas of internal market (copyright legislation, full alignment of public procurement legislation, improved state aid monitoring) and regional development.

2. National Programme for the Adoption of the *Acquis* Assessment

In response to the Accession Partnership the Hungarian Government has adopted the National Programme for the Adoption of the *Acquis* on 26 March 1998 and presented it on 30 March 1998. The National Programme for the Adoption of the *Acquis* follows a similar structure to the Commission's Opinion, but the identification of priorities is not the same as in the Accession Partnership.

Some short-term priorities in the Accession Partnership (e.g. Public Procurement) are medium term priorities in the National Programme for the Adoption of the *Acquis*. Other medium term priorities of the Accession Partnership are short-term tasks in the National Programme for the Adoption of the *Acquis* (e.g. agriculture, Justice and Home Affairs). Some Accession Partnership priorities such as those dealing with the Roma and those relating to employment and labour market, are not covered in the National Programme for the Adoption of the *Acquis*. Others are dealt with in a less precise manner. For example, the chapter on Justice and Home Affairs, the section on 'fight against organised crime', lacks specific details on sub-fields (e.g. money laundering, drugs and trafficking in human beings). There are few details on visa policy and admission provisions for immigrants and nothing on corruption. In the transport chapter the areas of combined transport and rail are not sufficiently covered.

The National Programme for the Adoption of the *Acquis* does not cover the full *acquis*. In most areas the information is incomplete, and no link is drawn between the proposed Hungarian measures and the respective *acquis*. Weaknesses in particular have been identified in the chapter on the Single Market, telecommunication, sectoral policies (energy, agriculture, transport, industry), environment protection and consumer protection.

Although the National Programme for the Adoption of the *Acquis* differentiates between short- and long-term priorities, a systematic and precise time schedule envisaged for the implementation of the foreseen measures is lacking. In some areas, such as single market and environment, the time frame provided seems unrealistic.

Information on implementation structures is poor and the administrative implications of the adoption of the *acquis* need to be further elaborated. Detailed plans are only presented for a few cases.

As there is no indication of human resources requirements in the National Programme for the Adoption of the *Acquis*, the programme does not allow for the definition of concrete actions in the area of institution building.

No reference is made to the budgetary implications of the adoption of the *acquis*, neither in relation to the national budget nor to Phare.

The Hungarian Government has indicated that it will revise the document. On basis of the revised text the Commission will take a position on the document which it will communicate to the Council during the second semester of 1999 on the occasion of the re-examination of the Accession Partnership.

Annex

STATISTICAL DATA

STATISTICAL DATA

	1993	1994	1995	1996	1997
Basic data	in 1000				
Population (end of period)	10277	10246	10212	10174	10135
	in 1000 hectares				
Total Area	9303	9303	9303	9303	9303
National Accounts	in Bn Forint				
Gross Domestic Product at current prices	3548.3	4364.8	5614.0	6893.9	8372.2
	in Bn ECU				
Gross Domestic Product at current prices	33.0	34.9	34.1	35.6	39.6
	in ECU per capita				
Gross Domestic Product at current prices	3200	3400	3300	3500	3900
Structure of Production	in % of Total Gross Value Added				
- Agriculture	:	:	6.7	:	:
- Industry	:	:	26.3	:	:
- Construction	:	:	4.6	:	:
- Services	:	:	62.4	:	:
Structure of expenditure	as % of Gross Domestic Product				
- Final consumption expenditure	:	:	77.3	74.2	72.6
- household and NPISH	:	:	53.8	52.2	51.2
- general government	:	:	23.6	22.0	21.4
- Gross fixed capital formation	:	:	20.0	21.4	22.3
- Exports of goods and services	:	:	37.3	38.9	46.4
- Imports of goods and services	:	:	38.5	39.9	46.9
	% change over the previous year				
Gross Domestic Product	-0.6	2.9	1.5	1.3	4.4
	in Purchasing Power parities				
Gross Domestic Product per capita	7100	7600	7800	8300	8900
Inflation rate	% change over the previous year				
Consumer Price Index	22.5	18.8	28.2	23.6	18.3
Balance of payments	in millions of ECU				
-Exports of goods	6933	6429	9835	11171	:
-Imports of goods	10367	9553	11695	13259	:
-Trade balance	-3434	-3124	-1860	-2089	:

-Services, net	184	134	491	1179	:
-Income, net	-1016	-1182	-1379	-1147	:
-Net current transfers	626	765	810	725	:
-of which government transfers	18	11	10	-12	:
-Current account balance	-3640	-3408	-1938	-1330	:
-Reserve assets (incl. gold)	6109	5571	9203	7847	7703
-Reserve assets (excl. gold)	6069	5536	9170	7817	7676
Public Finance	in % of Gross Domestic Product				
General Government Deficit/Surplus	:	:	:	:	:
Gross foreign debt	67.2	63.4	65.1	63.1	:
	1993	1994	1995	1996	1997
Financial indicators					
Monetary Aggregates	in Bn ECU				
- M1	8	7.1	5.7	6	6.8
- M2	15.7	14.5	12.9	13.8	15.6
- Total credit	31.9	30.9	26	24.6	25.3
Average short-term interest rates	% per annum				
- Lending rate	25.4	27.4	32.6	27.3	21.8
- Deposit rate	15.7	20.3	24.8	20.6	17.6
ECU exchange rates	(1ECU=..National currency)				
- Average of period	107.65	135.61	164.55	193.74	211.65
- End of period	112.35	136.73	183.3	206.91	224.71
- Effective exchange rate	71.1	58.9	45.7	40.7	36.7
Foreign Trade	in millions of ECU				
Imports	10701	12240	11824	14289.4	18724.2
Exports	7607	9000	9837	12367.8	16842.4
Balance	-3094	-3240	-1987	-1921.6	-1881.8
	corresponding period of the previous year = 100				
Terms of trade	102.3	102.3	101.3	97.7	101.2
	as % of total				
Imports with EU-15	40.1	45.3	61.5	62.3	62.8
Exports with EU-15	46.5	51	62.8	69.7	71.2
Demography	per 1000 of population				
Natural growth rate	-3.2	-3.0	-3.3	-3.7	:
Net migration rate	0.0	0.0	0.0	0.0	:

	per 1000 live-births				
Infant mortality rate	12.5	11.5	10.7	10.9	10.0
	at birth				
Life expectancy : Males	64.5	64.8	65.3	66.1	66.5
Females	73.8	74.2	74.5	74.7	75.0
	in % of labour force				
Labour market					
Economic Activity rate (ILO methodology)	59.2	57.1	55.9	55.6	55
Unemployment rate (ILO methodology) :	11.3	10.2	9.5	9.2	8.1
Total					
< 25 years	19.2	17.6	16.6	15.7	13.9
> 25 years	9.8	8.7	8.2	8	7
	in % of total				
Average employment by NACE branches (LFS)					
- Agriculture and Forestry	:	:	:	8.3	7.9
- Industry	:	:	:	26.6	27.1
- Construction	:	:	:	6	6
- Services	:	:	:	59.1	59
	in Km per 1000 Km2				
Infrastructure					
Railway network	83	83	83	83	83
	in km				
Length of motorways	:	:	293	336	:
	previous year = 100				
Industry and Agriculture					
Industrial production volume indices	104	109.6	104.6	103.4	111.1
Gross agricultural production volume indices	90.3	103.2	102.6	106.3	99.4

Methodological Notes

Gross domestic Product per capita in PPS: Revised data using the new PPP results from the 1996 International Comparison Project.

Reserve assets: are end-year stock data. They are defined as the sum of central bank holdings of gold, foreign exchange, and other (gross) claims on non-residents. Gold is valued at end-year market price.

General government deficit / surplus: is an approximation of the national accounts definition, derived from data based on the IMF's GFS (government finance statistics) methodology. The general government deficit / surplus is obtained by adding the central government deficit / surplus (normally including certain extra-budgetary funds) to the local government deficit / surplus. The total is adjusted for net lending / borrowing for specific policy purposes, which is a financing item in the national accounts.

Monetary aggregates: are end-year stock data. M1 generally means notes and coin in circulation plus bank sight deposits. M2 generally means M1 plus savings deposits plus other short-term claims on banks. Total credit generally means domestic credit to the government and private sectors. It should be noted that the problem of measuring the circulation of foreign currency in some Applicant Countries may affect the reliability of the data.

