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ON

HUNGARY'S

PROGRESS TOWARDS ACCESSION

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Table of contents

A. Introduction.....	8
a) Preface	8
b) Relations between the European Union and Hungary	10
Recent developments under the Europe Agreement, including bilateral trade	10
Accession Partnership.....	11
Action Plan for reinforcing administrative and judicial capacity	11
National Programme for the Adoption of the Acquis.....	12
Community Assistance	12
Twinning.....	16
Negotiations	17
B. Criteria for membership	18
1. Political criteria	18
Introduction.....	18
Recent developments	19
1.1. Democracy and the rule of law	20
The parliament	20
The executive	20
The judicial system	22
Anti-corruption measures	25
1.2. Human rights and the protection of minorities	27
Civil and political rights	27
Economic, social and cultural rights.....	29
Minority rights and the protection of minorities.....	30
1.3. General evaluation	33
2. Economic criteria	34
2.1. Introduction	34
2.2. Summary of economic developments since 1997	34
2.2. Assessment in terms of the Copenhagen criteria.....	39
The existence of a functioning market economy	39
The capacity to cope with competitive pressure and market forces within the Union.....	44
2.3. General evaluation	48
3. Ability to assume the obligations of membership	49
Introduction.....	49
3.1. The chapters of the <i>acquis</i>	52
<i>Chapter 1: Free movement of goods.....</i>	52
Progress since the last Regular Report.....	52
Overall assessment.....	53

Conclusion	54
Chapter 2: Free movement of persons	55
Progress since the last Regular Report.....	55
Overall assessment.....	56
Conclusion	56
Chapter 3: Freedom to provide services	57
Progress since the last Regular Report.....	57
Overall assessment.....	58
Conclusion	59
Chapter 4: Free movement of capital.....	59
Progress since the last Regular Report.....	59
Overall assessment.....	60
Conclusion	60
Chapter 5: Company law.....	61
Progress since the last Regular Report.....	61
Overall assessment.....	61
Conclusion	62
Chapter 6: Competition policy	63
Progress since the last Regular Report.....	63
Overall assessment.....	63
Conclusion	64
Chapter 7: Agriculture	64
Progress since the last Regular Report.....	64
Overall assessment.....	69
Conclusion	72
Chapter 8: Fisheries	72
Progress since the last Regular Report.....	72
Overall assessment.....	73
Conclusion	73
Chapter 9: Transport policy	74
Progress since the last Regular Report.....	74
Overall assessment.....	75
Conclusion	76
Chapter 10: Taxation	77
Progress since the last Regular Report.....	77
Overall assessment.....	78
Conclusion	78
Chapter 11: Economic and Monetary Union.....	79
Progress since the last Regular Report.....	79
Overall assessment.....	79
Conclusion	80
Chapter 12: Statistics.....	80
Progress since the last Regular Report.....	80
Overall assessment.....	81
Conclusion	82

Chapter 13: Social policy and employment.....	82
Progress since the last Regular Report.....	82
Overall assessment.....	84
Conclusion	86
Chapter 14: Energy	86
Progress since the last Regular Report.....	86
Overall assessment.....	88
Conclusion	90
Chapter 15: Industrial policy.....	90
Progress since the last Regular Report.....	90
Overall assessment.....	91
Conclusion	91
Chapter 16: Small and medium -sized enterprises.....	92
Progress since the last Regular Report.....	92
Overall assessment.....	93
Conclusion	93
Chapter 17: Science and research	94
Progress since the last Regular Report.....	94
Overall assessment.....	94
Conclusion	95
Chapter 18: Education and training.....	95
Progress since the last Regular Report.....	95
Overall assessment.....	96
Conclusion	96
Chapter 19: Telecommunications and information technologies.....	96
Progress since the last Regular Report.....	96
Overall assessment.....	97
Conclusion	98
Chapter 20: Culture and audio-visual policy	98
Progress since the last Regular Report.....	98
Overall assessment.....	99
Conclusion	99
Chapter 21: Regional policy and co-ordination of structural instruments	100
Progress since the last Regular Report.....	100
Overall assessment.....	101
Conclusion	102
Chapter 22: Environment	103
Progress since the last Regular Report.....	103
Overall assessment.....	105
Conclusion	107
Chapter 23: Consumers and health protection	108
Progress since the last Regular Report.....	108
Overall assessment.....	109
Conclusion	110
Chapter 24: Co-operation in the field of justice and home affairs	110

Progress since the last Regular Report.....	110
Overall assessment.....	114
Conclusion	117
<i>Chapter 25: Customs union</i>	<i>117</i>
Progress since the last Regular Report.....	117
Overall assessment.....	118
Conclusion	118
<i>Chapter 26: External relations</i>	<i>119</i>
Progress since the last Regular Report.....	119
Overall assessment.....	120
Conclusion	121
<i>Chapter 27: Common Foreign and Security Policy.....</i>	<i>121</i>
Progress since the last Regular Report.....	121
Overall assessment.....	122
Conclusion	123
<i>Chapter 28: Financial control</i>	<i>123</i>
Progress since the last Regular Report.....	123
Overall assessment.....	124
Conclusion	126
<i>Chapter 29: Financial and budgetary provisions</i>	<i>126</i>
Progress since the last Regular Report.....	126
Overall assessment.....	127
Conclusion	128
3.2. Translation of the <i>acquis</i> into the national languages.....	128
3.3. General evaluation	129
C. Conclusion	133
D. Accession Partnership and Action Plan for strengthening administrative and judicial capacity: Global assessment	137
Political criteria.....	138
Economic criteria.....	139
Ability to assume the obligations of membership.....	139
Annexes	146
<i>Human Rights Conventions ratified by the Candidate Countries, 15 September 2002</i>	<i>147</i>
<i>Statistical data.....</i>	<i>148</i>

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 with preparations for membership, and that it would submit its first Report at the end of 1998.

The Luxembourg European Council 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 Eastern European applicant State towards accession in the light of the Copenhagen criteria, in particular the rate at which it is adopting the Union *acquis* [...] The Commission’s reports will serve as the 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.”

On this basis, the Commission presented a first series of Regular Reports in October 1998, a second in October 1999, a third in November 2000, and a fourth in November 2001.

In its 2001 Enlargement Strategy Paper, which accompanied the 2001 Regular Reports, the Commission indicated that, given the pace of negotiations and the progress made so far, the Commission should be able to make recommendations on those candidate countries ready for accession on the basis of its 2002 Regular Reports. At its meeting in Seville in June 2002, the European Council concluded that “in order to enable the European Council to be held in the coming autumn to decide which will be the candidate countries with which negotiations can be concluded at the end of 2002, [...] the Commission will have to draft appropriate recommendations in the light of the Regular Reports.” The Commission has prepared this fifth series of Regular Reports with a view to the Brussels European Council in autumn 2002.

The structure followed for this Regular Report is largely the same as that used for the 2000 and 2001 Regular Reports. In line with previous Regular Reports, the present Report:

- describes the relations between Hungary and the Union, in particular in the framework of the Association Agreement;
- analyses the situation in respect of the political criteria set by the 1993 Copenhagen European Council (democracy, rule of law, human rights, protection of minorities);
- assesses Hungary’s situation and prospects in respect of the economic criteria defined by the Copenhagen European Council (a functioning market economy and the capacity to cope with competitive pressures and market forces within the Union);

- addresses the question of Hungary's capacity to assume the obligations of membership, that is, the *acquis* as expressed in the Treaties, the secondary legislation, and the policies of the Union. In this part, special attention is paid to nuclear safety standards, which were emphasised by the Cologne and Helsinki European Councils. This part includes not only the alignment of legislation, but also the development of the judicial and administrative capacity necessary to implement and enforce the *acquis*. The European Council stressed the importance of this latter aspect at its meeting in Madrid in 1995 and on a number of subsequent occasions, most recently at Seville in June 2002. At Madrid, the European Council stressed that the candidate countries must adjust their administrative structures, so as to create the conditions for the harmonious integration of these States. The Seville European Council also stressed how important it was that candidate countries should continue to make progress with the implementation and effective application of the *acquis*, and added that candidate countries must take all necessary measures to bring their administrative and judicial capacity up to the required level.

This Report takes into consideration progress since the 2001 Regular Report. It covers the period up to 15 September 2002. In some particular cases, however, measures taken after that date are mentioned. It looks at whether planned reforms referred to in the 2001 Regular Report have been carried out, and examines new initiatives. In addition, this Report provides a global assessment of the overall situation for each of the aspects under consideration, setting out for each of them the main steps still to be taken by Hungary in preparing for accession.

Furthermore, in view of the fact that the 2002 Regular Reports will provide the basis on which the Commission will formulate its recommendations as to which countries are ready to conclude negotiations, this Report includes an evaluation of Hungary's track record since the 1997 Opinion. As regards the economic criteria, the report also provides a dynamic, forward-looking evaluation of Hungary's economic performance.

For each of the negotiating chapters, this Report provides a summary evaluation of the extent to which commitments made in the negotiations have been implemented, as well as an overview of transitional arrangements that have been granted. The commitments made by each country reflect the result of the accession negotiations, and, in accordance with the principle of differentiation underlying the negotiation process, may differ between countries. Where negotiating countries have committed themselves to completing specific measures by the time of accession, the Commission assesses the relevant preparatory processes. For chapters on which the accession negotiations continue, and final commitments remain to be defined, an indicative assessment is given of the state of implementation of the commitments that have been made to date.

The Report contains a separate section examining the extent to which Hungary has addressed the Accession Partnership priorities. This section also assesses the progress Hungary has made in implementing the measures set out in the Action Plan for strengthening administrative and judicial capacity that the Commission developed with each negotiating country in the spring of 2002.

As has been the case in previous Reports, "progress" has been measured on the basis of decisions actually taken, legislation actually adopted, international conventions actually ratified (with due attention being given to implementation), and measures actually implemented. As a matter of principle, legislation or measures, which are in various

stages of either preparation or parliamentary approval, have not been taken into account. This approach ensures equal treatment for all the candidate countries and permits an objective assessment of each country in terms of their concrete progress in preparing for accession.

The Report draws on numerous sources of information. The candidate countries have been invited to provide information on progress made in preparations for membership since the publication of the last Regular Report. The information each of the candidate countries has provided within the framework of the Association Agreement and the negotiations, the National Programmes for the Adoption of the Acquis where they are available, as well as the process of developing the Action Plans, and various peer reviews that have taken place to assess candidate countries' administrative capacity in a number of areas, have served as additional sources. Council deliberations and European Parliament reports and resolutions¹ have been taken into account in the preparations. The Commission has also drawn on assessments made by various international organisations, and in particular the contributions of the Council of Europe, the OSCE and the international financial institutions, as well as those of non-governmental organisations.

b) Relations between the European Union and Hungary

Recent developments under the Europe Agreement, including bilateral trade

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

The Association Committee held its tenth meeting in May 2002, when it reviewed progress in Hungary's preparations for accession, notably in the light of the Accession Partnership priorities, and in bilateral relations under the Europe Agreement. The system of sub-committees continued to function well as a forum for technical discussions. The Joint Parliamentary Committee, comprising representatives of the Hungarian and European Parliaments, held its 17th meeting in February 2002 in Budapest.

In general, trade relations between the European Community and Hungary remain good and trade continues to expand. In 2001, EC imports from Hungary amounted to €24.1 billion, and EC exports to Hungary to € 23.6 billion. The EC accounts for about 74% of Hungary's total exports and 58% of its imports. In 2001, the main product groups imported from the EC were machinery, followed by transport equipment and chemical products. Hungary's main exports to the EC for the same period were machinery, followed by transport equipment and textiles.

Under the agreement resulting from the first round of trade negotiations in the agriculture sector (adopted on an autonomous basis pending the conclusion of an Additional Protocol to the Europe Agreement), approximately 87% of EC agricultural imports from Hungary and 98% of EC agricultural exports to Hungary are duty-free or benefit from preferential rates (average trade figures 1998-2000).

Negotiations on a further round of liberalisation, covering more sensitive sectors, began at the end of 2001 and were concluded in April 2002. The result of this further round,

1 For the European Parliament the rapporteur is Mr Luis Queiro.

applicable as of July 2002, enhances the existing agricultural trade preferences between the parties and promotes the full or partial lifting of import duties, either within tariff quotas or for unlimited quantities, in sectors such as cereals, dairy products, beef and sheep meat. This new agreement also includes a commitment by the parties to remove export refunds for certain sectors.

In April 2002 the Association Council decided to further liberalise trade in processed agricultural products between the EC and Hungary, essentially through the mutual reduction of custom duties. The decisions came into force retroactively from January 2002.

An Additional Protocol to the Europe Agreement entered into force in January 2002. It provides for preferential conditions for trade between the EC and Hungary of certain fish and fishery products.

An anti-dumping proceeding concerning imports of hot-rolled coils originating, *inter alia*, in Hungary was initiated in December 2001.

In March 2002, in response to protectionist measures by the US, which greatly restricted access to their market and created the risk of considerable trade diversion, the EU initiated provisional safeguard measures, with *erga omnes* effect, on imports of certain steel products. The measures were partly confirmed in September 2002.

In September 2002 Hungary gave its approval to the Annex to the Protocol to the Europe Agreement on conformity Assessment and Acceptance of Industrial Products (PECA) on Good Laboratory Practice. Implementation will help remove barriers to the functioning of the internal market, as there will now be mutual recognition of good laboratory practice between Hungary and the Member States. Amended antitrust implementing rules under the Europe Agreement were adopted by the Association Council and entered into force in Hungary in April 2002.

Hungary has adopted legislation in July 2002 to bring motorway construction under standard public procurement rules. The alignment of Hungarian legislation with EC rules on public procurement in general is expected to be completed in the course of this year.

Accession Partnership

A revised Accession Partnership was adopted in January 2002. Its implementation is reviewed in Part D of this Report.

Action Plan for reinforcing administrative and judicial capacity

As announced in the Commission's 2001 Enlargement Strategy, in spring 2002 the Commission and Hungary jointly developed an Action Plan to strengthen Hungary's administrative and judicial capacity, on which a common understanding was reached in March. The revised Accession Partnership adopted in January has served as the point of departure for this exercise.

The purpose of this Action Plan is jointly to identify the next steps required for Hungary to achieve an adequate level of administrative and judicial capacity by the time of accession, and ensure that all necessary measures in this regard are taken, providing

Hungary with targeted assistance in areas that are essential for the functioning of an enlarged Union. As such, the Action Plan is a key tool for meeting the common objective of the EU and Hungary, i.e. to ensure that Hungary's preparations for accession take place as effectively as possible within the planned timeframe.

The implementation of the Action Plan is reviewed in Part D of this Report.

National Programme for the Adoption of the Acquis

In March 2002 the Hungarian Government adopted the revised National Programme for the Adoption of the Acquis (NPAA). This has served as one of the bases for the preparation of the Action Plan for reinforcing Hungary's administrative and judicial capacity.

Community Assistance

Three **pre-accession instruments** have been financed by the European Community to assist the applicant countries of Central and Eastern Europe with their pre-accession preparations: the **Phare** programme; **SAPARD**, which provides aid for agricultural and rural development; and **ISPA**, which finances infrastructure projects in the fields of environment and transport. The support provided by these programmes is focused on the Accession Partnership priorities, which are intended to help the candidate countries meet the criteria for membership.

For the years 2000 to 2002, total financial assistance to Hungary amounts to around € 96 million annually from Phare, € 38.7 million from SAPARD and between € 72.8 million and € 104 million from ISPA.

The **Phare** programme has been providing support to the countries of Central and Eastern Europe since 1989, helping them through a period of fundamental economic and social transition and political change. Its current "pre-accession" focus was established in 1997, in response to the Luxembourg European Council's launching of the present enlargement process.

Phare provides the applicant countries of Central and Eastern Europe with support for institution building, investment to strengthen the regulatory infrastructure needed to ensure compliance with the *acquis*, and investment in economic and social cohesion. This support comprises co-financing for technical assistance, "twinning" and investment-support projects, to help these countries with their efforts to adopt the *acquis* and strengthen the institutions necessary for implementing and enforcing the *acquis*. Phare also helps the candidate countries develop the mechanisms and institutions that will be needed to implement Structural Funds after accession and is supported by a limited number of measures (investment and grant schemes) with a regional or thematic focus. In the context of the Action Plans for strengthening administrative and judicial capacity, particular emphasis is placed on the issue of institution building and associated investment intended to ensure compliance with the *acquis*. For 2002, the Commission has mobilised special financial assistance of up to € 250 million to accompany negotiating countries' efforts, over and above the indicative annual allocations for each of the Phare countries, bringing total Community assistance for strengthening the administrative and judicial capacity of the negotiating countries in 2002 to around € 1 billion.

The Phare programme allocated commitments of € 1.03 billion to Hungary during the 1992-1999 period, € 119.8 million in 2000, and € 108.8 million in 2001.² The **2002 Phare Programme** for Hungary consists of an allocation of € 87 million for the National Programme, complemented by € 24.7 million under the Phare 2002 supplementary institution building facility. The 2002 Phare programme focuses on the following priorities:

- developing of administrative capacity in sectors including agriculture, social policy and employment, regional policy, the environment, justice and home affairs, and customs;
- establishing capacity for the efficient use of future Structural Funds assistance;
- participation in Community programmes and agencies.

An additional € 19 million have been allocated for cross-border co-operation programmes (CBC), whereof € 10 million for co-operation with Austria, € 5 million for co-operation with Romania, € 2 million for co-operation with Slovakia and € 2 million for co-operation with Slovenia.

Hungary also participates in and benefits from Phare-funded multi-country and horizontal programmes, such as TAIEX, the Small- and Medium-sized Enterprises Facility, SIGMA and the nuclear safety programme.

Furthermore, Hungary participates in the following Community programmes: fifth Framework Research Programme (including Euratom), Leonardo da Vinci, Socrates, Youth, the Multi-annual Programme for Enterprises and Entrepreneurship, Culture 2000, Life III and Fiscalis. Following the ratification and entry into force of the agreement, Hungary's formal participation in the European Environment Agency started in January 2002. In order to streamline Community legal procedures and thereby facilitate Hungary's future participation in Community programmes, a Framework Decision was adopted in December 2001 by the Association Council establishing the general principles for such participation.

Overall, the impact of Phare has been positive. Effective transfer of know-how, equipment and financial resources has taken place in a number of important fields such as agriculture, aid co-ordination, education, trade and investment promotion, transport and the environment. Phare support for the environment, privatisation and restructuring and SME development has contributed to the successful development of sector strategies and essential institutional and financial mechanisms serving enterprises in these sectors

For example, in Hungary, Phare has played a particularly important role in the following:

- In the **justice and home affairs sector**, € 30.3 million was allocated between 1997 and 2001 to purchase surveillance equipment such as patrol boats, mobile thermal camera systems and radio communication equipment in order to step up the fight against cross-border crime and prevent illegal immigration, particularly at Hungary's southern and eastern borders. This investment was complemented by twinning

2 These figures include an allocation for Cross-Border Co-operation (CBC) Programmes of €19 million in 2000, and €19 million in 2001.

operations aimed at strengthening border management systems and training officials (€ 3.9 million since 1997). The 2002 programme also includes a (€ 6 million) project for establishing an information system in line with Schengen requirements.

- **Support for the Roma minority** has been a priority of the Phare programme since 1999. Several projects have been carried out to promote the social integration of the Roma population in Hungary, by reducing the primary school drop out rate and focusing on supportive schooling and on vocational training at the level of secondary education. Practical support was provided by renovating two dormitories in a school for exceptionally able Roma pupils and by providing 17 school buses. The Phare contribution to these projects amounted to € 7 million;

In the social and employment sector, in response to a need identified during the negotiations, a twinning project is being financed under the 2001 National Programme (€ 2 million) to strengthen "autonomous" social dialogue. The objective is to help establish of a functioning social dialogue system by complementing the existing tripartite social dialogue structures with more independent bipartite channels. The project supports the creation of sectoral committees that will not only provide the social partners with the opportunity to exert influence on domestic issues but will also prepare them for participation in similar sectoral structures at European level.

- In the area of regional policy, Phare has provided considerable support since 1998, both for institution building through twinning projects and for pilot investment projects. As a result, under Phare 2002, the Commission and the Hungarian Government have agreed on a comprehensive two-year framework (2002 – 2003) for programming, implementing and monitoring Structural Fund-type measures as a precursor to actual implementation of the Structural Funds. This scheme, with an approved Phare contribution of € 41.5 million in 2002 and a planned contribution of over € 70 million in 2003, will be co-financed by Phare and the Hungarian Government.

The 2000 Phare Review confirmed the accession-driven approach and emphasised the importance of helping countries to prepare for the Structural Funds. The trends introduced in 1997 have continued, with an increased role for Commission Delegations, further streamlining of procedures and increasing emphasis on raising the verifiable and quantifiable impact of Phare projects on institution building, investment in compliance with the *acquis* and economic and social cohesion.

The Review also provided for the possibility of further decentralisation of Phare management, by waiving the requirement for *ex ante* approval by the Commission Delegations for tendering and contracting. For this to be possible, strict pre-conditions covering programme management, financial control and structures regarding public finance must be met. An extended decentralised implementation system (EDIS) should be put in place for each negotiating country at the latest by the time of accession. High Level Working Groups are being established for each country to oversee this process, along with other key procedural steps in the run up to accession.

The Hungarian **SAPARD** programme was approved by the Commission in October 2000. The indicative allocation for SAPARD in Hungary for 2002 is € 39.8 million at 2002 prices (allocation 2001: € 39.4 million at 2001 prices).

The programme is based on two major priorities, namely improvement of the agricultural sector and processing industry's competitiveness, focusing on environmental protection aspects, and the enhancement of capacities for adaptation in rural areas (renovation and development of villages, diversification of activities, development and improvement of rural infrastructure).

The Multi-annual Financing Agreement (MAFA), setting out the rules for implementing SAPARD, and the *Annual Financing Agreement (AFA)* setting out the Community financial commitment to Hungary for the year 2000, are both in force since June 2001.

The Commission agreed to the text of the AFA for 2001 in November 2001, which is still unsigned.

The following structures are responsible for the implementation of SAPARD; the National Fund, located within the Ministry of Finance administers SAPARD funds under the responsibility of the National Authorising Officer (NAO) and is responsible for the national accreditation of the SAPARD Agency; the Managing Authority is located within the Ministry of Agriculture and Regional Development (MARD); the SAPARD Agency is established within the Ministry of Agriculture and Regional Development and has got its own regional offices; the State Audit Office will act as the Certifying Body

The Hungarian authorities are proceeding with the preparation of their implementing and paying structures (SAPARD Agency and National Fund). No Community funds can be released until the Commission Decision conferring provisional management of aid to Hungary is taken.

A Monitoring Committee has been established by the Managing Authority and has met once.

The **ISPA** programming framework is governed by the national strategy papers, which the Hungarian authorities drew up in 2000 for transport and environment. The main transport objectives are: promotion of integration into the EU; improved co-operation with neighbouring countries; contribution to balanced regional development; protection of human life and the environment; and effective market-oriented transport regulations. For the environment, priority project areas for funding include waste management and waste water projects. The strategic objective for Hungary is to achieve sustainable development by integrating environmental protection considerations into all sectoral policies. The two priority areas for the first stage of ISPA financing (2000-2001) are water protection and municipal waste treatment. The priorities for the period 2000-2006 also include air quality.

For the years 2000 and 2001, the full (mid-range) allocation for Hungary has been committed, i.e. € 178.8 million (€ 88 million in 2000 and € 90.8 million in 2001). The allocation for 2002 is approximately € 93.9 million.

Nine environmental projects were approved in 2001: a technical assistance (TA) project for the implementation of urban waste water directives (€ 0.14 million), a further two TA measures for drinking and sewage water project preparation (€ 0.3 million and €1.1 million), a sewage network treatment project in Sopron (€ 9.3 million), an extension of the sewer system in Pecs (€ 10.8 million) and four solid waste collection systems in Miskolc, Tisza Lake, Mid-Danube-Tisza, and Sajo-Bodva (€ 32.15million). Two transport projects were approved in 2001: one providing TA for rail projects

(€1.5 million) and a road rehabilitation programme for achieving 11.5 tonnes load-bearing capacity on roads 3 and 35 (€ 20 million).

Two transport projects were presented for approval in 2002, addressing the rehabilitation of the Szolnok-Lökösháza railway line and the rehabilitation of roads 2, 6, 42, 47 and 56 for achieving 11.5 tonnes load bearing capacity. In the environmental field, five regional solid waste management systems are currently being approved, in South Balaton and the Sio valley area, in the regions of North Balaton, Homokhatsag, West Balaton and the Zala valley area, and in the north-east of Pest County. Further projects are in preparation.

A *Gap Assessment* has been carried out in preparation for the decentralisation process (EDIS).

Contracts have been signed for three projects in the transport sector. Tenders for the remaining projects under ISPA 2000 and 2001 are currently being launched or in preparation.

Twinning

One of the main challenges still facing the candidate countries is the need to strengthen their administrative and judicial capacity to implement and enforce the *acquis*. As of 1998, the European Commission began to mobilise significant human and financial resources to help them with this process, using the mechanism of twinning administrations and agencies. In 2001, the Commission strengthened this emphasis on institution building further, through the launch of the Action Plans for strengthening administrative and judicial capacity.

The twinning process makes the vast body of Member States' expertise available to the candidate countries through the long-term secondment of civil servants and accompanying short-term expert missions and training.

A total of 503 twinning projects were funded by the Community between 1998 and 2001. Between 1998 and 2000, these projects primarily targeted the main priority sectors identified in the Accession Partnerships: agriculture, the environment, public finance, justice and home affairs and preparation for the management of the Structural Funds. Since 2000, other important sectors of the *acquis* have also been addressed through twinning, such as social policy, the fight against drugs, transport, and telecommunications regulation. Twinning now covers all sectors pursuant to the *acquis*.

Thanks to the strong support of the EU Member States, 103 twinning partnerships were funded by Phare 1998, involving all the candidate countries and almost all the Member States. These first-generation projects have already come to an end. Under Phare 1999, a further 123 projects are currently being implemented and the programming exercise for Phare 2000 included a further 146 twinning projects. The 2001 programming exercise includes 131 twinning projects embracing all the Phare beneficiary countries, as well as Cyprus and Malta. Under the 2002 programming exercise, 119 twinning projects have already been planned and approved for implementation. A substantial number of additional twinning projects are planned and these should be approved and implementation launched before the end of 2002. They include twinning projects identified in the Action Plans for strengthening administrative and judicial capacity in the negotiating countries. It is estimated that around 300 twinning projects are operational throughout the candidate countries at any one time. Furthermore, the candidate countries

are being offered a further way of drawing on Member States' expertise through "Twinning light"; a mechanism to address carefully-circumscribed projects of limited scope, which emerge during the negotiation process as requiring adaptation.

For Hungary, 23 twinning projects were financed under the 1997, 1998 and 1999 Phare programmes; 22 of them have been completed. Eight additional projects, financed under Phare 2000, are currently being implemented. They provide assistance in the areas of agriculture, the environment, regional development, social policy, customs and the fight against drugs. 17 twinning projects financed under Phare 2001 have already started. They cover areas such as energy, market surveillance, agriculture, the social dialogue, the environment, justice and home affairs, traffic control, regional policy and the future management of the Structural Funds. Five "Twinning light" projects, also financed under Phare 2001, have been launched. Concerning the 2002 Phare programme, eight out of 12 twinning projects have already been approved by the Commission. Under the same programme, three "Twinning light" projects have already been identified, two of which have already been launched.

Negotiations

Since the opening of the accession negotiations, substantive discussions have been held on the individual chapters of the *acquis* and, by December 1999, negotiations on all chapters (except Chapter 30 – Institutions) had been initiated. The Institutions Chapter was opened in June 2002.

By 15 September 2002, the following 26 chapters had been provisionally closed: free movement of goods, free movement of services, free movement of capital, free movement of persons, company law, fisheries, transport policy, taxation, economic and monetary union, statistics, social policy and employment, energy, industrial policy, small and medium-sized enterprises, science and research, education and training, telecommunications and information technologies, culture and audio-visual policy, regional policy and co-ordination of structural instruments, environment, consumers and health protection, justice and home affairs, customs union, external relations, common foreign and security policy and financial control.

B. Criteria for membership

1. Political criteria

Introduction

The political criteria for accession to be met by the candidate countries, as laid down by the Copenhagen European Council in June 1993, stipulate that these countries must have achieved “stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities.”³

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

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

There are no major problems regarding observance of fundamental rights in the country. The rights of minorities are guaranteed and protected. Although some improvement is still needed, progress has been made in the form of measures recently taken by the government to ensure justice and protection for the Roma (gypsies). Efforts to combat corruption need to be made more effective.

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

In its 2001 Regular Report, the Commission found that:

“In its 1997 Opinion, the Commission concluded that Hungary fulfilled the political criteria. Since that time, the country has made considerable progress in further consolidating and deepening the stability of its institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. Over the past year, further efforts have been made in this direction. Hungary continues to fulfil the Copenhagen political criteria.

In the area of public administration reform, positive steps were taken with the introduction of a new legal framework increasing accountability and efficiency of the administration. In addition, better salaries and career possibilities have made the civil

3 In the meantime, through the entry into force of the Treaty of Amsterdam in May 1999, the political criteria defined at Copenhagen have been essentially enshrined as a constitutional principle in the Treaty on European Union. Article 6(1) of the consolidated Treaty on European Union reads: "The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms and the rule of law." Accordingly, Article 49 of the consolidated Treaty stipulates that "Any European State which respects the principles set out in Article 6(1) may apply to become a member of the Union." More recently, these principles were emphasised in the Charter of Fundamental Rights of the European Union, that was proclaimed at the Nice European Council in December 2000.

service more attractive. Efforts also continued in the area of training, which has become an important element of the career structure.

Within the judiciary, the overall efficiency of courts further improved after the introduction of additional measures in the area of institution building, notably the modernisation of IT systems, procedures, continued training and new staff. However, the continued overloading of the Supreme Court reduces its ability to provide guidance to lower courts and to unify the courts' practice. The scarce budgetary resources make it difficult to implement the remaining elements of the judicial reform.

The fight against corruption remained high on the political agenda and new legislation on asset declaration and more severe punishment was adopted to address the issue. Corruption however remains a problem, and the new measures would need to be implemented quickly to make the fight more effective.

As regards human rights and freedoms, progress can be reported with regard to asylum, where the situation considerably improved due to faster and better procedures and more appropriate reception facilities. However, there is a need to address police behaviour, notably with regard to reported cases of ill treatment. In the area of public service media, a solution needs to be found regarding the composition of the Supervisory Boards of Trustees.

New policy instruments and measures were adopted for the Roma minority. This process was accompanied by a significant increase of budgetary means for the further implementation of the medium-term action programme, already adopted by the Government in 1999. Support measures in 2001 mainly focused on the areas of education, employment, social policy, legal protection and culture. In this context, it will be important to enhance efforts to fight against widespread discrimination and to fully implement and enforce the legislation already in place. The Roma minority should also be given the possibility to participate more actively in public life.

Hungary had implemented the short- and medium-term priorities of the 1999 Accession Partnership priorities which related to the continued implementation of the medium-term action programme for the Roma and the increase of budgetary means for this purpose, as well as the further reform of public administration and of the judiciary."

The section below provides an assessment of developments in Hungary, seen from the perspective of the Copenhagen political criteria, including the overall functioning of the country's executive and its judicial system. Such developments are in many ways closely linked to developments regarding Hungary's ability to implement the *acquis*, in particular in the domain of justice and home affairs. Specific information on the development of Hungary's ability to implement the *acquis* in the field of justice and home affairs can be found in the relevant section (*Chapter 24 – Co-operation in the field of justice and home affairs*) of part B.3.1. of this report.

Recent developments

Following Parliamentary elections in April 2002, the former Centre-Right Government was replaced by a Socialist-Liberal Coalition. Participation in the elections was the highest ever. The elections were free and fair and in line with international standards and commitments on democratic elections.

Accession to the European Union has continued to be the key priority for the new Government and there remains consensus amongst all political parties in Parliament over accession.

1.1. Democracy and the rule of law

Hungary has achieved stability of institutions guaranteeing democracy and the rule of law. This was the conclusion of the 1997 Opinion and the subsequent Regular Reports, and has been confirmed by developments over the past year. This section focuses on the most significant developments since the last Regular Report.

The parliament

Parliament has continued to function smoothly and further progress has been made on legislative work with good overall results regarding alignment with the *acquis communautaire*.

Following the elections, a new legislative programme started in June 2002, with sessions every week instead of every third week. The new House is now composed of four political parties. As no extremist party passed the electoral threshold of 5%, none is represented in Parliament. The constitutional obligation to ensure direct parliamentary representation of minorities in a systematic manner remains unfulfilled. The Hungarian Constitutional Court had ruled in 1992 that the absence of such a system was unconstitutional. However, in the recent elections, four members of Parliament of Romani origin were elected via the national party lists.

The four Ombudsmen continued to fulfil their mandate in the areas of civil and political rights (the responsibility of the Ombudsman and his Deputy), national and ethnic minorities, education, data protection and freedom of information. The Ombudsmen are elected for six years by a two-thirds majority of votes in Parliament. The last vote took place in December 2001, when the Ombudsman for data protection was elected.

The Ombudsmen are responsible for investigating violations of constitutional rights and for initiating general or individual measures to remedy such violations. However, the Ombudsmen are not entitled to impose legal sanctions on perpetrators of infringements of constitutional rights.

Modifications to the Law on Ombudsmen came into force in December 2001, clarifying the scope for control. Thus, the Ombudsmen are entitled to control all governmental authorities, as well as a number of other organisations, such as the public service providers or public prosecutors.

The executive

In line with the 2001 reform of the legal framework for civil servants, further progress was made during the reference period to modernise the public administration and to enhance its professionalism. However, the issue of financing of local self-governments, referred to in previous Regular Reports, has not yet been addressed.

Implementation of public administration reform has continued according to schedule; the re-structuring of central public administration was already largely completed in 2000. The

main focus of the reform process was deconcentration (devolving official powers to lower-level organs of state administration), decentralisation (devolving official powers to organs outside the system of public administration) and deregulation (reviewing existing and planned legislative acts to simplify the legal system). Following the Parliamentary elections of April 2002, the portfolio of certain ministries was restructured and two new ministries were created (Ministry for Labour and Employment, the Ministry for Information Technology and Telecommunications), whereas two others were abolished (Ministry for Transport, Telecommunications and Water Management, Ministry for Social and Family Affairs).

Within the Hungarian public administration, the legality of administrative decisions and actions is ensured through judicial review (although there are no courts specialised in administrative law). Liability is institutional, not personal to the individual official. Appeals are brought against the administrative authority, not against the civil servant responsible for a decision, action or fault.

At the level of counties (of which there are 19, with Budapest also having county status), towns and villages, certain administrative tasks are assumed by the self-governments, which are elected every four years. The 3 158 local self-governments have, in particular, powers and rights in the areas of basic welfare services, such as social and health care, and education. Most of their revenues come from the central government budget, with predetermined distribution keys. The proportion of revenues at the free disposal of self-governments has fallen steadily since 1990 and currently represents only 5% of locally collected personal income taxes. As mentioned in previous Regular Reports, this situation has led over the years to a deterioration of the financial situation of self-governments. According to a 2001 report by the State Audit Office, one third of the self-governments need additional financial resources to carry out their increasingly wide range of tasks resulting from decentralisation. This problem has not been addressed over the last year. Concerning the overall administration, the following new measures have been taken during the reference period:

For the first time, by end-October 2001, senior civil servants had to declare their own assets and those of their relatives living in the same household. The declarations cover real estate property, savings, securities and company interests. Members of the Government, state secretaries and deputy state secretaries are obliged to make such declarations annually. The heads of ministerial divisions and departments, public notaries, officials with decision-making rights in public procurement cases and civil servants subject to national security checks have to present such documents once in every two years. The Government Control Office is responsible for monitoring the declarations and investigating questionable variations.

A system of performance appraisal of civil servants was introduced in January 2002 and the first staff reports are to be produced by the end of 2002. These will be used in setting the remuneration for the following year, which might be up to 20% higher or lower as a result.

To complete the reform, an Inter-Ministerial Committee on Public Administration was set up in February 2002 to produce an action plan based on the conclusions of the 2001 Regular Report and on the recommendations of the OECD report on the regulatory regime. The Hungarian Institute for Public Administration is in charge of implementing this action plan.

In spring 2002, 450 civil servants were appointed as senior civil service staff (300) and to law enforcement agencies (150). The appointments are part of a new scheme for civil servants – introduced by the Law on Civil Servants of June 2001 – aimed at making government more efficient, strengthening strategic planning skills and helping to prepare more efficiently for EU membership. Participants in the scheme were selected on the basis of a simple application. Minimum requirements were a university degree, civil servant status and a declaration of personal assets, but no professional track record was required. A committee of three experts did the pre-selection, and the Prime Minister took the final decision. Once appointed, the civil servants in question can be dismissed only in exceptional circumstances, and receive a particularly high salary. Their status is totally incompatible with any other remunerated activity or involvement in political matters. In July 2002, the selection criteria for the appointment of this special staff were made more transparent through an amendment to the law on civil servants.

Progress was made in preparing for e-government with the opening of an Internet portal. The portal aims at promoting a more effective use of data related to public administration, accessible to the public and enabling citizens to conduct their official affairs more quickly and more flexibly.

Following a complex review of the salary structure for the public service, the gap between earnings in the public and private sectors was further reduced: in January 2002 law enforcement officers received an increase of around 70%, while other civil servants received a further salary increase of 30% (which resulted for the latter in an overall increase of 70% from 2001 to 2003).

As part of the reform, training has continued to be a priority. The 2001 Law on Civil Servants introduced a compulsory specialist examination for promotion to management positions. So far, more than 16 000 civil servants have taken this examination under the supervision of the Institute of Public Administration.

The reform of the public administration at central level has nearly been completed. The 2001 Law on Civil Servants, of which parts entered into force in 2002, was an important step forward in the consolidation of the legal framework for civil servants. However, the introduction of the senior civil service scheme without fully transparent selection and appointment criteria has increased the scope for politicisation of the administration.

At the local level, the lack of sufficient financial resources puts the autonomy of the local administration at risk. The financial reform of local administration should be speeded up to allow the authorities to carry out their new additional tasks in the context of decentralisation and with a view to EU accession.

The judicial system

Several important steps have been taken over the past year to continue implementation of judicial reform. However, the budgetary resources available for this purpose remain limited.

The Code of Civil Procedure and the Code of Criminal Procedure regulate the jurisdiction and competence of courts.

Under the Constitution, the courts are responsible for the administration of justice, with the Supreme Court exercising control over the operation and judicial procedure of all other courts. There are three levels of courts. First instance jurisdiction in most matters rests with the local courts. Appeals against their rulings may be made to the county courts or to the Budapest Municipal Court, which in addition has first instance jurisdiction in a range of other matters, such as civil law cases with a minimum value of HUF 10 million (€40 000) and criminal law cases with a sentence up to life imprisonment. The Supreme Court is the final court of appeal and oversees the uniform application of the law by courts, while the Constitutional Court is in charge of constitutional matters. The Supreme Court also hears appeals against decisions by military courts.

A National Council of Justice makes judicial appointments, except to the Constitutional Court, and prepares each year the proposal for the budget for the administration of the judicial system.

The Constitutional Court is charged with reviewing the constitutionality of laws and statutes brought before it as well as the compliance of these laws with international treaties that the Government has ratified. Parliament elects, by a two-thirds majority, the 11 members of the Constitutional Court, who serve nine-year terms. The Constitutional Court operates to full strength. Citizens may appeal direct to the Constitutional Court if they believe that their constitutional rights have been violated.

Recruitment to the judiciary consists of several stages – clerkship, examinations, and probationary period – leading to final appointment. The President of the Republic appoints judges, on nomination by the National Council of Justice, for three years, after which they may be re-appointed for an indefinite period subject to an evaluation of their performance.