Interest rates: Annual average rates. Lending rates generally consist of the average rate charged on loans granted by reporting banks. Deposit rates generally refer to average demand and time deposit rates.

Exchange rates: Where available, the ECU exchange rates are those officially notified to DG II. The effective exchange rate index is weighted by major trading partners, with a base year of 1990.

Imports and exports (current prices): The data is based upon the "special trade" system, according to which, external trade comprises goods crossing the customs border of the country. Trade data excludes direct re-exports, trade in services as well as licenses, know-how and patents. Since 1997, trade data includes trade between industrial customs free zones and foreign markets. Since 1997 also, operative leasing and repair are excluded from external trade turnover. The data for 1996 were recalculated according to the methodological changes in 1997. The data for periods up to 1996 are published in the original content, therefore they are not comparable with the data of 1996 and 1997. Value of external trade turnover includes the market value of the goods and the additional costs (freight, insurance etc.).

Trade Classification: Until end of 1996, the recording of merchandise trade occurred by two types of classification in parallel: the Hungarian External Trade Classification (KTJ) and the Harmonised Commodity Description and Coding System (HS) nomenclature. The customs documentation is the statistical data source of external trade turnover. Since 1996, the data are collected according to the Combined Nomenclature. The earlier data are updated on the basis of the later processing.

Imports are recorded on CIF basis and are captured on the date of custom clearance. Exports are recorded on FOB basis and are captured with the date on which the commodities cross the state border.

Eurostat has converted the National Currency to the US dollar by applying the International Monetary Fund annual average exchange rates.

Terms of trade: “Unit value” index calculation is used for measuring price changes in external trade, with the exception of heterogeneous commodity groups, where the sample method is applied for the price observation. Since the I quarter of 1996 due to the modifications in the calculation of unit value indices and the application of Fisher indices instead of Paasche indices, the quarterly volume indices have been changed.

Imports and exports with EU-15: Data declared by the Hungary. Data for years 1993 and 1994 refer to trade with EU-12 only.

Economic activity rate (ILO Methodology): - Percentage of labour force in total population aged 15+.

Unemployment rate (by ILO methodology): - Percentage of the unemployed labour force.

These rates are derived from LFSS (Labour Force Sample Survey) observing the following ILO definitions and recommendations:

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

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

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

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

Average employment by NACE branches (LFS): This indicator is derived from LFSS (Labour Force Sample Survey) observing the ILO definitions and recommendations.

Industrial production volume indices: Industrial production covers mining and quarrying, manufacturing and electricity, gas, steam and water supply (according to the NACE Rev.1 Classification Sections C,D,E).

Index of total industrial production and industrial sales includes the data of all industrial enterprises. The indices by branches refer to enterprises with more than 20 employees up to the end of 1994 and with more than 10 employees since 1995.

Gross agricultural production volume indices: Chain indices were calculated using the fixed price basis applied for national accounts. The prices that serve as fixed basis in the calculations are:

- Until 1996: prices of 1991
- For 1997: prices of 1995

Sources

Basic data, National Accounts, Foreign trade, Demography, Labour market, Infrastructure, Industry and Agriculture : New Cronos.

Reserve assets and Financial indicators : Where possible Eurostat B-4's questionnaire on monetary and financial statistics has been used as the source. Applicant Countries are asked to supply regularly an update of tables contained in the questionnaire. The statistics covered include foreign official reserves, monetary aggregates, interest rates, and exchange rates. Failing this, the IMF's 'International Financial Statistics' publication has been used as the source. The European Commission (DG II) is used as the source for exchange rates against the ECU, where possible

Concerning gross foreign debt, the OECD External Debt Statistics publication has been used as the source.

Concerning general government deficit / surplus, Applicant Countries are presently unable to provide reliable data. Unit B-4 is working closely with these countries with the aim of improving their national accounts based government finance statistics. Given the lack of reliable data, an approximation for general government deficit / surplus is derived from the IMF's Government Finance Statistics Yearbook (for an explanation of methodology, see below).