Besides being prevented from joining political parties or engaging in any political activity, judges do not have the right to be involved in business activities or to be members of an arbitration court. Furthermore, members of the Constitutional and Supreme Courts are not allowed to be members of Parliament or to be employed in local government. Since December 2001, judges are required to make asset declarations, which are collected and monitored by the National Council of Justice.

The remuneration of judges has progressively been raised over the years, but increases have remained below the annual inflation rate since 1998, resulting in a decrease in real terms. In order to remedy the situation, the Government has proposed to increase the basic salaries of judges by 50% as of January 2003.

The prosecution system is a centralised body within the judicial system and independent from government. The Prosecutor-General is the leader and supervisor of the system. He is elected by Parliament, on a proposal by the President of the Republic, for a six-year term. The Prosecutor-General is answerable only to Parliament, to which he reports on his activities. One of his tasks is to appoint prosecutors, who may not be members of political parties or pursue any political activity.

Trials are, in general, public. Defendants are in principle entitled to counsel during all phases of criminal proceedings and are presumed innocent until proven guilty.

Judicial proceedings are reasonably expeditious. The majority of proceedings at first instance are finished in less than one year.

During the reference period the following new developments can be reported.

In line with the constitutional requirements, a decision was taken in June 2002 to establish five Regional Courts of Appeal. These Courts will hear appeals from the county courts, currently heard by the Supreme Court. The introduction of this new tier of courts should reduce the backlog of cases before the Supreme Court and enable it to concentrate on its main functions, i.e. to guarantee the uniform application of law by courts and provide judicial guidance to lower courts, and to examine applications for the review of final judgements as extraordinary remedy. The five Regional Courts of Appeal will come into operation in July 2003 (Budapest, Pécs and Szeged) or 2004 (Győr and Debrecen). It is estimated that around 6 000 appeal cases will be immediately transferred to the Regional Courts from the Supreme Court. The decision to create a new tier of courts had been taken in 1997, but the Government postponed implementation for budgetary reasons. In November 2001, the Constitutional Court ruled that the failure to establish appeal courts violated the Constitution.

At the level of the Supreme Court new rules for the review of final judgements entered into force in January 2002, following the amendment of the Code of Civil Procedure. The new rules restrict the possibilities for the review of final judgements. Exceptional review may be submitted only if the judgement to be reviewed infringes legal provisions which vitally influenced the merits of the case, and if the case differs from the binding decisions of the Supreme Court on uniformity of interpretation of law, or if it is contrary to current judgement practice. This should reduce the number of requests for judicial review addressed to the Supreme Court, and thereby contribute to reducing the backlog of cases the Supreme Court faces at present.

In the prosecution system, a comprehensive structural reform was implemented during 2001 to address the fight against new forms of crime, in particular organised crime, economic and environmental crime, and corruption. The core elements of this reform were the establishment of a Central Investigation Office at the Budapest Metropolitan Public Prosecution Office, with nation-wide competence to investigate cases of national importance, and an increase of staff. The Chief Public prosecutor had been designated the Hungarian single contact point for EUROJUST.

At the beginning of 2002, a system of predefined distribution of cases was introduced for courts. This makes the order of the distribution of cases public and thus contributes to the transparency of court proceedings.

At the level of courts, the overall number of staff has continued to increase. At the end of the first quarter of 2002 the number of posts for judges was 2 604 (2 599 in April 2001). In addition, there were at that date 345 court secretaries (274 in 2001) and 470 junior clerks (453 in 2001).

The development of the Court Information System, which also provides access to Internet and on-line access to CELEX progressed and is now operational at 18 county courts, the Budapest Municipal Court, the Supreme Court, and the National Council of Justice. The system should be finalised by the end of 2002 and all 152 courts should be connected to the system,

The training of judges in Community law, which started in September 1999 with Community assistance, continued; by March 2002 1 872 of the 2 604 judges had received training and 60 judges had become national trainers.

As regards court infrastructure, technical facilities are still inadequate and judges have to spend a large part of their time on administrative matters connected with their cases. The new profession of “legal assistants”, created in 2001, should help to improve this situation, but so far there are not enough well-trained staff available to fill such posts.

Moreover, the budgetary resources of the judicial system remained limited. The annual budget proposal, prepared by the National Council of Justice, requires government approval. Over the last four years the Government regularly reduced the proposals of the National Council of Justice by about 40%; the judicial chapter of the central budget shrank from 2.6% in 1999 to 1.96% in 2002. As a consequence, it has not been possible to invest in buildings and information systems as planned, or to raise the number of judges and court staff in step with the growing caseload. To strengthen the financial independence of the judiciary, the Government has submitted a new law to Parliament in August 2002, which would empower the National Council of Justice to submit its proposal for the 2004 annual budget directly to Parliament.

There remains also room for improvement as regards the citizen’s access to justice in the context of the availability of legal aid (*see also under Civil and political rights*)

Overall, the constitutional and legislative guarantees of judicial independence are well-established in Hungary and the system of judicial self-administration functions efficiently. The decisions to introduce the Regional Courts of Appeal and to strengthen the judiciary’s financial independence are important steps as regards the improvement of the judicial capacity.

Anti-corruption measures

Surveys indicate that corruption continues to be a problem in Hungary. In line with the long-term anti-corruption strategy adopted in 2001, a number of new measures have been taken during the reference period.

Declarations of assets became compulsory for senior civil servants as from the end of October 2001 (*see above under The executive*).

In December 2001 this obligation was extended to the President of the Republic, judges, ombudsmen, chairman, vice-chairmen and controllers of the State Audit Office, chairman, vice-chairmen and employees of the National Bank, public notaries, mayors, members of local governments and other persons entitled to manage public properties. The first set of declarations of assets for these categories had to be submitted to the competent authorities within the first three months of 2002. They are subject to regular controls. As mentioned in last year's Regular Report, members of Parliament are also required to make asset declarations. These are regularly published in the Hungarian Official Journal.

The revised Law on Public Procurement adopted in November 2001 tightened up the surveillance of contract award procedures. Among other things, it introduced in particular an obligation to supply data related to the awarding of contracts concluded under public procurement procedures. In addition, the penalties for remedy procedures were differentiated according to the seriousness of the offence committed. The impact of the revised Law on tackling the problems of corruption in this area remains to be seen.

In December 2001 a new law was adopted concerning the liability of legal persons. Under this law, penalties may be imposed upon a legal person in respect of crimes committed by a natural person for the benefit of a legal person. The law will come into force upon Hungary's accession to the EU.

Within the amended Penal Code, which entered into force in April 2002, more severe punishments and sentences for bribery were introduced. Rules on the immunity of elected persons exercising public powers and those on the possible confiscation of property gained through contacts with organised crime were made more stringent. In order to apply more efficient measures against bribe-takers, bribe-givers may be exempted from punishment if they provide information to the authorities and help to identify the bribe-taker. Officials may now be punished if they fail to fulfil their obligation of reporting the case to the competent authorities.

With the entry into force in December 2001 of the new law on combating terrorism, on tightening the provisions to prevent money laundering and on the ordering of restrictive measures, measures to prevent and combat money laundering imposed stricter requirements on auditors, accountants, tax-advisers, real estate agents, traders of high-value moveable assets, and members of legal professions. These persons must also report any data, facts or circumstance indicating money laundering to the police. The scope of business secrecy – banking secrecy in particular – has been restricted (*see also chapter 4 - Free movement of capital*).

Practical measures revising the salary structure in the customs service, whereby salaries were increased and a bonus system introduced, should have a positive impact on problems of corruption in that area.

On the institutional side, the Ministry of the Interior and the Ministry of Justice share overall responsibility for the implementation of the anti-corruption strategy. In addition, several enforcement agencies such as police, tax administration, and customs authorities have now a special unit to detect corruption. The corruption cases of high-level authorities (Members of Parliament, Ministers, heads of public departments) are in the hands of a special department at the Prosecutor's Office, the Central Investigation Office.

Hungary is a party to the Council of Europe Convention on Money Laundering, Search, Seizure and Confiscation of the Proceeds from Crime; the Criminal Law Convention on Corruption, which entered into force in July 2002; and the OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions. Hungary has not yet signed the Council of Europe Civil Law Convention on corruption. It has concluded bilateral agreements of relevance for the fight against corruption with 45 countries. A further 17 bilateral agreements are under preparation.

Hungary is participating in the monitoring of anti-corruption measures effected by the OECD Working Group on Bribery in international commercial transactions, and is a member of GRECO, the Council of Europe Group of States against Corruption, which has made provisions in its statute for regular evaluation of its member countries. An evaluation of Hungary took place in October 2001, but the report has not yet been adopted by GRECO.

Despite these efforts, overall public perception of efforts to fight corruption has not really improved and many areas in the public sphere continue to have a bad reputation in this respect.

1.2. Human rights and the protection of minorities

Hungary continues to respect human rights and freedoms. This was the conclusion of the 1997 Opinion and the subsequent Regular Reports, and has been confirmed over the past year. The following section focuses on the most significant developments since the last Regular Report.

Hungary has acceded to most of the major human rights instruments (see annex). In May 2002, Hungary signed Protocol No 13 to the European Convention on Human Rights on the abolition of the death penalty in all circumstances.

Whilst the Constitution provides for equal treatment and protection against *discrimination*, Hungary does not yet have a unified law against discrimination. The current anti-discrimination legislation is fragmented, with provisions in, among others, the Laws on Labour, Public Education, Health Care and Minorities. Moreover, there is no comprehensive system to effectively enforce the implementation of anti-discrimination legislation. Thus, the majority of anti-discrimination provisions are not yet backed up by appropriate sanctions.

The new Government has now decided to present a comprehensive anti-discrimination law to Parliament in autumn 2002, which should ensure the transposition and implementation of the anti-discrimination *acquis* based on article 13 of the EC Treaty (see Chapter 13 - Social policy and employment).

Civil and political rights

During the reference period, some further progress was made in this area, notably regarding the respect of basic constitutional rights and asylum. However, some issues continue to merit attention.

According to the Ombudsman for Civil Rights, the number of complaints lodged in the area of civil and political rights has declined over the last year. Most of them concerned property rights and rights to legal remedy, and related to the functioning of the mayor's office and the courts. As regards basic constitutional rights, the overall number of complaints in 2001 was significantly less than a year before (210 in 2001 compared to 599 in 2000).

According to the opinion of the Ombudsman for Minorities the situation concerning *degrading treatment by the police* has been improving marginally over the past year, but there continue to be reports of ill-treatment and forced interrogation, and, in one case, a police raid on a Roma settlement. Although the data protection law prohibits the identification of individuals by ethnicity, Roma are particularly at risk of such treatment. During 2000, the Public Prosecution Office reported 850 cases of ill treatment during official proceedings and 283 cases of forced interrogation. As in earlier years, only a very limited number of cases (11%) were followed up. Further efforts by Hungary will be needed to ensure an effective system for addressing complaints of police misconduct.

Hungary continues to be primarily a country of transit and destination for *trafficking in human beings*. Trafficking is prohibited by law and the penalties have been stricter since April 2002, when the amendments to the Penal Code entered into force. Trafficking in human beings was defined as a crime in 1999 and since then international police co-

operation has started and continuously improved. Since the entry into force of the Law on Entry and Stay of Foreigners in January 2002, detected traffickers may be expelled from Hungary with immediate effect. Special facilities for victims are available in the form of a victim protection fund and victim protection offices. A person can be kept in *pre-trial custody* by the police for 72 hours, a relatively long period of time. After the expiry of this time the persons concerned must be released unless the court has ordered pre-trial detention.

Hungarian *prisons* continue to be overcrowded, but apart from this problem, meet international standards. Over the reference period, additional facilities have been made available following the modernisation and extension of some old buildings and construction of a new penitentiary institution. Under the Government's long-term development programme, further projects are under way to improve overall accommodation facilities in Hungarian prisons.

The possibilities for *legal aid* are different in criminal and in civil proceedings. Contrary to the principles generally applied to legal aid, existing provisions are rather restricted in a criminal case. A free defence counsel may be ordered by the police, the prosecutor, or the court if the accused has not yet appointed one and if defence counsel is compulsory (i.e. for serious offences, or where the accused is under preliminary arrest, deaf, dumb, blind or mentally ill, or does not speak Hungarian). However, if convicted, the accused must pay all the costs of the proceedings. As of July 2003, new legislation will enter into force, extending the rights to a free defence counsel, which will become dependant on the income situation of the accused. In civil proceedings the principle of access to justice includes the right to legal aid (full or partial) if the financial circumstances of the party concerned are such that he or she is unable to cover the costs of the procedure. A person who has been granted legal aid is also exempted from advancing and paying costs arising in the course of proceedings. Legal aid can be granted upon request of the person concerned. A party to whom legal aid has been granted, but who loses the case must pay the costs of the other party. With a view to facilitating access to justice, the Government has prepared a proposal to modify the rules on legal aid to bring them in line with European standards. The Government should be encouraged to submit the draft law to Parliament without further delay.

In addition to the existing legal provisions, free legal information services are offered by 13 offices, set up under the authority of the Ministry of Justice. The offices provide legal advice, covering the interpretation of legal rules, the identification of competent authorities and/or the applicable procedure. They do not prepare petitions, claims, pleas or any other documents for submission to the courts or authorities, nor do they represent citizens in legal proceedings. In 2001 the offices gave advice to 3 449 citizens.

As mentioned in the previous Regular Report, new legislation on *asylum* and the residence of foreigners entered into force in January 2002. These laws introduced a legal remedy against the rejection of visa applications and reduced the maximum period of detention for illegal migrants by the Border Guard from 18 to 12 months. Further elements included the definition of unaccompanied minors and the re-definition of temporary protection and safe third country. An accelerated procedure for processing asylum applications was introduced and the number of grounds for rejecting an asylum claim as "manifestly unfounded" was increased.

According to the Office of Immigration and Nationality, which is in charge of asylum matters, the number of applications for refugee status rose in 2001 to 9 554, an increase of about 22.5% compared to 2000 . The number of asylum-seekers granted refugee status, however, remains at an extremely low level. In 2001 only 174 applicants were granted refugee status. In general, cooperation between the Border Guards and the Office for Immigration and Nationality should be improved as regards the handling of asylum cases.

On the basis of the Criminal Code not only *racially* motivated violent actions but also racially motivated non-violent actions inciting hatred against groups of people are punishable. As a positive development, a fine was imposed by the National Media Council on a radio station in January 2002 for regularly broadcasting language insulting such groups as Jews and Roma.

Hungary continues to respect *freedom of expression*. The Constitutional Court had declared disproportionate draft legislation that would have restricted the freedom of the print media to publish critical opinions on public persons. Since May 2002, the Government and opposition are again equally represented in the Presidium of the Boards of Trustees for the supervision of public service media. However, during the election campaign, the presence of Government parties was more evident in public service media, while private media generally provided a more neutral coverage of events, as underlined by the OSCE in its final observations report on the Hungarian Parliamentary elections.

Freedom of religion is enshrined in the Hungarian Constitution and no particular problems have been reported in this respect.

Sexual orientation plays a role in the armed forces, where homosexuals are excluded from serving as professional soldiers. In September 2002, the Hungarian Constitutional Court declared unconstitutional the provisions of the Penal Law, setting a different age of consent for homosexual and heterosexual intercourse. The relevant provisions will have to be repealed.

Economic, social and cultural rights

Since last year's Regular Report, Hungary has continued to make progress in this area, notably as regards equal opportunities.

The legal framework on *equal opportunities* was strengthened in 2001 with the adoption of the new Labour Law (*see Chapter 13 - Social policy and employment*). Women represent 45% of the economically active population. They are increasingly participating in active political life. Following the Parliamentary elections of April 2002, the number of women represented in the House has slightly increased (from 31 to 34 seats, representing 8.8%). Another three women became Ministers and one became Speaker of the House. In general the level of women's political participation is higher in local government than at national level.

A national programme for *disabled persons* had already been adopted by the Government in 2000, containing measures in the fields of public health, employment, social care, education, traffic, housing and other areas of state administration. Implementation of the programme seems still rather slow; as services for the disabled remain limited and access to public buildings is difficult.

In the area of *social dialogue*, the new Government indicated its firm intention of improving the involvement of the social partners in the decision-making process. (*see chapter 13: Social Policy and employment*) For this purpose, the social partners and the Prime Minister signed an agreement on the restructuring of the system of the social dialogue. In a first step the Labour Law was amended in July 2002, extending further the rights of the trade unions. At the same time, the formerly abolished National Interest Co-ordination Council was re-established; its task is to discuss various aspects of economic development, such as matters affecting economic Policy, the budget, taxation, wages, labour related legislation and social benefits. Efforts should be continued to fully respect trade union rights at enterprise level and bipartite dialogue should therefore be further developed.

Hungary is a party to the *European Social Charter*. It has not yet signed the revised European Social Charter.

Minority rights and the protection of minorities

Since the last Regular Report, efforts in this area have focused mainly on the further implementation of the medium-term programme for the social integration of the Roma.

The Law on the Hungarian Minorities living in Neighbouring Countries (“status law”) entered into force in January 2002 and created some political concern in the region, notably in Slovakia and Romania. The law was designed to foster the position of the Hungarian minorities abroad and granted them, on the basis of registration, in Hungary, certain rights and privileges in the areas of education and culture. Following the recommendations of the Council of Europe’s Commission for Democracy through Law (Venice Commission) on the roles and tasks of kin-states and home-states in minority protection, Hungary adopted in December 2001 and January 2002 legislation implementing the status law, which is broadly compatible with these recommendations. As agreed in a Memorandum of Understanding between Hungary and Romania, the law should have been revised in certain points in June 2002, but no progress can be reported in this respect. As regards Slovakia an agreement on the application of the law is still pending. Hungary committed itself to repeal before accession any provision which would not be compatible with EC law (*see Chapter 27 - Common Foreign and Security Policy*).

Hungary has a well-developed institutional framework protecting the interests of its minorities and promoting their cultural and educational autonomy. The Office for National and Ethnic Minorities, established in 1990, is in charge of developing a policy framework for minority issues.

The 1993 Law on Representation of National and Ethnic Minorities enabled minorities to choose their representatives at the level of self-governments with considerable power, through which they could voice demands and make proposals. Two elections have been held since 1993 within this framework and there has been a significant increase in the number of self-governments established, of which there are currently 3 158.

The Ombudsman for the Rights of National and Ethnic Minorities monitors the implementation of minority rights and investigates complaints of violations. In 2001, some 453 new cases (431 in 2000) were registered at the Office of the Ombudsman, of which 292 (291 in 2000) affected the Roma Community. Most cases targeted the activities of local governments (118), police (49) and courts (31). Around two thirds of these cases were followed-up by the Ombudsman.

In June 2002 the Prime Minister's Office became responsible for National and Ethnic Minorities; a political State Secretary is in particular in charge of Roma related issues, which were separated from minority affairs in general. Within the Ministries of Education and Employment and Labour, Ministerial Commissioners in charge of Roma affairs had been appointed.

In addition, a Roma Coordination Council had been set up. The Council is a consultative body headed by the Prime Minister and responsible for steering the development of a new Roma policy. It is assisted by the secretariat of the political State Secretary for Roma affairs in performing its tasks.

Furthermore, the monitoring system was strengthened and the concerned Ministries were requested to provide systematic data on the implementation of the medium-term programme.

There are 13 recognised minorities in Hungary.

Amongst those, it is the Roma community⁴ that is most seriously affected by social inequalities: around 70% of Roma of working age are at present unemployed. Only 33% of Roma children start secondary education (compared to 90% of non-Roma children) and the percentage of Roma with higher education is small (scarcely 1% of the total). Housing conditions are very poor for a large proportion of Roma and often do not meet the most basic health and safety requirements. Recent health surveys confirmed a life expectancy for Roma of 15 years below the Hungarian average.

Despite the efforts of the Government to address the situation through the continued implementation of the 1999 medium-term programme for the social integration of the Roma, members of the Roma community continued to suffer from widespread discrimination in education, employment, the criminal justice system and access to public services, health in particular.

The implementation of the 1999 medium-term programme has further progressed, but slowly, due to ineffective planning and lack of proper co-ordination between the Ministries involved. Support measures mainly focused on the areas of education, employment, social policy, legal protection and culture. Certain forms of assistance were targeted specifically at the Roma while some other resources were made available in general to persons belonging to national or ethnic minorities or concentrated on economically/socially disadvantaged groups. However, the programme itself does not provide a detailed strategy for addressing the problems specified.

The total amount of Government resources that was made available for actions benefiting mainly the Roma increased from around € 18 mio in 1998 to around € 38 mio in 2001. The budgeted figure for 2002 is € 49 mio, representing a 15% increase (9% in real terms).

So far, some results within the medium-term programme have been achieved in the areas of education, employment and health. Some positive developments can be noted also within the judicial system.

4 There are between 550,000 and 600,000 Roma in Hungary

In the area of education, measures undertaken include the provision of scholarships (12 500 in 2002 as 7 580 in 2001), the construction of student dormitories and support for vocational education programmes and certain pilot projects such as the Ghandi Secondary School. Specific educational and teaching materials for Roma education have been prepared and are being used as of the 2002/03 school year. However, the measures do not address the frequent transfer of Roma children out of the mainstream system into special education facilities. According to estimates there are still around 150 schools in Hungary where special Roma classes are maintained.

Employment initiatives generally focused on public work schemes. At local level, the Roma self-government concluded agreements with labour centres, creating increased access to these facilities for Roma. Employment perspectives within this initiative are however limited to the short- or medium-term.

In the area of health, the National Health Programme, as part of the economic development plan (Széchenyi Plan), provides targeted support to Roma on drug prevention and health development, and provides nursing care where needed.

Within the judicial system the overall attitude towards Roma has slightly improved during recent years and courts have started to sentence perpetrators of racially-motivated crimes against Roma, according material compensation for injuries and ordering apologies.

Persons belonging to national and ethnic minorities may receive legal assistance free of charge through a special Anti-Discrimination Network of legal aid offices set up by the Ministry of Justice in co-operation with the National Roma self-government and the Office for National and Ethnic Minorities. The Network, established in late 2001, offers free counsel and representation to individuals claiming discrimination. Between October and December 2001, the Network had handled some 200 cases, of which 140 could be closed. Most of the cases related to housing (43), criminal law (32), social issues (26) and employment (20). However, the operation of this Network is rather restrictive and covers only issues related to discrimination against persons belonging to national and ethnic minorities. Furthermore, the fact that this system does not cover the costs of the legal proceedings, which must be paid by the plaintiff if the case is not upheld, acts as a disincentive.

On the whole, the Hungarian Government has continued to make efforts to address the situation of the Roma minority. In this respect the medium-term programme offered a good basis, yet continued efforts, including efforts to tackle the specific problem of discrimination, are necessary to achieve positive changes in the situation of the Roma. Roma policy is not well integrated into general social development strategies and exists as a separate and parallel project. In this respect the long-term strategy proposed by the Government in summer 2001 would have been a further step in the right direction; however, it had not yet been adopted. The Government is currently revising its Roma policy and the forthcoming adoption of a new comprehensive anti-discrimination law will be a major step forward in this regard.

As reported in previous years, Hungary is a party to the Council of Europe Framework Convention on National Minorities. The Resolution⁵ adopted by the Committee of

5 Resolution RES CMN (2001)4 of 21 November 2001

Ministers of the Council of Europe on the basis of the opinion on Hungary by the Advisory Committee on the Framework Convention largely endorsed the above assessment.

1.3. General evaluation⁶

In its 1997 Opinion, the Commission concluded that Hungary fulfilled the political criteria. Since that time, the country has made considerable progress in further consolidating and deepening the stability of its institutions guaranteeing democracy, the rule of law, human rights and respect for the protection of minorities. This has been confirmed over the past year. Hungary continues to fulfil the Copenhagen political criteria.

Public administration reform at central level has been completed to a large extent. In this respect, the 2001 Law on Civil Servants, partly enforced in 2002, was an important step forward in the consolidation of the legal framework for civil servants. Following a complex review of the salary structure, the gap between earnings in the public and private sector was further reduced. A financial reform of the local self-governments is still outstanding.

Within the judiciary, the constitutional and legislative guarantees of judicial independence are well-established in Hungary and the system of judicial self-administration functions efficiently. The decisions to introduce the Regional Courts of Appeal and to strengthen the judiciary's financial independence are important steps as regards the improvement of the judicial capacity.

In line with its anti-corruption strategy, the Hungarian Government has continued to adopt a series of legal and practical measures to fight corruption, which remains a cause for concern. It is important that the new decisions be implemented quickly to better address the situation.

Hungary continues to respect human rights and freedoms. In the area of public service media, political parties are again fully represented in the Supervisory Boards of Trustees. New steps were taken to improve social dialogue.

With a view to addressing the difficult situation of the Roma, the implementation of the 1997 medium-term programme continued. The institutional framework has been further strengthened and a new monitoring system introduced. Still, Roma policy is not well integrated into general social development strategies and exists as a separate and parallel project. Roma continue to suffer discrimination. The Government is currently revising its Roma policy. The envisaged adoption of a comprehensive long-term strategy and comprehensive anti-discrimination legislation would be major steps forward in this regard.

6 See "Towards the Enlarged Union: Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries", COM (2002) 700.

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 the competitive pressure and market forces within the Union in the medium term”.

In its 2001 Regular Report, the Commission found that:

“Hungary is a functioning market economy. Provided that it fully maintains and implements its reform programme in a consistent manner, it should be able to cope with the competitive pressure and market forces within the Union in the near term.”

In examining economic developments in Hungary since the Opinion, the Commission's approach was guided by the June 1993 conclusions of the Copenhagen European Council, 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 and in the previous annual Regular Reports. The analysis in this year's Regular Report takes stock of the developments since the Opinion was drafted.

2.2. Summary of economic developments since 1997

On the basis of far-reaching institutional and structural reform, Hungary achieved robust economic growth and falling unemployment, combined with sustainable external deficits. After several years of structural reforms that encouraged the emergence of a dynamic foreign-led export sector, the focus of economic policy since 2000 has shifted towards an immediate improvement of living standards through wage and pension increases, and of infrastructure through public investment, at the cost of a higher budget deficit. The resulting strong domestic demand, both private and public, helped to moderate the decrease in economic growth since the second half of 2001. Average real GDP growth between 1997 and 2001 was strong, at an annual rate of 4.5%. The current account deficit peaked at 4.9% of GDP in 1998, and has continuously declined since. The low external deficits were easily financed, thanks to the continuous inflow of foreign direct investment (FDI). Inflation, which had remained relatively high, only started to decline after the depreciating exchange rate target was replaced by an inflation target as the main monetary policy anchor in mid-2001. The general government deficit measured according to harmonised EU standards (ESA95) has averaged 5.4% of GDP since 1997. Over the period since the Opinion, general government gross debt has declined rapidly, from 64.2% of GDP in 1997 to 53.1% in 2001. A fiscal stabilisation package during the period 1995-1998 effectively balanced the economy, and laid the foundations for rapid

growth thereafter. Since 2001, fiscal policy has turned expansionary to support growth during the economic slowdown. The introduction of a mixed public-private three-pillar pension system in 1998 constituted a major step towards long-term sustainability of public finances. Reforms of the health-care system have been initiated, but need to be further advanced.

Main Economic Trends								
Hungary		1997	1998	1999	2000	2001	Average	2002 latest
Real GDP growth rate	per cent	4.6	4.9	4.2	5.2	3.8	4.5	2.9 Q1
Inflation rate	per cent	18.5	14.2	10.0	10.0	9.1	12.4	6.8 June ^b
- annual average								
- December-on-December	per cent	18.6	10.1	11.4	10.0	6.8	11.4	4.8 June
Unemployment rate	per cent	9.0	8.9	6.9	6.6	5.7	7.4	5.6 Q2
- LFS definition								
General government budget balance	per cent of GDP	-6.8	-8.0	-5.3	-3.0	-4.1	-5.4	
Current account balance	per cent of GDP	-2.1	-4.9	-4.4	-3.2	-2.2	-3.4	
	million ECU/€	-840	-2.059	-1.969	-1.627	-1.248 ^c	-1.549	-1.799 Jan.-June ^c
Gross foreign debt of the whole economy	per cent of exports of goods and services	116.3	94.7	95.0	72.5	:	:	
- debt export ratio	million ECU/€	21.354	20.090 ^a	22.688	22.448	:	:	
Foreign direct investment in flow	per cent of GDP	4.8	4.3	4.2	3.6	4.7	4.3	
- balance of payments data	Million ECU/€	1.928	1.815	1.873	1.837	2.730	2.037	474 Jan.-June ^c
Sources: Eurostat. National sources. OECD external Debt Statistics								

^a series break as a result of some technical changes to the definition.

^b Moving 12 months average rate of change.

^c Source: Website of the National Bank.

Having started the process of structural reforms at an early stage of transition, Hungary is already at an advanced stage of second-generation reforms. First-generation reforms with regard to trade and price liberalisation and to the privatisation of the manufacturing base and the financial sector had been broadly completed by 1997. The country is now addressing the challenge of reducing the gap between Hungarian living standards and the EU average, by expanding the growth base of the economy, where the most important factors include an improved infrastructure and increased labour market participation. Plans for structural reform had been bundled since 2000 in the so-called 'Szechenyi Plan', which has achieved some first positive results with regard to tourism infrastructure, access to financing for SMEs and private housing construction. The new

government has announced that it will continue the successful measures of the Plan in modified versions, concentrating the available funds primarily on SME development and preparations for EU accession. At a later stage, the Plan would be integrated into the country's National Development Plan. Infrastructure shortcomings, the main obstacle to opening up the disadvantaged regions to economic development, are being tackled through a massive public motorway construction programme, while the restructuring of the railway system proceeds rather slowly. A few remaining enterprises are being restructured by the privatisation agency for later sale, while a number of enterprises earmarked as 'strategic' are intended to remain in state ownership. The opening up of the telecom market in early 2002 was a step forward in price liberalisation, and will continue with the partial opening up of the electricity market as of January 2003, according to the electricity law adopted in December 2001. However, public transport, household energy and certain publicly subsidised pharmaceuticals remain tightly regulated. The business climate continues to be good, and is supported by the high degree of credibility attached to the country's proven track record of successful macro-economic management over the review period.

Hungary has made good progress in catching up with the EU average income level. GDP per capita in purchasing power standards (PPS) was 51% of the EU average in 2001. However, there are significant regional disparities: per capita GDP in PPS of the central region around Budapest was 76% of the EU average, while that of the northern great plain stood at a modest 32%. The official unemployment rate in the Northern Hungary region in 2001 remained at 8.5% (with evidence suggesting a considerable level of hidden unemployment adding to this ratio) while Budapest and the industrialised west of the country enjoy virtually full employment. The employment rate at the national level has been steadily increasing from 52.7% in 1997 to 56.6% in 2001, generating a downward trend in the unemployment rate from 8.7% to 5.7%. While male and female employment have both grown steadily, the female employment rate has grown faster, starting from a lower level. Female unemployment (5.1%) was even lower than male unemployment (6.3%) in 2001. At 44.8%, the share of long-term unemployment in total unemployment is high and points to a rather low active labour reserve. This share has constantly declined from a 50.8% peak in 1998. Youth unemployment as a percentage of the 15 to 24 year old population stood at only 3.9% in 2001, a rate that had also constantly fallen from 6.1% in 1997. Pensions and wages, and in particular the statutory minimum wage – which was lifted to a level above half of the national average wage in two steps – increased substantially in 2001 and 2002. Living standards for the low-skills segment of the workforce have improved accordingly. However, a strong continuation of this trend could also develop opposite effects, by pricing out parts of the lower skilled work force in certain industries.

Main Indicators of Economic Structure in 2001		
Population (average)	Thousand	10,190
GDP per head ^a	PPS	11,900
	per cent of EU average	51
Share of agriculture ^b in:		
- gross value added	per cent	:
- employment	per cent	6.1
Gross fixed capital formation/GDP	per cent	23.4
Gross foreign debt of the whole economy/GDP ^c	per cent	44.6
Exports of goods & services/GDP	per cent	60.5
Stock of foreign direct investment	Million €	:
	€ per head ^a	:
Long term unemployment rate	per cent of labour force	2.6

^a Figures have been calculated using the population figures from National Accounts, which may differ from those used in demographic statistics.

^b Agriculture, hunting, forestry and fishing.

^c Data refer to 2000.

2.2. 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.

The EU accession process continues to provide a key anchor for the economic policy agenda. Popular consensus for a free market economy and EU accession has been strong throughout the economic reform process and has never been called into question. All political parties that are represented in the newly elected Parliament strongly support EU accession. The structural reforms and institutional deepening required by rapid transition have at no point endangered social and political stability in Hungary, and the momentum of progress has been well maintained. The two Pre-accession Economic Programmes (PEPs) which Hungary submitted to the Commission in 2001 and 2002 reflect the highly-developed analytical and technical capacity of the Hungarian authorities. Co-ordination functions reasonably well between several ministries, the National Bank and other institutions involved in medium-term economic planning. In general, the considerable degree of credibility attached to Hungarian government forecasts and related commitments has contributed to the successful creation of a stable and predictable market environment.

GDP growth has been robust, backed since 2001 by an expansionary fiscal policy. Average growth since 1997 has been 4.5%. After peaking at 5.2% in 2000, it remained robust at 3.8% in 2001, and appears to have bottomed out at 3% in the first half of 2002. Economic policy shifted in 2001 towards immediate improvement of living standards and infrastructure. Consequently, the composition of GDP growth changed considerably. Higher transfers and robust wages and pensions growth have led to an expansion in consumer demand, up by 7.6% year-on-year in the first quarter of 2002, with private consumption expanding twice as quickly as government consumption. Exports were still growing strongly in 2001 and early 2002 (by 9.1% and 6.3% respectively), as were imports (by 6.3% and 7.5%), although the rates have declined markedly from their earlier levels of over 20% in 2000. Fixed investment grew at a rate of 3.1% in 2001, much more slowly than in earlier years, when it had been one of the main factors in growth; in the first quarter of 2002, however, the year-on-year rate rose strongly again to 8.6%. Corporate investment continues to be weak, while public and household investment keep providing a strong stimulus, in particular to the construction industry. The stability of development throughout last year's economic slowdown once again provided evidence of Hungary's ability to absorb external shocks through sound fundamentals.

The external balance has further improved and the current account deficit remains modest, while its financing is unproblematic. The current account deficit peaked at 4.9% of GDP in 1998, but has since declined continuously to a mere 2.2% of GDP in 2001. The main reasons for this quite favourable result were an improvement in both the trade and services balances, to which tourism is an ever more important contributor, along with

lower-than-expected profit repatriations, reflecting a high willingness to re-invest in the country. On the whole, however, present current account deficit levels mainly reflect a significant drop in corporate investment activity, and thus appear quite low in view of Hungary's status as a catching-up economy that needs high investment inflows. The figures for the first half of 2002 do in fact indicate a slight increase in the deficit, in the wake of economic recovery. Financing of the current account continues to be unproblematic, thanks to the continued inflow of FDI. Hungary's increasing ability to borrow on international markets provides further scope for financing the savings-investment gap.

The sustained decline in unemployment is one of Hungary's major successes on its path of transition. Since 1997 unemployment gradually fell from 9.0% in 1997 to 5.7% in 2001. This sustained reduction in the rate of unemployment was accompanied by a rapid increase in jobs in the late 1990s, which strongly contributed to economic growth. Even in the present difficult economic environment, flexible labour markets kept unemployment at 5.9% during May-July 2002. Adjustment in the hardest-hit exporting sector so far appears to have been achieved primarily through a lowering of labour-use intensity, with the numbers of hours worked steadily declining since the beginning of 2001. Some layoffs in manufacturing industry have been largely offset by an increased demand for labour in the expanding services sector. There are still labour shortages in the industrialised regions, and in particular in the skilled work segment.

A forward-looking and transparent inflation targeting regime succeeded in breaking high inflation expectations. Until last year, inflation rates were stubbornly high, at an annual 12.4% on average over the review period. In mid-2001 the National Bank of Hungary (NBH) reacted to this major macro-economic imbalance by adopting an inflation-targeting monetary policy, which was supported by the abandonment of the crawling-peg exchange rate system and accompanied by the opening-up of short-term capital markets. Inflation has since fallen rapidly, to 4.6% year-on-year by July 2002. Disinflation over the past year was based primarily on strong nominal exchange rate appreciation, low oil prices, strongly declining food prices, deflation in producer prices and a favourable base effect, but was also supported by the economic slowdown and by capping the rise in administered prices. The NBH's open and transparent publication policy has been rewarded by the markets with an increased propensity for inflation expectations to match the NBH's guidance. Recently a relaxation of the initially very ambitious inflation targets to a maximum of 5.5% for end-2002 and 4.5% by end-2003 was agreed between the new government and the NBH. These levels appear achievable without a significant cost for the real economy.

A flexible exchange rate system combined with an inflation-targeting monetary policy supports macro-economic stability. A devaluating crawling peg was abolished last year in favour of a more flexible exchange rate system with a 30% trading band. Subsequently, the currency was allowed to rapidly appreciate by some 10% in nominal terms, close to the upper range of its new intervention band, where it appears to have stabilised. In real terms, the exchange rate appreciated by roughly 15% over the past year. The new monetary policy framework appears suitable to Hungary's state of economic development. Its introduction has been the main contribution to the effective reduction of inflation over the past year. Under the new regime, the main tools of central bank monetary policy have been the setting of benchmark interest rates and verbal interventions, and so far the NBH has refrained from market intervention. As a result of the crawling peg, real exchange rate developments have been very flat over recent years,

but with the introduction of the more flexible exchange rate system, a continuous upwards trend can be observed.

After the achievement of a commendable degree of consolidation of public finances, the budget situation has worsened since 2001. By 2000, general government net borrowing had been brought down to 3% of GDP, from 6.8% in 1997 and a peak of 8% in 1998. However, pre-election and counter-cyclical spending increased the deficit again to 4.1% of GDP in 2001. While transparency of the budget was improved before 1998, the previous government increasingly resorted to off-budget spending, in particular for motorway construction. The fiscal stabilisation programme in the 1995-1998 period helped reduce the expenditure ratio from 52.2% of GDP in 1997 to 48.9% in 2000, but lately this ratio went back up to 50.2%.

Reflecting the business as well as the political cycle, fiscal policy in 2001 and 2002 has been eased significantly. The direct fiscal impact on demand is estimated by the NBH at roughly 2% of GDP in 2001 and around 3% for 2002. Although the fiscal expansion has been dampening the economic downturn during the slowdown of world markets in 2001 and 2002 to date, it could become pro-cyclical during the economic recovery, and result in an unfavourable public finance situation. An additional budget for 2002 was presented to Parliament, and the overall deficit projection has been revised upwards to 5.5-6% of GDP for 2002, from the original estimate of 4.9%. A swift tightening of fiscal conditions, starting with the 2003 budget, will be necessary for the re-stabilisation of public spending, which otherwise would threaten to compromise the inflation targets. Accordingly, a reduction of the government deficit is highlighted as the main medium-term policy objective in the Hungarian 2002 PEP.

The ongoing reform of the pension system helps to ensure longer-term budgetary stability. In 1997, Hungary introduced a comprehensive multi-pillar reform of the pension system. Existing employees were offered a choice between the state-run pay-as-you-go system (first pillar) and the private funded system (second pillar). By the end of 2001, the second pillar covered 2,25 million Hungarians. A state-guaranteed minimum benefit for privately funded pensions was abolished last year, which reduced the public liability for the pension system. According to the new government's plans, the second pillar will be made mandatory for new market entrants from 1 January 2003. The government will also implement the planned increase in its contribution to the second pillar from 2003 onwards, from currently 6% to 8% of the national wage bill, a move which was postponed repeatedly by the previous government. As an immediate effect, this increase will put some pressure on the general government deficit, due to a reduced surplus in the public first pillar. The management and performance of the second pillar need to improve. Despite the rather conservative investment behaviour of the pension funds, average annual administration fees appear excessively high. In a situation of modest real returns, this situation could threaten both the popular credibility and the longer-term sustainability of this private segment of the Hungarian pension system.

The consolidation and modernisation of Hungary's health care sector remains an important challenge. Hungary's 160 hospitals are currently owned by municipalities or state-run universities, and receive a lean monthly allowance from the National Health Fund which is based on the number of cases treated and meant to cover their operating costs. Since the issue is highly controversial, several reform concepts that were proposed faced strong opposition and led to modest results only. Progress has been made with regard to improving the IT infrastructure of the National Health Fund Administration, as

well as with regard to the legal framework for hospitals and general practitioners. On 1 January 2002 a law allowing hospitals to turn into enterprises and doctors into entrepreneurs entered into force. The new law allows owners to operate hospitals in the form of non-profit public benefit associations. The new government's programme declared health care reform a number one priority.

Hungary is growing out of the high debt levels inherited from the past. At the beginning of transition, the country had high levels of indebtedness and was not granted any debt relief. Despite incipient fiscal relaxation, general government gross debt continued to decline to 53.1% of GDP at the end of 2001, from 64.2% in 1997. Over previous years, GDP growth had regularly outpaced real interest rates, while real expenditures grew far slower than real GDP. On the basis of sustained primary surpluses the share of interest payments in the budget went down from 10.3% of GDP in 1997 to just 4.4% in 2001. A trend towards increasingly fixed-rate debt further contributes to reducing interest risks for the budget. The high demand for forint-denominated government securities on international markets allows the government to systematically replace maturing foreign debt by domestic paper, thus reducing the budget's exposure to exchange rate developments. Finally, increasing demand for (very) long-term Hungarian government bonds enables the debt maturity to be extended.

Hungary has a proven track record on stability and a credible economic policy mix which has helped to steer the country through the various ups and downs of its rapidly maturing economic transition. Generally, co-ordination between the government and the National Bank on matters of economic policy functions well. Where differences appear, as in the recent public debate between the newly-elected government and the NBH about the latter's ambitious inflation targets for 2003 and beyond, these issues are not allowed to get out of hand, and a compromise is usually hammered out swiftly.

Market forces determine the prices of the vast majority of goods and services, and administered prices are being gradually deregulated. Trade, the financial sector and the foreign exchange regime were liberalised early in the transition. The government has committed itself to completing the process of gradual price deregulation by the end of 2004. Regulated prices account for 18.5% of the consumer basket. Administered prices in the energy, transport and drugs sector have been kept at very low levels for some time. The adverse effects of nominal price caps have been somewhat attenuated since last year with faster-than-projected disinflation. Regulated prices in the telecom sector were abolished from 1 January 2001. In the pharmaceuticals field a planned price rise in prescription drugs receiving state subsidies was postponed by six months to the end of the year, while over-the-counter medications were freed up as of 1 July 2002. A new system of gas price regulation took effect on 1 July 2002. Gas and electricity prices are now set once a year by the Energy Office (on 1 January for electricity, on 1 July for gas), based on expected price developments and according to the principles of asset and cost-based pricing. Legislation was adopted in December 2001 to open up the electricity market for large corporations, which corresponds to a volume of about 30 to 35 percent of the market, in 2003. A similar law on the liberalisation of the gas market envisaging a market opening of around 20% as of January 2003 is still pending in Parliament.

The private sector is responsible for the bulk of wealth creation. It accounts for more than 80% of GDP. The share of state-owned enterprises in net worth has declined steadily, from 17.6% in 1996 to 14.5% in 2000. While in 1996 28.3% of land in Hungary belonged to agricultural co-operatives, this share had receded to 15.3% by 2000. Agricultural land had been widely privatised in the early 1990s, but throughout the

various stages of the process a number of new problems emerged, such as a high fragmentation of land parcels along with an increasing discrepancy between land and asset ownership. New legislation on agricultural land was presented in July 2002 which addresses some of these problems. Private housing construction has been given a major boost since 2001, on the back of a highly popular state-backed mortgage scheme.

The privatisation process has been broadly completed since 1997, and the government is preparing for the sale of remaining items. Private ownership has become the dominant form of ownership. The sales of state-owned assets were mostly carried out swiftly and early on, often to strategic foreign investors. The state, through the privatisation agency APV, still holds stakes in 162 companies, of which 93 are classified as "strategic". APV's role in recent years has switched from that of a selling agency towards asset management, as well as the administration of remaining obligations from previous privatisations, such as investment and employment guarantees. The new government has recently speeded up preparations for the privatisation of some remaining enterprises following their restructuring by APV.

There are no significant legal or institutional barriers to the establishment of new firms in Hungary, and property rights are clearly established and transferable. The economic framework is favourable to enterprise creation. The public administration provides a one-stop registration for new companies, which can be founded with very low minimum capital requirements. The legal framework for bankruptcy is quite good, but its implementation with regard to company liquidation and the treatment of creditors' claims is still lengthy and cumbersome.

The financial sector's privatisation was largely completed in 1997, and private ownership and foreign participation are prevailing. The Hungarian financial system with its open capital markets is highly integrated with global markets and the international financial system. Banks clearly dominate the financial sector, representing around 80% of total assets, but insurance and securities are growing faster, and are slowly increasing their market shares. Total state ownership in the financial sector, including minority stakes, was 25% at the end of 2001. However, the assets of banks majority-owned by the state only accounted for 9% of total banking sector assets at the end of 2001. The Hungarian banking sector is reasonably profitable and adequately capitalised. Non-performing loans were just 2% at the end of 2001, down from 3.2% in 1997. The overall financial intermediation ratio, measured by total domestic credit as a percentage of GDP, was 50% in 2001. The private sector credit-to-GDP ratio increased from 24.2% in 1997 to 31.3% in 2001. This is still rather low, but it mainly reflects the easy access by the enterprise sector to foreign financing, and in particular the high share of inter-company loans for foreign-owned companies. Fast credit growth together with increased lending to smaller creditors reflects the transition to a mature financial system. On the basis of strong government incentives, lending to households and SMEs is accelerating rapidly, and shows signs of being the most important channel for future financial deepening. Interest spreads vary considerably across different market segments, with spreads of about 3% in the highly competitive corporate market, and spreads in the more risky retail sector as high as 12%.

The non-bank financial sector is small, but developing dynamically. The insurance sector is growing rapidly, and foreign participation is close to 90 percent. Insurance accounts for roughly 7% of households' financial assets. Hungary's capital market plays only a minor role, with only a modest national and international market for government bonds. There

is no significant corporate bond market. The successful introduction of a multi-pillar pension system has led to the creation of a small investment fund sector, which is dominated by six major funds controlling about 11% of consumer savings. The majority of investment funds are controlled by banks. The stock exchange does not play a major role in domestic corporate finance or at international level. In addition, trading in Hungarian blue chip equity is increasingly done abroad, which further reduces the trading volume in Budapest.

Hungarian financial markets have been stable and relatively well regulated and supervised. The consolidated Hungarian Financial Supervisory Authority (HFSA) has been systematically strengthened, both in its independence and in its administrative capacity, since its establishment in 2000, when it integrated all the former sector supervision bodies. This policy has led to an improvement in the strength, quality and effectiveness of the supervisory framework. Supervision of the rapidly expanding mandatory private pension funds (second pillar) needs to be strengthened in order to provide more transparency on cost structures and administration fees. The NBH continued the six-monthly publication of its high-quality 'Report on Financial Stability' which increasingly covers developments in the non-banking financial sector.

The capacity to cope with competitive pressure and market forces within the Union

The 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 before accession. Both the volume and the range of products traded with EU Member States provide evidence of such integration.

The degree of macroeconomic stabilisation and the advanced stage of structural reforms allow economic agents to make decisions in a climate of stability and predictability. Macroeconomic stability has continuously strengthened over the review period, but has recently been marked by growing fiscal imbalances. Macroeconomic policy has been conducted with a high degree of predictability to allow proper decision-making by economic agents. Co-ordination of economic policies between different institutions in combination with increased macroeconomic stability have contributed to a steadily improving environment for economic activity.

The quality of its labour force is an important asset in Hungarian competitiveness and growth. Hungary ranks high with regard to all major education indicators. The percentage of the 25-64 year-old population with university education, which indicates the share of highly-skilled human capital, is 14%. More importantly, the trend has been continuously rising since the start of transition. Enrolment in tertiary education at 72%, and the net entry rate to university education at over 50%, point towards a continuation of this very favourable development. A high standard of education contributes to growth not only through the improvement of human capital as a factor of production, but, more importantly, as a determinant of the rate of change of total factor productivity. The good

quality of professional education of the labour force is a clear advantage when competing for foreign direct investment. However, there is still a need to further improve the transition from education and training to work.

Employment policy measures are intended to reduce regional disparities, and raise low participation and employment rates. A package that has been implemented since 2001 comprises a mix of actions to address shortcomings in the labour market. Rules on eligibility for and duration of unemployment and welfare benefits have been tightened up, while considerable minimum wage increases have helped to 'whiten' parts of the grey labour market. Pension income has been exempted from the tax base, encouraging retirees to start participating again. Certain segments of the labour market have been opened to foreigners. On the demand side, social security contributions for employers have been lowered in several steps, and tax relief is being granted to employers of disabled persons. The labour market is slowly reacting to this active labour market policy, although there have been cyclical setbacks. Unemployment levels within what are considered high-risk groups are finally going down. However, the slowly rising trend of employment rates over the past few years has been interrupted by the economic slowdown. Combined with a shrinking population and the low mobility of the Hungarian labour force, this could create a bottleneck for growth in the longer run.

Hungary has experienced reasonably high levels of gross fixed capital formation over the entire review period. Fixed investment as a percentage of GDP grew from 22.2% in 1997 to 24.2% in 2000, and declined again to 23.4% in 2001. The additions to the capital stock in combination with early corporate restructuring are bearing fruit, and the physical infrastructure has gradually and visibly improved. Investment by central and local government declined from 4% of GDP in 1997 to 3% in 2001. This trend reflects a streamlining of public spending, but also an increasing share of off-budget spending for infrastructure.

Hungary has constantly received high FDI inflows. Average annual inflows have been 4.3% since 1997. Despite a strong drop in overall corporate investment in 2001, FDI net inflows – both in the form of inter-company loans and primarily greenfield investment – remained high, at 4.7% of GDP. Cumulative FDI inflows per capita at the end of July 2001 amounted to €2,400. Since privatisation is no longer a relevant source of FDI creation in Hungary, these figures reflect the attractiveness of Hungary as a location for foreign investment, based on competitive total labour cost, a liberal foreign trade regime and a predictable and business-friendly policy framework. The quality of the investment is becoming increasingly high-tech and service-oriented. Under its national development plan, the government is trying to diversify further the pattern of specialisation towards services, and in particular tourism and business services, and also to attract foreign investors to underdeveloped regions.

Infrastructure gradually improves. A massive road construction programme is under way to open up the backward north-east of the country to investment. Progress on speeding up the relatively underdeveloped railway network has been slow. Expenditure on research and development has grown slightly from 0.7% of GDP in 1997 to 0.8% in 2000, the overwhelming and growing share of which is generated in the manufacturing and business services sectors. There are encouraging signs of innovation initiatives to improve the creation of research-industry networks.

The process of enterprise restructuring has been uneven. Restructuring of export-oriented firms in foreign ownership has been proceeding considerably faster than that of domestic firms. As a result, the process of rapid modernisation did not spread evenly over the entire economy, but led to the development of ‘modern islands’ that are concentrated in certain sectors and regions. Large multinational corporations, often operating in industrial free zones, have represented the backbone of growth and external trade in Hungary since the second half of the 1990s. By now, roughly two thirds of machinery exports and about one half of machinery imports derive from these industrial free zones. While the vast majority of industries have already recovered from the transitional shocks, restructuring of the steel sector and the airline industry, among others, still has to be tackled.

Shifts in the sectoral structure of the economy have changed Hungary’s economic landscape. In 2001, agriculture was a surprise contributor to growth, and its share in GDP increased to around 5% due to a record harvest. In previous years, the share of agriculture in GDP had dropped from 5.9% in 1997 to 4.1% in 2000. The sector’s share in total employment also declined from 7.8% in 1997 to 6.1% in 2001. While the share of industry remained rather stable around 33% of GDP and 34% of total employment, the share of services over the same period expanded somewhat from 61.4% to 62.6% of gross value added between 1997 and 2000, and from 59% to 59.6% of total employment.

The importance of small and medium-sized enterprises (SMEs) has been growing constantly, in terms both of GDP contribution and of employment. The SME sector accounts for roughly two thirds of total employment and half of GDP. In 2001, there was a slight trend correction in the growth contribution by sectors, when for the first time the export volume of regular Hungarian companies grew faster, at about 12%, than that of the industrial free-zone enterprises, at about 8%. It is not yet possible to say whether this development is purely mirroring the global business cycle, to which the export-oriented enterprises in the free zones are more exposed than SMEs, or whether the figures point towards a sustainable redirection of economic contributions.

A micro-credit scheme and the provision of business know-how are addressing some of the most pressing problems that have been restraining the economic potential of the SME sector. In 2001, the government adopted a number of measures to further enhance the economic environment for SMEs, in particular through a scheme that provides small and micro companies with access to business advice and credit. Commercial banks had long remained cautious in lending money to SMEs. In the framework of the new scheme, the government started a credit card programme in mid-2002, giving very small companies fast access to inexpensive credit backed by state guarantees. The scheme is available to almost 700 000 micro and small companies, and allows cardholders to receive HUF 1 million (€4,100) of revolving credit for a three-month period at subsidised nominal interest rates of around 10%.

Through an active investment promotion policy, Hungary created new industry clusters, in particular in the electrical machinery, automotive and electronics industries. Thanks to the high level of foreign direct investments and the openness of the Hungarian economy, industrial free zones play a significant role in the economy. However, some of the existing support schemes have been marked by a lack of transparency. Legislation aiming at redirecting investment incentives was presented to Parliament before the summer. The new rules would phase out implicit support through tax breaks in favour of explicit budgetary support, in order to align investment incentives with EU rules on state

aid by 2003. The new policy also focuses on the creation of industrial parks, and the provision of employee training and skills development to foreign investors and Hungarian start-up companies.

Hungary is a small open economy with a high degree of trade integration with the EU. The Hungarian economy has been steadily becoming more open. In 2001, exports and imports of goods and services amounted to 123.1% of GDP, compared with just 91% in 1997. As regards the commodity structure, machinery, transport equipment and other manufactured products remain the main traded goods. In 2001, the Hungarian export basket contained 68% of high value-added, technology-intensive and know-how-intensive products. Hungarian exports to the EU accounted for 74.3% of total exports in 2001, while imports from the EU were 57.8% of the total. In general, trade with developed market economies has intensified over the entire period. Intra-industry trade with the EU is around 60%. Large enterprises working in industrial free zones played a significant role in the development of Hungary's external trade, especially in machinery exports, where they account for two thirds of exports and roughly 50% of imports. Overall, these industrial free zones account for roughly one third of Hungary's exports and a quarter of imports.

After a period of considerable wage restraint during the stabilisation period, real wages started to rise faster than productivity, a trend that will not be sustainable over a longer period of time. Public wages, previously at low levels that had put a strain on the ability of the public sector to attract and retain a high-quality workforce, were increased most rapidly, by an average 50% since 2001. At the same time, minimum wages were raised significantly in two steps, to roughly €200 a month, which lifted them to a level of about half of national average wages. With inflation declining more rapidly than projected, the private sector has also been slow in adjusting wage growth to the disinflationary environment. As a combined result of all these effects, real wages in the overall economy increased by 6.4% in 2001, and by 11.3% year-on-year during the first half of 2002. The upcoming tripartite consultations will be crucial with regard to the adjustment of corporate wages with the country's overall economic development.

Hungary's sustained export performance, in the context of strong real appreciation of the currency and a global economic downturn, is a clear indicator of the competitiveness of the country's manufacturing base. By starting reform early and accumulating a large stock of FDI, Hungary obtained a considerable competitive edge. The real exchange rate based on unit labour costs, which had depreciated by a total of 52% over the second half of the 1990s, jumped by 9.1% in 2001, with wages growing more rapidly than labour productivity. The CPI-based real effective exchange rate increased by around 10% in 2001. While such rapid appreciation can result in a loss of external competitiveness, it has considerably contributed to bringing down inflation via lower imported price inflation, and thus improved the overall macro-economic balance of the economy. In fact, the appreciation appears to have been broadly absorbed by very high enterprise profits of around 13-15% of GDP over the past five years. In addition, the resilience of exports to the strengthening currency as observed since mid-2001 confirms that, as Hungary is a small, open and industrial-processing-based economy, currency appreciation leads to its competitiveness being as much improved by cheaper imports and lower inflation as it is impeded by costlier exports.

2.3. General evaluation⁷

The 1997 Opinion already acknowledged the comprehensive reform efforts undertaken by the Hungarian authorities to transform their economy. Since the Opinion, and against a challenging international economic environment, economic performance has improved. Macroeconomic stability has been achieved, reforms have continued while the Hungarian authorities' commitment to the economic requirements of EU accession has been sustained.

Hence, it is concluded that Hungary is a functioning market economy. The continuation of its current reform path should enable Hungary to cope with competitive pressure and market forces in the Union.

Improvements can be made to macroeconomic management by reducing the general government deficit, thus preventing fiscal policy to become pro-cyclical and supporting a further reduction of the inflation rate. A more fundamental reform of the health care sector now needs to be embarked on. Wage developments will have to be brought in line again with productivity growth in order not to compromise the country's competitiveness.

⁷ See "Towards the Enlarged Union: Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries", COM (2002) 700.

3. Ability to assume the obligations of membership

Introduction

This section addresses the question of Hungary's ability to assume the obligations of membership – that is, the legal and institutional framework, known as the *acquis*⁸, by means of which the Union implements its objectives. Alongside an evaluation of relevant developments since the 2001 Regular Report, this section seeks to provide an overall assessment of Hungary's ability to assume the obligations of membership, and of what remains to be done. Furthermore, it includes an evaluation of Hungary's track record since the 1997 Opinion. It also provides, for each of the negotiating chapters, a summary evaluation of the extent to which commitments made in the negotiations have been implemented, as well as an overview of transitional arrangements that have been granted.

This section is structured in accordance with the list of 29 negotiating chapters, and incorporates an assessment of Hungary's administrative capacity to implement the *acquis* in its various aspects. Hungary's progress in translating the *acquis* into its official language is assessed in a separate section.

In December 1995, the Madrid European Council remarked on the need to create the conditions for the gradual, harmonious integration of the candidate countries, particularly through the adjustment of their administrative structures. Taking up this theme, in Agenda 2000 the Commission underlined the importance of effectively incorporating Community legislation into national legislation, and the even greater importance of implementing it properly in the field, via the appropriate administrative and judicial structures. This is an essential precondition for creating the mutual trust indispensable for future membership.

In June 2002, the Seville European Council repeated how important it was that candidate countries should continue to make progress with the implementation and effective application of the *acquis*, and added that candidate countries must take all necessary measures to bring their administrative and judicial capacity up to the required level. Building on the assessment of Hungary's administrative capacity provided in the 2001 Regular Report, the present Report seeks to add further depth and detail, focusing on the main administrative structures required for implementing the various aspects of the *acquis*.

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

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

In the 2001 Regular Report, the Commission found that :

8 A description of the *acquis* for each chapter can be found in the Commission's 1997 Opinion on Hungary's application for EU membership.

"Hungary continued to make progress in aligning and implementing the acquis in many areas. In the reporting period, the country has moved steadily towards achieving a degree of administrative capacity needed to satisfactorily implement the acquis.

Continued good progress could be noted concerning the internal market. In this area, the major part of the acquis has been gradually adopted, and basic administrative structures are in place. As regards the free movement of goods, the alignment process has continued in respect of harmonised and "new approach" product legislation, and Hungary has been able to apply for full membership in the European standard bodies CEN and CENELEC. Work should be continued to ensure a coherent and comprehensive market surveillance system. With regard to public procurement, efforts will be needed to achieve full alignment and to ensure transparency and enforcement of the current rules at all levels of government and in all sectors, in particular in motorway construction. In the field of services, banking and insurance legislation has largely been aligned, and the supervisory authority appears to be working satisfactorily. Capital movements were almost fully liberalised. The adoption of an important new law on the fight against money laundering, which aims at, inter alia, phasing out anonymous savings books in order to meet the recommendations of the Financial Action Task Force (FATF), is pending at Parliament. In the field of company law, the Hungarian legislation with regard to industrial and intellectual property rights is already largely in line with the acquis; Hungary has a relatively good enforcement record. In competition policy, substantial and procedural rules for state aid control were further aligned with the acquis. Further efforts are needed to align state aid schemes, in particular the fiscal aid schemes. Both anti-trust and state aid enforcement bodies are working satisfactorily.

Alignment of VAT and excise duty levels continued in the area of taxation. However, appropriate IT systems allowing for the exchange of electronic data with the Community and the Member States have still to be developed. In the area of customs, in particular, the administrative and operational capacity was strengthened through training and modernisation of the equipment. Hungary still needs to work on the compatibility of its IT system with the EC customs computerised systems in order to ensure interconnectivity by the time of accession. In the area of economic and monetary union, the independence of the National Bank was consolidated with the adoption of a new law. With regard to industrial policy and small and medium-sized enterprises, Hungary made further progress by the adoption and implementation of the Széchenyi Plan. The issue of the restructuring of the Hungarian steel industry has progressed in the reporting period.

Significant progress was also made in the area of environment, notably through the adoption of legislation on Environmental Impact Assessment, on water, waste, industrial pollution control and risk management, on chemicals and on radiation protection. The administrative capacity in this sector was also improved, but needs further strengthening, in particular as regards the clear distribution of tasks between the ministries involved.

As to agriculture, progress in the reporting period was limited to the food safety and veterinary sectors, while the inspection arrangements in the veterinary and phytosanitary areas still need to be updated. Further efforts are needed to establish in time the necessary procedures and structures for Hungary's participation in the Common Agricultural Policy. Legal alignment needs to be sustained in the area of transport, and efforts are needed to carry out the restructuring of the rail sector that is indispensable to prepare for the implementation of the market access acquis. In addition, appropriate institutions will have to be set up in order to enforce the acquis adequately. In the energy

sector, only limited progress was made. The necessary legal framework for the participation of Hungary in the internal energy market still needs to be created. No progress could be noted with regard to the audio-visual sector.

Considerable progress was made in the area of social policy and employment, notably through the adoption of the revised Labour Law. As to social dialogue, confidence-building measures are needed to enhance real dialogue.

In relation to regional policy, Hungary has been making good progress in preparing for programming Structural Funds and in defining the implementation structures, but administrative capacity as well as financial and budgetary procedures need to be further strengthened. Effective inter-ministerial co-ordination mechanisms should also be set up, and an even wider application of the principle of partnership should be ensured.

The progress made in legal terms in the telecommunications sector needs to be followed up by appropriate enforcement measures.

*In the area of Justice and Home Affairs, significant progress was achieved through further alignment with the *acquis* in the fields of visa policy, migration and asylum. The fight against fraud, corruption, money laundering and organised crime was made more efficient through the adoption of additional legislation and reinforced institutional structures. As regards external borders, a strategy on the integrated development of border crossing points was adopted. The Schengen Action Plan addresses the main issues of the *acquis*.*

*In the area of common foreign and security policy, some of the provisions laid down in the Law on Hungarian minorities living in neighbouring countries apparently conflict with the prevailing European standard of minority protection. Hungary should therefore find an agreement with its neighbouring countries with a view to complying with the recent findings of the Report of the 'Venice Commission'. Also, as foreseen in its Article 27 (2), the Law will need to be aligned with the Community *acquis* at the latest upon accession, since it is currently not in accordance with the principle of non-discrimination laid down in the Treaty.*

As to financial control, some progress has been made both as regards external audit and public internal financial control. However, the administrative capacity in general and the functional independence of the auditors in the internal audit sector should be further strengthened. As to financial and budgetary provisions, further efforts continue to be needed in order to meet Community requirements with regard to co-financing and multi-annual programming.

*Hungary made further progress in building up its administrative capacity to apply the *acquis* in most areas. However, with regard to the administrative and judicial capacity, further efforts will have to be made in particular in areas such as state aid control, audio-visual, market surveillance, transport and agriculture. Further efforts are also required in establishing the necessary administrative capacity to ensure the sound, efficient and controllable management of EC funds.*

Hungary has continued to address its short-term Accession Partnership priorities with the exception of certain items in the field of agriculture, audio-visual policy, free movement of goods and competition policy. In addition, Hungary has implemented a

number of medium-term priorities in the areas of social policy and employment, environment and Justice and Home Affairs (on asylum matters and visa policy)."

3.1. The chapters of the *acquis*

As indicated, the following review of Hungary's ability to assume the obligations of membership has been structured in accordance with the list of 29 negotiating chapters. Accordingly, this section opens with an assessment of progress relating to the cornerstones of the internal market which are known as the "four freedoms", and continues with a systematic review of progress on each of the chapters, covering all aspects of the *acquis*, including sectoral policies, economic and fiscal affairs, regional policy, environment, justice and home affairs, external policies, and financial questions.

Chapter 1: Free movement of goods

Progress since the last Regular Report

Hungary has continued to register steady progress in the field of free movement of goods.

In the area of **horizontal and procedural measures**, Hungary continued the rapid adoption of European standards as Hungarian national standards. By December 2001, the Hungarian Standards Institution (MSZT) had implemented 11968 European standards as national standards, or 90% of all European standards. They include 96% of the European standards harmonised to the New Approach Directives. This, combined with the adoption in December 2001 of Act CXII on national standardisation and the entry into force in January 2002 of the amendment to the Copyright Act, extending copyright protection to voluntary standards, paved the way for full membership of CEN and CENELEC. The MSZT became a full member of CENELEC in June 2002 and should become a member of CEN in January 2003.

Hungary has continued transposition as regards **sector specific legislation**. In the areas covered by *New Approach Directives*, Community rules on equipment for use in potentially explosive atmospheres, personal protective equipment, radio and telecommunications terminal equipment and lifts were transposed. As regards sectors covered by the *Old Approach Directives*, some further pieces of legislation were adopted in the fields of cosmetics, metrology, medical devices, pharmaceuticals for human and for veterinary use, motor vehicles and classification of wood.

As regards the issue of *food safety and foodstuffs legislation* (see also Chapter 7 - Agriculture), Hungary has made significant progress with the entry into force in January 2002 of amendments to the Food Act and subsequent implementing legislation that entered into force in May 2002.

Progress has continued to be made in institutional development, with the establishment of bodies involved in market surveillance and inspection, such as the Lift and Elevator Supervision Body and the Market Surveillance Council, and the reinforcement of the capacity of some existing bodies. Furthermore, as announced in last year's Report, Hungary decided to set up a National Food Safety Agency, but its functions have still to be specified.

With regard to **non-harmonised sectors**, legislation on cultural goods has been adopted in November 2001. However, there have been no developments regarding the transposition of the *acquis* on firearms.

In the area of **public procurement**, Hungary has adopted legislation in July 2002 amending the regime for award of contracts in the field of motorway construction. This legislation has entered into force in August 2002. However, all remaining shortcomings concerning motorway construction as well as those in the area of public procurement in general have still to be addressed. Legislation had also entered into force in January 2002 fine-tuning public procurement rules. In 2001, the total number of public procurement procedures processed increased slightly to 3846, with the total value increasing by almost 16% compared to 2000 to HUF 607 billion (around € 2.4 billion). The proportion of open procedures rose to 78 % in value terms in 2001, and in terms of aggregate value, almost 8% of the tenders were won by bidders with headquarters abroad, mostly in the EU. In terms of administrative capacity the Council for Public Procurement and its administrative authority, the Public Procurement Arbitration Committee, have been strengthened. The number of public procedures addressed to the Arbitration Committee rose by 21% in 2001.

Overall assessment

As regards horizontal and procedural measures, the New and Global Approach is well established in Hungary. As stated in the 2001 report, the infrastructure required for legislation, standardisation, accreditation and certification is in place. Full membership of CEN should be achieved by January 2003. As regards safety checks on products, while the infrastructure is now in place, efforts need to continue to strengthen effective administrative co-operation between competent regulatory and surveillance authorities and to ensure the full implementation of the Central Information System on Market Surveillance (CMSIS), which has been fully operational since June 2002. Continued infrastructure development is required as regards market surveillance and testing and certification. Safety control checks still do not take place at the border and need to be addressed. However, steps are being taken to fully equip the border facilities and to provide appropriate training.

A large part of the sector-specific *acquis* is also in place. With regard to the *New Approach Directives*, work remains to be done on construction products, civil explosives, in vitro diagnostic medical devices and cableway installations. The outstanding legislative issues under the *Old Approach* relate mainly to metrology, where an impact analysis has been carried out in relation to legislation aimed at harmonising with the *acquis*; transparency of pricing of pharmaceuticals for human use; and the *acquis* on chemicals.

The transposition and implementation of the food safety *acquis* is almost completed and remaining efforts between now and accession will need to focus on further amending the Food Act and related legislation and on bringing these into line with EC law. The Food Act will require changes in particular on infant formulae, definitions, remaining pre-market approval procedures, food contact materials, additives and production licence. Implementing decrees will need to be adapted in particular on labelling, novel foods, food for special nutritional uses and control.

Institutionally, Hungary has decided to set up an Agency to deal with scientific assessment and to co-ordinate some of the activities of the bodies involved in food safety. The responsibilities of the Agency will need to be clarified in the light of the competencies of the institutes and ministries involved. Better co-ordination between the bodies in charge of food safety will need to be ensured so as to set up an effective rapid alert system for food and feed and a national contact point is still to be designated. Such improved co-ordination between the ministries and agencies involved will facilitate controls and assessment for novel foods and genetically modified foods, which do not at present take place. Hungary is promoting the introduction of Hazard Analysis and Critical Control Points (HACCP) principles across the entire food chain and HACCP training, which is now mandatory, is taking place. HACCP is now applied by 30-40% of food business operators – this accounts for 85% of Hungarian food production.

As a result of a new screening of laws and regulations which Hungary carried out in order to identify those measures that might be in conflict with the Articles 28 to 30 of the EC Treaty, a number of measures were identified. However, this screening was incomplete and needs to be carried out in a more comprehensive way in order to identify all the national measures that could be contrary to the *acquis*.

It was already highlighted in the 2001 report that the principle of mutual recognition will have to be well established by accession. For this to occur in good time, a detailed review of the national regulations that do not yet comply with the principle of mutual recognition needs to be carried out urgently. Further delays have resulted in the *acquis* on firearms not yet being transposed and this needs to be dealt with speedily.

A particular effort will be needed to adopt legislation on public procurement and to ensure that legislation and practice are brought into line with Community standards. In particular, further efforts are necessary to address shortcomings such as coverage (e.g. limited definition of public works, far reaching exemptions) and with regard to time limits and the treatment of utilities.

As noted in the 2001 report, Hungary had already put in place the necessary bodies to implement this part of the *acquis*. The relevant bodies have since been strengthened, but the rising number of complaints means that further reinforcement is still required if these bodies are to discharge their duties in a satisfactory manner. Efforts are still needed to ensure effective review mechanisms and review procedures.

Conclusion

In its 1997 Opinion, the Commission concluded that significant progress had been made and that Hungary was progressively taking on the *acquis* related to the free movement of goods, and had already taken on the most important directives. Implementation had generally been good. It was pointed out that further work was required in the areas of standards and certification. It was highlighted that special attention will have to be paid to type-approval of motor vehicles, tractors and motorbikes, the procedures for authorising market placement and the rules on labeling. Attention also needed to be paid to ensuring that national legislation in areas not covered by Community harmonisation would not act as a barrier to trade, and to check that the measures in force are proportionate to the objectives pursued.

Since the Opinion, Hungary has made steady progress in transposing the *acquis* in this area, and has continued to strengthen enforcement and surveillance capacity and infrastructure. Hungary has overall achieved a high degree of transposition of the *acquis* in the field of free movement of goods, with the exception of that on public procurement. Administrative capacity is generally good.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this area. Hungary is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts now need to focus on the adoption of the limited amount of outstanding legislation, and on further strengthening surveillance infrastructure and institutional capacity. A particular effort will be needed to bring public procurement legislation and practice into line with Community standards.

Chapter 2: Free movement of persons

Progress since the last Regular Report

The current reporting period has seen further alignment with Community provisions, and preparations for complete alignment, as well as for the establishment of the required administrative structures, have continued.

Good progress can be reported in the area of **mutual recognition of professional qualifications**, with the entry into force, in January 2002, for the greater part, of the Act on the Recognition of Foreign Degrees, Diplomas and Certificates. This Act provides the framework for a system of mutual recognition in accordance with Community practice. Legislation was also adopted in relation to the health professions. The Act on Provision of Public Health Care Services and on Forms of Practising Medicine entered into force in March 2002 with the exception of certain provisions on pharmacy. Except for midwives, where legislation is already aligned, new legislation was introduced for all medical professions covered by the sectoral directives in January and May 2002. Amendments to the Act on Pharmacies were adopted in October 2001 (entry into force January 2002) and June 2002 (entry into force September 2002) aligning the rules of ownership and operation of a pharmacy. Further alignment relating to the in-service training requirements for pharmacists resulted from amendments to secondary legislation, which entered into force in September 2002.

Some progress can be reported on **citizens' rights**. The Law on Entry, Stay in Hungary and Immigration of Foreigners entered into force in January 2002 and implementing measures have since been adopted. Legislation on student rights has been further aligned. There were no notable developments in the area of voting rights.

There have been some legislative developments in the area of **free movement of workers** covering access to the public sector for EU migrant workers. Preparatory work has continued to facilitate Hungary's participation in the European Employment Services system (EURES).

Hungary has continued to make legislative preparations in order to be able to apply the Community system of **co-ordination of social security** and has continued to develop its

institutional capacity in this area, through increasing staff numbers and training of personnel. A bilateral agreement on social security with the Netherlands, relating to the export of social security benefits, was ratified and entered into force in March 2002.

Overall assessment

Hungary is now aligned almost fully with the *acquis* in the area of mutual recognition of professional qualifications. With the adoption of the Act on the Recognition of Foreign Degrees, Diplomas and Certificates the establishment of the necessary administrative bodies has been provided for. Outstanding issues include alignment with EC legislation on lawyers. Efforts will need to be maintained in order to ensure full alignment by accession and should now focus on appropriate staffing of the various competent authorities. By accession, it has to be ensured that all Hungary's legislation is aligned with Community rules, in particular with respect to nationality, residence and language requirements. Legislation on mutual recognition needs to be monitored to ensure that it distinguishes between academic and professional recognition and includes simpler procedures to allow the provision of services. With respect to professional qualifications obtained before harmonisation, Hungary needs to introduce measures to ensure that all its professionals can, as of accession, meet the requirements laid down by the directives.

Hungary was already largely aligned with the *acquis* on citizens' rights. Preparations should continue, however, to align with the provisions on voting rights, in particular relating to the European Parliament elections.

In the area of the free movement of workers, legislation is only partially aligned and efforts are required to ensure complete alignment by accession, including the social and cultural integration of migrant workers and their families.

As regards future participation in the European Employment Services system (EURES), efforts should continue, especially with regard to language training.

With a view to the future co-ordination of social security systems, work needs to continue to develop the necessary administrative structures and institutional capacity needs to be strengthened further through training and recruitment of additional staff so as to enable Hungary to apply the *acquis* on co-ordination of social security.

Conclusion

In its 1997 Opinion, the Commission concluded that Hungary's legislation already recognised the principle of non-discrimination between nationals and foreigners legally residing in the country, and that training, for those professions where a minimum co-ordination is foreseen in the directives, was broadly in line with the *acquis*, although some adaptation was still necessary. It added that the necessary structures in the area of the free movement of persons seemed to be in place, but that it was difficult to assess their real effect and enforcement. The Commission further indicated that, from a technical point of view, adaptation of regulations would be necessary in the medium term. With regard to co-ordination of social security the Commission concluded that, although certain technical adaptations would be necessary, major problems were not to be expected. However, further preparation and training would be needed to have the required administrative capacity and structures in place.

Since the Opinion, Hungary has made progress in aligning with the *acquis* in this area, and has further strengthened the relevant institutions, including with regard to the future co-ordination of social security systems. The process of bringing Hungary's legislation and structures in relation to the free movement of persons into line with the *acquis* has developed satisfactorily and, although further efforts are required, legislative and other work has generally been carried out in a timely manner.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this area. It has agreed to a transitional arrangement in respect of the free movement of workers put forward by the EU. Restrictions on the movement of workers from Hungary to the EU will apply for a minimum two-year period as of the date of accession and may remain in force for a maximum of seven years. Hungary is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts now need to focus on the adoption of outstanding legislation with regard to voting rights, lawyers and free movement of workers, and on further strengthening institutional capacity to ensure the effective implementation of mutual recognition of professional qualifications and in relation to the co-ordination of social security.

Chapter 3: Freedom to provide services

Progress since the last Regular Report

Since last year's Regular Report, Hungary has made good progress regarding financial services and enhancing administrative capacity.

In the field of **the right of establishment and the freedom to provide services** (other than financial services), there were no significant legislative or administrative developments.

In the field of **financial services**, a new consolidated Capital Market Act entered into force in January 2002. This new legislation has amended legislation on the capital market and has brought further alignment with the *acquis* on investment services, public offering and trading of securities, investment funds, investor protection and supervision of the financial sectors. The Act also establishes new types of investment funds, but falls short of fully implementing the Community directive on undertakings for collective investment in transferable securities (UCITS). The legal concept of contractual netting was also introduced in December 2001 and entered into force in January 2002.

There were no particular legislative developments in the insurance sector during the period under review.

Amendments to the statutory law of the Hungarian Financial Supervisory Authority (HFSA) in January 2002 have further reinforced its independence. The HFSA has become more independent since January 2002, although it still does not have the power to issue its own regulations. The total staff of the Authority in 2001 was 534. As a result of inspections carried out in 2001, measures were taken in 1744 cases. In 221 cases fines were imposed, and in 42 cases licences were withdrawn or liquidation procedures initiated. Training programmes for staff at the Supervisory Authority have continued

throughout 2001. Furthermore, the HFSA signed a Memorandum of Understanding with the Austrian and German Insurance Supervisory Authorities, which further develops the supervisory system.

Concerning the **protection of personal data and the free movement of such data**, while there were no particular legislative developments in the reference period, December 2001 saw the election of the Parliamentary Commissioner for Data Protection.

Further alignment has been achieved with **information society regulations** with the adoption of legislative measures in September and December 2001. Furthermore, alignment with the directive on electronic commerce continued with the adoption of legislation in December 2001.

Overall assessment

The *freedom to provide cross-border services* is not yet fully in place. However, the entry into force in December 2001 of legislation on the mutual recognition of qualifications (see *Chapter 2*) will facilitate effective access of non-nationals to industrial, trade, tourism and agricultural activities. Restrictions on the acquisition of real estate, in particular as regards agricultural and forestry activity, continue to hamper effective access.

On the other hand, Hungary has, at this stage, achieved a substantial degree of alignment in *financial services*. The consolidated Capital Market Act is a significant piece of legislation which further fine-tunes Hungarian approximation with the *acquis*. In particular, this law addresses investor compensation schemes.

While progress in the area of financial services has been steady and substantial, there are some outstanding issues in relation to capital requirements and bank accounting. In relation to banking, alignment with Community rules on consolidated supervision is needed. Further efforts will also be needed to transpose in good time before accession the *acquis* relating to core EC insurance provisions.

The Hungarian Financial Supervisory Authority is an effective body, but it should be given the power to issue its own regulations.

As far as Articles 43 and 49 of the EC Treaty are concerned, Hungary still has to complete a screening of its legislation in order to identify and eliminate legal provisions and administrative practices, which are in conflict with the Treaty.

Concerning the protection of personal data and the free movement of such data further alignment is needed by adopting a new Data Protection Act, which is to be submitted to Parliament by end 2002.

The election of the Parliamentary Commissioner for Data Protection satisfies the requirement for complete independence imposed by the *acquis*. The office is operational and has achieved a great deal in terms of ensuring compliance with the law and raising awareness. However, the authority needs to be significantly strengthened in terms of staffing and infrastructure if it is to be able to effectively discharge its duties. Its budgetary independence needs to be assured and its powers enhanced, in particular with regard to implementation of data protection rules in the private sector.

Good progress has been made in aligning with the rules relating to *information society services*. Some further work will be needed to complete alignment with the *acquis* on e-commerce and media society, in particular in relation to the transparency directive governing this area and satellite broadcasting.

Conclusion

In its 1997 Opinion, the Commission concluded that the *acquis* in this sector had already been largely transposed and that important progress had been achieved. Considerable progress had been made in adopting the *acquis* relating to financial services (banks). Regarding the financial market, the legislative framework was said to be largely in compliance with EC criteria on many points. The Commission indicated however that full free establishment in the areas of banking and insurance had still to be adequately introduced in the sectors' legislative frameworks and duly implemented.

Since the Opinion, Hungary has made steady progress in most areas of the chapter, both in terms of legislation and in bolstering the administrative and regulatory infrastructure required to supervise the financial services sector. Hungary's alignment process is now well advanced, but further legislative alignment is still needed with regard to some aspects of the *acquis*.

Negotiations on this chapter have been provisionally closed. Hungary has been granted a transitional period (until 31 December 2007) to ensure its legislation on investor compensation schemes fully complies with the *acquis*. Hungary has been granted exclusion of two specialised institutions from the scope of application of the banking directives. Hungary is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts now need to focus on completing alignment with regard to securities and data protection, strengthening the existing supervisory institutions and facilitating rules on effective establishment and the provision of cross-border services.

Chapter 4: Free movement of capital

Progress since the last Regular Report

Good overall progress has been made in this field, with important developments as regards the removal of Hungary from the Financial Action Task Force (FATF) list of non-co-operative countries.

In the area of **capital movements and payments**, the entry into force in January 2002 of the Act on the Abolishment of the Foreign Exchange Restrictions and on the Amendments of the Related Acts has lifted all restrictions on foreign exchange operations (thus completing last year's foreign exchange liberalisation). In addition, there is now full convertibility of the national currency. The Capital Markets Act also entered into force in January 2002 and provides for, among other things, new investment fund opportunities. With regard to the *acquis* on **payment systems**, further alignment has taken place in the area of cross-border credit transfers and electronic payments.

Land legislation was adopted at the end of 2001 and entered into force in January 2002 with the aim of encouraging family farms. This legislation was revised in July 2002. It will need to be further adapted to comply with the *acquis* and with negotiated transitional arrangements on the purchase of land.

As for the *acquis* on **money laundering**, Hungary adopted in November 2001 the Act on Combating Terrorism, on Tightening up the Provisions on the Impediment of Money Laundering and on the Ordering of Restrictive Measures. This legislation, which entered into force in December 2001, has been instrumental in bringing Hungary in line with the *acquis* and in the removal of Hungary from the FATF list of non-co-operative countries in June 2002.

Overall assessment

With respect to the liberalisation of capital movements, only a few further measures remain to be taken. As highlighted in the 2001 report, there are still certain restrictions on direct investment. Institutional investors still face restrictions on investment in foreign assets and the state maintains golden shares in a limited number of privatised companies. In this regard Hungary still needs to modify its Act on Privatisation and to conduct a case-by-case examination of existing special rights. This was expected to be done in January 2002, but has been delayed.

Harmonisation has continued in the area of payment systems. Full alignment with the *acquis* needs to be achieved, notably with the directive on settlement finality. There are no major problems with respect to the payment and securities settlement infrastructure.

With respect to real estate, Hungary still needs to enshrine in its legislation the transitional arrangement granted and liberalise all other transactions where restrictions remain.

As well as being instrumental in Hungary's removal from the FATF list, Hungary's new legislation on money laundering aligns further with the *acquis* in this area. A satisfactory timetable for the phasing out of anonymous savings books has been established and Hungary has demonstrated its serious intent to combat such crimes. Improvements in administrative capacity and structures have been promised. The number of staff assigned to the financial intelligence unit operating within the Organised Crime Directorate of the National Police has doubled since last year. Further staff resources have been decided by the government, but this decision has yet to be implemented.

Conclusion

In its 1997 Opinion, the Commission concluded that Hungary's efforts to liberalise its capital markets had met with considerable success in several areas. It pointed out that further efforts were still required, though, especially in liberalising outward capital movements and removing investment restrictions on institutional investors (e.g. insurance companies.)

Since the Opinion, Hungary has made steady progress in aligning with the *acquis* in this area. While Hungary's legislation is now largely aligned with the *acquis*, further efforts are required in particular as regards land legislation.

Negotiations on this chapter have been provisionally closed. Hungary has been granted a transitional arrangement for five years after accession during which it may maintain its national provisions on the acquisition of secondary residences. Hungary has also been granted a transitional period for seven years after accession with regard to the acquisition of agricultural land. However, EU nationals who want to establish themselves as self-employed farmers and who have been legally resident and active in farming in Hungary for at least three years continuously are excluded from the scope of this transitional period. Hungary is generally meeting its commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts now need to focus on the adoption of the few remaining legislative measures still needed, and on introducing a complaints and redress procedure for the settlement of disputes on cross-border credit transfers.

Chapter 5: Company law

Progress since the last Regular Report

Since last year's Regular Report, Hungary has made further progress in the areas of company law and the protection of intellectual and industrial property rights.

Regarding **company law** as such, no significant legislative progress can be reported. As regards accounting, modifications to the Act on Accounting, which were adopted in November 2001, have established the legal basis for the introduction of national accounting standards. Amendments in January 2002 to the Act on the Chamber of Auditors provided for the establishment of an external quality assurance system. Due to modifications to the criminal code in December 2001 (entry into force April 2002) regulations on the violation of accounting regulations have become more rigorous. 2002 has also seen the registration and initial operations of a Fund established to ensure the translation into Hungarian of the International Accounting Standards.

Some progress was made in the field of **industrial and intellectual property rights** with the entry into force of legislation on copyright in January 2002 improving alignment with the *acquis* on databases including the *sui generis* protection. The Act on protection of designs entered into force in January 2002.

To enhance administrative capacity, staff numbers in the Hungarian Patent Office have continued to increase to over 260. Furthermore, training of judges in Community law has continued so that, by the end of 2002, over 1500 judges will have been trained.

As regards the **Regulation replacing the Brussels Convention** on jurisdiction and enforcement of judgements in civil and commercial matters and the **Rome Convention** on the law applicable to contractual obligations, no progress can be reported.

Overall assessment

In the field of *company law* a significant degree of alignment has been achieved. Outstanding issues are of a technical nature. Provisions on economic interest groupings still need to be introduced.

As regards accounting, work has continued on the introduction of national accounting standards and steady progress has already been achieved with the adoption of legislation in this area and negotiations on the creation of the National Accounting Standards Board.

In the field of *industrial and intellectual property rights*, Hungarian legislation has been aligned further with the *acquis*. Further efforts are required to achieve alignment with the *acquis* on copyright in the information society and resale rights. Also, Hungary will need to fully implement the *acquis* on the legal protection of biotechnological inventions.

Hungary has not yet joined the European Patent Organisation.

Administrative capacity continues to be sufficient, with staff reinforcements made in some cases, and training activities have continued. Demand is also strong with patent applications up by 30% in 2001. There has also been a significant increase in trademark cases pending before the courts as a result of changes to the law, which requires that three professional judges sit in chamber for these cases.

Despite some leniency in imposing penalties in industrial and intellectual property cases, the percentage market share of pirated goods fell to an estimated 18% in 2001. The value of counterfeited and pirated goods seized in the first half of 2002 was less than €2.6 million. Further efforts continue to be needed to ensure rapid and deterrent legal action against offences and to ensure efficient border control measures. The fight against counterfeiting and piracy should remain a priority.

Preparatory work is ongoing to apply the new Regulation replacing the Brussels Convention as of accession.

Conclusion

In its 1997 Opinion, the Commission concluded that Hungary had already taken on the most important Directives in the sectors included under this part of the *acquis* but that further work was required in all areas. It was highlighted that efforts would be required in the area of patents concerning pharmaceuticals. The Commission added that special attention should be paid to enforcement, in particular with regard to intellectual and industrial property. Efforts of a lesser degree were required to align legislation in the field of company law.

Since the Opinion, Hungary has made progress on alignment with the *acquis* in this area, and has further strengthened the relevant institutions. Hungary has to a large extent achieved alignment with the *acquis* in the area of company law, and with regard to industrial and intellectual property rights, although further efforts are still required with respect to patent protection, copyright in the information society and resale rights.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this area. It has agreed to the EU proposal relating to industrial property rights for pharmaceutical products and Community Trademarks. Hungary is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts now need to focus on ensuring full alignment with the *acquis* along the lines set out above, intensifying measures to combat piracy and counterfeiting, strengthening border controls and ensuring

rapid and deterrent legal action. Co-ordination between and training for enforcement bodies (customs, police, judiciary) should be improved.

Chapter 6: Competition policy

Progress since the last Regular Report

Since last year's Regular Report, Hungary has made progress in this area.

In the **anti-trust** field, secondary legislation in the form of block exemptions in the area of vertical restraints and horizontal co-operation agreements came into force in April 2002. In January 2002, the EU-Hungarian Association Council adopted amended anti-trust implementing rules under the Europe Agreement, which entered into force in Hungary in April 2002.

The *Office for Economic Competition*, together with its decision-making Competition Council, has continued to build on its enforcement record over the past year. In 2001, it took 120 anti-trust decisions (compared to 144 in 2000), two prohibitions (two with fines). The decisions included 30 cases of abuse of dominant position, 10 cases of restrictive agreements and 80 merger cases. Staff has increased by 14 to a total of 124, and training efforts continue.

In the field of **state aid**, amendments to the state aid legislation, strengthening the previous state aid control system, entered into force in January 2002. The Act on Public Finance now includes a general prohibition of state aid. The new legislation on exemptions from the prohibition to grant state aid contains the basic principles of state aid control. However, important fiscal aid schemes are still excluded and regional aid ceilings remain too high. The legislation also provides for increased control and monitoring as regards aid granted by local authorities. Hungary's annual state aid report for 2000 was presented to the European Commission in April 2002.

The *State Aid Monitoring Office* within the Ministry of Finance has been further strengthened and now has a staff of 12. Training activities have continued. In 2001, there were 360 decisions/opinions taken in state aid cases.

Overall assessment

As regards anti-trust, the overall assessment is positive. The Hungarian Competition Act contains the main principles of Community anti-trust rules as regards restrictive agreements, abuse of dominant position and merger control. The Office for Economic Competition, together with its decision-making Competition Council, functions well with a continued high level of training. In view of the planned modernisation and decentralisation of the application of the EC anti-trust rules, efforts to further strengthen the enforcement record should continue by giving priority to cases concerning the most serious distortions of competition and by imposing more deterrent sanctions. Increased awareness of the rules is important, especially among the business community, as is training the judiciary.

As regards state aid, the overall assessment is not yet positive, in particular because of Hungary's incompatible fiscal aid policy. Hungarian legislation still needs to be further aligned with the *acquis*, in particular since the legislation does not allow for the full

control of fiscal aid and does not include a regional aid map with acceptable maximum aid intensities (as justified by GDP figures). An immediate closure of incompatible fiscal aid schemes is required, as is a conversion of individual aid benefits (most of them lasting until 2011) into aid arrangements that are compatible with the *acquis*. As regards transparency, state aid reports have been submitted for the years up until 2000, which closely follow the methodology and the presentation of the European Commission's survey on state aid in the EC and are of good quality. The State Aid Monitoring Office is functioning well (staff increases may have to be considered, depending on notification levels), and its decisions are generally respected by the Government. Increased awareness of the rules is important, especially among aid grantors, the business community and the judiciary.

Conclusion

In its 1997 Opinion, the Commission concluded that the progress in approximation of legislation was significant in the field of anti-trust and that the skills of and efforts made so far by the Hungarian anti-trust authority represented a significant step forward towards credible competition law enforcement. In the field of state aid, however, the Commission added that more needed to be done to achieve the degree of transparency required. The role and powers of the monitoring authority had to be clearly defined to ensure the compatibility with the Community rules of the aid granted. Furthermore, the Commission noted that a considerable effort would be necessary to fulfil the requirements in the field of state aid over the medium term. Close co-operation with the Commission would be necessary in this field.

Since the Opinion, Hungary has made steady progress in adopting anti-trust legislation, developing the Office for Economic Competition's administrative capacity and establishing an enforcement record. Steady progress has also been made in adopting state aid legislation and increasing the transparency of the system, as well as in developing administrative capacity in the State Aid Monitoring Office and establishing an enforcement record. Overall, on legislative alignment, administrative capacities and enforcement record Hungary is reasonably advanced, except in the area of fiscal aid.

Negotiations on this chapter continue. Hungary has not requested any transitional arrangements in this area.

In order to complete preparations for membership, Hungary's efforts now need to focus on ensuring that it continues to update its alignment as the *acquis* in this area evolves and, most importantly, on continuing to develop a track record of proper application and enforcement of both anti-trust and state aid legislation. In particular, Hungary will need to ensure the immediate closure of incompatible fiscal aid schemes, as well as the conversion of individual aid benefits into aid arrangements that are compatible with the *acquis*.

Chapter 7: Agriculture

Progress since the last Regular Report

Since the last Regular Report, Hungary has made limited progress in the area of agriculture, both with aligning legislation and with strengthening administrative capacity.

Agriculture in Hungary accounted for 4.3% of gross value added in 2000 compared with 4.9% in 1999⁹. Employment in agriculture has declined considerably over recent years, and now accounts for 6.1% of total employment¹⁰.

In 2001, cereal production was substantially higher than in 2000, owing to a larger area under production and far higher yields. In the dairy sector, milk production increased slightly, mainly due to higher average yield per cow. Beef and veal production continued their decreasing trend, as did pigmeat production. Poultry production strongly increased¹¹.

In 2001, overall agricultural trade¹² between Hungary and the EC increased significantly, largely due to the «double-zero agreement». EC imports of agricultural products originating in Hungary increased by 12 % to € 1,327 million. EC exports to Hungary increased by 17 % to € 709 million. The trade balance in favour of Hungary amounted to € 618 million compared to € 538 million in 2000. EC imports from Hungary were dominated by oil seeds, vegetables and preparations of vegetables, fruit or nuts. Meat, residues from food industries and fruit and nuts were the main export goods from the EC.

Hungary has taken further steps to develop its agricultural policy. Some decisions have been taken on the future management of the common agricultural policy measures. Hungary also introduced various types of measures to promote family farming activities.

In 2001 agricultural support in Hungary increased from HUF 138 billion (€ 538 million) to 191 billion (€ 744 million), including HUF 50.4 billion (€ 196 million) for rural development. The same figure will apply in 2002. In 2002, export refunds were substantially reduced (from 13 to three sectors), and a new set of agri-environment measures was created. Market access support amounted to HUF 38 billion (€ 148 million) in 2001, and HUF 41 billion (€ 160 million) are budgeted for 2002. Production aid support amounted to HUF 67 billion (€ 261 million) in 2001, and the same amount is budgeted for 2002.

Area-based subsidies are provided in the arable crop sector, without size limit for rice and hemp for fibre, and within specified farm size limits for all other arable crops. Export subsidies can be granted in the grain sector, although they have been reduced since January 2002. A subsidy is also paid to milk producers who deliver raw milk fulfilling the EC quality and hygiene requirements. Also tobacco growers receive subsidies in the form of a quality premium.

Horizontal issues

Since last year's Regular Report, Hungary has made some progress on implementing measures related to the *European Agricultural Guidance and Guarantee Fund (EAGGF)*. In January 2002 the Agricultural Intervention Centre (AIK), with a current staff of 165, was formally designated as the paying agency for the EAGGF Guarantee Section. In

9 The source for all agricultural statistics is EUROSTAT unless otherwise specified. Figures for share of agriculture in gross value added for 2001 are not available.

10 EUROSTAT Labour Force Survey definitions (LFS). Agricultural employment is defined in LFS terms as economically active persons who gain a significant part of their income from agriculture.

11 Source: Prospects for agricultural markets: 2002-2009, European Commission, June 2002.

12 Source of trade figures: WTO definition of agricultural products, figures from EUROSTAT COMEXT (see U.E. 12.15: Commerce des produits agricoles 1998-2000, 1 Partie D.G. AGRI/G.2 Analyses quantitatives, prévisions, statistiques, études, 2001, pp. 10-57 et 86-89).

August 2002 it was decided that AIK would be merged from July 2003 with the SAPARD Agency into a single agricultural agency for all EAGGF funds.

The only progress that can be reported on the setting up of the *Integrated Administration and Control System (IACS)* is a Government decision defining the immediate tasks to be accomplished, together with a feasibility study on IACS implementation, in July 2002.

Regarding *trade mechanisms*, Hungary has established a working group of all the Hungarian authorities involved in customs clearance and international trade.

As regards *quality policy*, a system similar to the EC system for protection of designations of origin, geographical indications and certificates of specific character, which had been in place since 1998, was implemented in practice in 2001 and 2002 when the first five product names were registered.

Since Hungary's legislation on *organic farming* is already aligned to the *acquis*, no new developments are to be reported on this sector.

Preparations for Hungary's participation in the *Farm Accountancy Data Network (FADN)* continued. Hungary decided to set the minimum threshold for FADN farms at two economic size units.

Common Market Organisations

Since last year's Regular Report, Hungary has made limited progress on implementing measures related to the European Agricultural Guidance and Guarantee Fund (EAGGF) (*see above*).

The Research and Information Institute for Agricultural Economics has been appointed as the authority responsible for the price monitoring and reporting system.

The Agricultural Market Regulation Act came into force in November 2001. It establishes national measures for the balanced development of the market for agricultural produce and cost-effective agricultural production. It provides the legal basis for secondary legislation passed between December 2001 and August 2002 establishing several national support schemes.

No progress can be reported on *arable crops*.

In October 2001, the Ministry of Agriculture and Regional Development adopted a decree introducing a transitional *sugar* market regime from July 2002. This regime defines the marketing year, includes quotas for sugar and isoglucose, specifies the conditions for quota allocation and use, and prescribes the conclusion of an inter-professional agreement. In January 2002, the sugar beet delivery rights were allocated by the Sugar Product Council. According to the new legislation, a maximum of 400 000 tonnes of sugar and 130 000 tonnes of isoglucose produced in Hungary may be sold on the domestic market by the undertakings to which a quota has been allocated. AIK is in charge of quota management.

As regards *specialised crops*, in the *fruit and vegetable* sector, 18 producer organisations have received preliminary recognition. They benefit from public financial support of up to 20% of their marketable production.

In December 2001 the Commission adopted a decision by which fresh fruit and vegetables originating in Hungary can be imported without routine inspection of conformity to EC marketing standards by the Member States, provided that the products have been examined beforehand in Hungary. Hungary exports annually to the EC around 85 000 tonnes of fruit and vegetables, in particular peppers, cherries and plums.

In the *wine* sector, since January 2002 the rules on statistical survey, harvest, production and stock declarations have been applied in Hungary. Data on the general statistical survey of vineyards were published in July 2002. The National Institute for Wine Qualification (private storage, distillation, specific aids) and the National Institute for Agricultural Quality Control (production potential, vineyard restructuring) have been designated to carry out the official control of the specific measures under the wine CMO after accession.

Hungary also adopted the legislation needed to comply with the *acquis* in the *spirits* sector, in particular for 'Vilmos', rum, whiskey and pálinka. From July 2002 the name pálinka may only be used for the designation of fruit or grape marc spirits, and the use of ethyl alcohol in its production is forbidden.

As regards *animal products*, no progress can be reported in the dairy sector.

Hungary has fully applied the SEUROP classification system for beef since January 2002. No further progress can be reported in the *meat* sector.

A Government decree on marketing standards for eggs entered into force in January 2002, in line with EC legislation.

Rural development and forestry

In this area, very little progress can be reported since the previous Regular Report. Hungary has decided that from July 2003 AIK and the SAPARD Agency (*see Section A.b. - Relations between the European Union and Hungary*) will be merged into a single agricultural agency for all EAGGF-related measures. Hungary has stated that this merged organisation will become responsible for the implementation of EAGGF Guidance and Guarantee funded rural development measures and will also serve as the EAGGF Paying Agency. Since the Hungarian SAPARD Agency has not yet received provisional conferral of management, and therefore the implementation of the SAPARD programme has not yet begun, it is not possible to assess the state of administrative preparation for implementation of post-accession rural development programmes. The Hungarian Government has decided that the Ministry of Agriculture and Regional Development will be responsible for the preparation of the Agriculture and Rural Development Operational Programme.

In the forestry sector, the Hungarian legislation on classification of wood in the rough has been aligned to the *acquis*.

Veterinary and phytosanitary issues, including food safety

Since last year's Regular Report, further progress has been made in transposing and implementing the *acquis* in the **veterinary** sector, and certain administrative structures have been strengthened.

On the basis of the new framework legislation in the veterinary sector, which was adopted in 2001, 19 Government decrees for implementing veterinary rules have been adopted and entered into force. New legislation on the production, marketing and use of feeding stuffs was adopted in December 2001 and entered into force in June 2002. An implementing decree on import of feeding stuffs entered into force in August 2002.

In the field of *animal welfare*, transposition of the *acquis* on the protection of farm animals was completed in 2002.

The capacity of administrative structures was reinforced during the past year. The Department of Animal Health and Food Control of the Ministry of Agriculture and the field veterinary service are responsible for enforcing legislation on animal health, animal welfare and public health. Around 800 veterinarians work permanently at the County Animal Health and Food Control Stations and in the district veterinary offices. The Department of Animal Health and Food Control is also responsible for the central management of the veterinary border inspection posts, where around 170 veterinarians are employed.

On *public health* and *animal health*, in 2002 legislation was adopted on animal health requirements of animal breeding and on animal diseases.

Work was undertaken to upgrade the nine border inspection posts that Hungary wishes to maintain after accession, to bring them up to the standard required by the *acquis*. Three of them have been completed and opened.

The Central Veterinary Institute has been appointed as the national reference laboratory for TSE.

Hungary has made progress in preparing the internal market control system. Preparations for setting up an animal identification system for bovines, sheep and swine have continued.

Since November 2001 Hungary carried out more than 40,000 prion tests on cattle aged over thirty months for BSE and no positive cases were found. It has already adopted most EC requirements in this area. At rendering plants, beef must be separated from other meat. Since 2001 specific risk material (SRM) rules are applied and fallen stock is burnt after rendering, although its use is not yet forbidden by law.

Hungary is also implementing a national plan for upgrading food establishments to meet EC requirements. All establishments that are supposed to be operational after accession have been inspected by the competent authority, and a plan to correct any deficiencies has been drawn up.

In the **phytosanitary** sector, despite the fact that most legislation is in line with the *acquis*, some further progress was made in the reporting period.

Although no progress is reported on *plant health*, in the *pesticide sector* a new decree in March 2002 fixed the maximum level of pesticide residues in and on plants and plant products.

Legal harmonisation on seed and *plant propagating material* has been virtually completed. The National Institute of Agricultural Quality Control is responsible for the

implementation of the EC rules in this field, and it was accredited by the International Seed Testing Association (ISTA) at the end of 2001. The Institute's IT system and technical infrastructure have been improved.

Administrative structures for phytosanitary issues have been strengthened in parts. Two greenhouses, one for quarantine and one for virology, have been built. The Central Service for Plant Protection and Soil Conservation was established for performing national official tasks and for organising and co-ordinating the activities of the Services in the counties. Within this Service a Directorate for Registration was also established.

A decree was adopted in 2001, establishing compulsory registration, under the Central Service for Plant Protection and Soil Conservation, for producers and importers subject to phytosanitary control.

Hungary is developing ten phytosanitary border inspection posts (BIP) in line with EC requirements.

As regards **food safety** (*see also Chapter 1 – Free movement of goods*), some progress has been made, particularly regarding the upgrading plans of food establishments and the increase in measures to deal with BSE.

A Deputy State Secretary within the Ministry of Agriculture has been appointed to deal with food safety issues, including the establishment of a National Food Safety Office, which will become the counterpart of the European Food Safety Authority.

Overall assessment

In terms of preparations to apply the Common Agricultural Policy, considerable further efforts are needed. Market intervention systems in line with the *acquis* are not yet fully established, although similar systems exist in the milk and sugar sectors. Schemes have been introduced to facilitate access by family farmers to bank loans and the land market.

In the area of **horizontal measures**, even if the final decision on the future paying agency for EAGGF Guarantee market-related measures (AIK) has been taken, significant progress remains to be made in terms of defining the precise tasks of AIK, setting up appropriate organisation and procedures, and preparing it for accreditation. Hungary should define, too, whether AIK will also be the paying agency for EAGGF Guarantee rural development measures.

Concerning *IACS*, although the system for animal identification is relatively advanced, the establishment of a parcel identification system and the connection of the separate *IACS* databases need to be tackled urgently. Hungary has decided to build the blocks from existing aerial photographs. However, the process of digitalisation is so far little advanced. Only a small pilot project has been organised. A number of decisions remain to be taken in key areas for building the Land Parcel Identification System (LPIS). Very serious efforts are urgently needed in order for Hungary to be able to build up an operational *IACS* by accession. The necessary decisions must be taken immediately and the related funding put in place without delay if Hungary is to be in a position to administer and control efficiently the aid-schemes of the Common Agricultural Policy as of accession. If the required administration and control structures are not fully operational, or do not operate correctly upon accession, Hungary will be unable to fully

benefit from the support systems under the Common Agricultural Policy, or will be required to reimburse EC funds already received.

In the fields of *FADN, quality policy, organic farming and trade mechanisms*, Hungary's stage of preparation for accession is advanced.

Important decisions still need to be taken by Hungary on the administrative structures required for the implementation of **Common Market Organisations**, in particular concerning the distribution of tasks among the Ministry, its county offices and the AIK.

No decision has been taken up to now on the future role of the product councils that currently manage a number of significant tasks in Hungary's agricultural policy. However, a decision on the body in charge of price monitoring and reporting has been taken, even if there is no legal obligation for operators to provide regular price data.

For arable crops a number of measures still need to be taken, such as the establishment of a register of warehouses suitable for intervention and determination of the future intervention centres. Unlike for other agricultural sectors, Hungary has not introduced a transitional market regime for arable crops.

As regards sugar, Hungary is well advanced as a result of the adoption of a transitional market organisation, although an inter-branch agreement remains to be concluded between representative professional organisations of the sugar beet growers and the sugar industry.

Significant steps have already been taken towards harmonisation in the fruit and vegetable sector, with rules and administrative procedures on recognition in place. Work on the introduction of rules for operational programmes and funds needs to be continued.

In the wine sector, some of the necessary administrative decisions have been taken, and Hungary has decided to establish the vineyard register in 2003, on the basis of the results of a general statistical survey conducted in 2001. It has also decided to designate in autumn 2002 the institutions that will be involved in the common market organisation for wine. The Hungarian Wine Codex is under preparation. Hungary's administrative capacity in this field can be considered as sufficient.

Hungary has a voluntary quota system for milk since 1996, managed by the product council, accompanied by a system of buy-up prices. The sector is managed by the company Livestock Performance Testing Ltd, which is responsible for the quality testing of milk and milk products. About 85% of milk complies with EC standards. Hungary needs to decide which body will administer the quotas and control the producers upon accession.

Very serious efforts are still required in preparing for Hungary's post-accession rural development programmes. Hungary's decision to amalgamate the AIK and the SAPARD Agency should facilitate the implementation and management of future rural development measures. It is important that a clear definition of tasks within the new structure is ensured. However, given that Hungary has not yet received accreditation for its SAPARD Agency, its capacity to implement EC-funded rural development measures remains to be proven. Even with these two agencies (AIK and the SAPARD agency) amalgamated into a single body, which will facilitate the implementation and management of future rural development measures, very serious efforts will be required

to achieve the necessary administrative capacity by the date of accession. The Ministry of Agriculture also needs to ensure that appropriate expertise to develop the Guidance and Guarantee funded rural development programmes is available and closely coordinated with all relevant services.

Hungary should also focus on the preparation of a rural development strategy for the period subsequent to accession. The existing agri-environment scheme should be developed. A National Forestry Programme, co-ordinated with the Rural Development Programme and a forest registry, remains to be completed.

Land reform is still an issue of major concern for Hungary's agriculture. As a result of compensation and privatisation, the average size of agricultural properties is less than 3 hectares. Such fragmented land ownership creates an urgent need for consolidation, in particular among smaller farms. Incentives to farms should take into account their profitability in the longer term.

In the **veterinary** field, a Veterinary Act is in place, based on the introduction of the principle of regionalisation, separation of the tasks of official and private veterinarians, amendment of the animal passport rules, extension of the list of notifiable diseases. This Act needs to be implemented through a number of decrees, half of which have already been adopted by the Hungarian Government. In particular, legislation has to be aligned as regards the use of fallen stock and the rules on specific risk material (SRM).

Part of the decrees to implement the Act on feeding stuffs still remain to be adopted.

Hungary should ensure that the plans for the upgrading of its red meat establishments cover all existing deficiencies. Serious efforts are urgently needed to ensure that all remaining issues are duly addressed, and that the appropriate financing is secured to guarantee the implementation of the *acquis* by all establishments evaluated.

The whole national bovine herd has been identified individually (eartagged) and registered in the central database. An internal cattle 'passport' system registers movement and possible problems. However, some decisions still need to be taken in this respect and the current system must be brought into line with the relevant EC legislation.

Further efforts are needed to ensure that the seven remaining border inspection posts will be set up upon accession. In particular, for the Ferihegy Airport BIP it is unlikely at this stage that the plans for completion in 2002 will be respected.

In the **phytosanitary** sector, some progress has been made in transposing and implementing legislation, but this process is not yet complete. Further efforts are needed as regards the issuing of plant passports, registration of pesticides and control of pesticide residues. Also, the legislation on seed varieties needs to be further harmonised. Preparations of the administrative structures in this field have improved and should be continued.

As regards food safety, although progress in preventing BSE and in monitoring the upgrading of meat establishments is continuing, there are serious difficulties in setting up the National Food Safety Office. Clear rules among the Ministries involved, continuity in management and adequate resources are highly necessary for an effective start of the Office activities.

Conclusion

In its 1997 Opinion, the Commission concluded that further alignment to the *acquis* was still necessary, although significant progress had been made in adopting the measures mentioned in the Commission's White Paper of 1995 on the Internal Market. The Commission added that particular efforts were needed on: implementation and enforcement of veterinary and phytosanitary requirements and upgrading of establishments to meet EC standards (an aspect of particular importance with regard to the inspection and control arrangements that protect the EU's external borders); strengthening of the administrative structures to ensure the necessary capacity to implement and enforce policy instruments of the Common Agricultural Policy; and further restructuring of the agri-food sector to improve its competitive capacity. The Commission further pointed out that, if such progress were accomplished, accession in the medium term should not be accompanied by significant problems in applying the common agricultural policy in an appropriate manner.

Since the Opinion, Hungary has made progress towards alignment with the EC agricultural *acquis* and, more recently, has progressed with developing the necessary administrative capacity to implement the *acquis* in this area. However, preparations have often been delayed due to a lack of decisions at all levels, in particular as regards the preparation for the management of the Common Agricultural Policy. Hungary's legislation in this area is now largely in line with the *acquis*. Serious further efforts are, however, needed to increase its administrative capacity in this sector.

Negotiations on this chapter continue, although all negotiation issues in the veterinary and phytosanitary fields have been clarified. Hungary has been granted a transitional arrangement for public health in a number of high capacity red meat establishments (until 31 December 2006) and a transitional arrangement (until 31 December 2009) for construction elements covering existing laying-hen cages located in twenty-one establishments brought into service before 1 July 1999. Hungary is meeting the majority of commitments it has made in the accession negotiations in this field. However, delays have occurred in the transposition of some parts of the *acquis* in the veterinary sector (animal identification and registration system, TSE issues). These issues should now be urgently addressed.

In order to be ready for membership, Hungary's efforts now need to focus on finalising the ongoing alignment; further reinforcing the administrative capacity to implement and enforce the *acquis*, in particular in the veterinary field and that of food safety; ensuring that establishments are duly upgraded to meet Community standards; and continuing to adequately prepare Hungary's institutions to manage the Common Market Organisations and the rural development measures. With regard to the establishment of the Integrated Administration and Control System (IACS), due priority needs to be given to the development of a parcel identification system. Ongoing efforts need to be substantially stepped up.

Chapter 8: Fisheries

Progress since the last Regular Report

Limited further progress has been made over the last year with regard to the alignment with the *acquis*.

With respect to **resource management**, the service in charge of fisheries in the Ministry of Agriculture and Regional Development has been extended. In December 2001, training for county veterinarians on fish-size measurement was carried out.

As regards **inspection and controls**, limited progress consisting of some fish farms having introduced a Hazard Analysis Critical Control Points (HACCP) system can be reported. In Hungary the County Animal Health and Food Control Stations are responsible for the implementation of controls.

Concerning **market policy**, in 2002 Hungary started the establishment of a fish marking system. Furthermore, in May 2002 a decree of the Ministry of Agriculture transposed the *acquis* on marketing standards and on the health conditions for the production and the placing on the market of fishery products. However, progress on the establishment of producers' organisations has been limited.

As regards **state aid to the fisheries sector** and **international fisheries agreements**, there are no new developments to report.

Overall assessment

Since Hungary is a landlocked country, only a small part of the *acquis* relating to fisheries is applicable to this country.

Although the basic framework legislation is mostly in line with the Common Fisheries Policy, further amendments to the Hungarian legislation are required, in particular to establish the conditions for the control of live and fresh imported fish.

Efforts must also be pursued for full alignment with EC hygiene standards.

Particular attention should be paid to the need to establish the framework for the management of structural projects under the Financial Instrument for Fisheries Guidance (FIFG).

Conclusion

In its 1997 Opinion, the Commission concluded that Hungary would not encounter any major difficulties in integrating its fisheries sector into the Common Fisheries Policy, and that it would be necessary for Hungary to ensure compliance with the EC health, hygiene and environmental standards.

Since the opinion, Hungary has progressed in the indicated direction. Alignment of the Hungarian legislation with the *acquis* in the fisheries sector is now well advanced. Overall, Hungary's administrative capacity in this sector can be considered as adequate to cope with the Common Fisheries Policy.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this area. Hungary is meeting the majority of the commitments it has made in the accession negotiations in this field. However, a delay has occurred as regards the amendment of legislation and the completion of the establishment of the system for size control on imports, which was scheduled to enter into force in January 2001. This needs to be addressed.

In order to complete preparations for membership, Hungary's efforts will now need to focus on finalising its legislative alignment with the applicable *acquis* and on preparing for the management of the structural measures in this field.

Chapter 9: Transport policy

Progress since the last Regular Report

During the past year, Hungary has continued to align its legislation with the *acquis* and made further progress in this area, particularly in the fields of road and railway transport, as well as strengthening administrative capacity in the road and aviation sectors.

As regards **Trans-European Transport Networks**, 466 km road sections have been marked out as the most urgent ones for rehabilitation in the framework of the "National Road Habilitation Programme". The programme has been continued with a view to meeting the requirement of the increased maximum axle load of 11.5 tonnes for trucks in 2009. Progress was achieved in the framework of the motorway construction programme financed under the Széchenyi Plan. Furthermore, relief for international road traffic was provided by the reopening of the reconstructed Maria Valeria Bridge between Esztergom and Sturovo (Slovakia). In 2002, the Hungarian government is spending HUF 117 billion (around € 456 million) on motorway development.

In the **land transport** sector, some further progress was achieved in the field of *road transport* through the adoption of implementing legislation. Hungary completed alignment with the *acquis* in relation to the issuing of licenses to transport operators and admission to the occupation by introducing the professional competence criterion for road passenger transport operators. Furthermore, Hungary continued legal alignment with the *acquis* on the transport of dangerous goods. Hungary ratified the INTERBUS Agreement on the international occasional carriage of passengers by coach and bus in January 2002.

The General Transport Inspectorate (GTI) performs key supervisory and control functions. An increase of staff levels by 44 additional experts has been approved for 2002. In addition, the technical equipment of control units performing roadside checks will be upgraded. As part of the implementation of Community legislation on driving and resting times, 10 instructors and 300 road controllers were trained in the reporting period. In addition, training was provided by the GTI on the control of dangerous goods, on customs controls and on labour safety supervision.

On *railways*, progress was made with the transposition and implementation of the revised railway *acquis*. This was based on implementing legislation on the interoperability of high-speed railway systems and on the functions and powers of the railway authority, which provided for the new tasks of the railway authority as regards the licensing of railway undertakings and the interoperability of high-speed railway systems. Restructuring of the railways continued, and the amended railway act, which regulates conditions for access to the railway network, entered into force in January 2002. The act stipulates that the provisions for separation of passenger and freight transport within the Hungarian State Railways Co. (MAV) will enter into force in January 2003.

On *inland waterways* transport, legislation declaring certain natural and artificial surface waters suitable as waterways for shipping entered into force in 2002. Legislation on technical requirements for inland waterway vessels was also introduced.

As regards **air transport**, Hungary had already aligned its legislation with a substantial part of the aviation *acquis*. Further alignment took place through the adoption of implementing legislation under the Aviation Act on the licensing of ground handling services and the licensing of commercial air transport services.

The national carrier MALEV continues to undergo restructuring. MALEV is now an independent company with an independent management, and the staff has been reduced. The programme for MALEV included the complete replacement of all Tupolev aircraft by a modern fleet in 2001. Furthermore, a regional subsidiary called MALEV EXPRESS was established with new aircraft with capacity for 50 passengers. A co-operation agreement between MALEV and a European air carrier has been established.

In January 2002, the Civil Aviation Safety Organisation was established as an independent body to investigate aircraft accidents and incidents with a current staff of 10. Furthermore, an independent slot co-ordinating body was set up with a staff of 6. The Civil Aviation Authority (CAA) has started to recruit its new staff: 14 additional experts have been recruited; the recruitment of another 9 has been approved. With regard to Budapest Ferihegy International Airport, a separate joint stock company was set up in January 2002 to operate the airport independently from HungaroControl, a public central budgetary agency providing air traffic control. Based on a Government Decision, the National Airspace Co-ordination Committee was set up to co-ordinate between civil needs and military airspace requirements as a reflection of the need for airspace management and Hungary's international obligations. As regards **maritime transport**, Hungary has made good progress in transposing the *acquis* on Port State control in the reporting period. In addition, legislation on conformity assessment in this area was promulgated in the first half of 2002. As to administrative capacity, the shipping authority currently has one inspection vessel at its disposal, in Mohács.

Overall assessment

Under the new government structure, transport matters have been covered since May 2002 by the Ministry of Economic Affairs and Transport. The main supervisory institution is the General Transport Inspectorate (GTI). Although the administrative capacity of the GTI has been significantly strengthened during the period of 2001-2002 (recruitment of 420 staff), there is still a need to further strengthen this body, which oversees the activities of the road, rail, inland and maritime transport sectors. This concerns in particular the different sub-sectors of land transport.

As regards Trans-European Transport Networks, the Hungarian authorities continue to take into account the objectives and priorities of the Community guidelines on the Trans-European Transport Network (TEN-T) and the requirements on TEN financing. Special emphasis should be given to ensuring the necessary administrative capacity (both in qualitative and quantitative terms) to prepare for the significant investments that will be needed for the development of the road and rail infrastructure.

Concerning road transport, Hungary still needs to adopt legislation on standard checking procedures and on technical controls for commercial vehicles. Further efforts are still

required on the implementation of social rules (admission to the occupation and checks on driving times and rest periods). An amendment also has to be made to Hungarian legislation on vehicle taxation in order to gradually approximate to the *acquis* in this area. As regards administrative capacity, the road police and the Road Transport General Inspectorate need to be further strengthened through additional staff and continuous training in the enforcement of social, technical and safety *acquis* and on the five-year development plan for establishing an internal weight-checking network.

In the railways sector, further efforts are necessary in order to allow for the implementation of the revised railway *acquis*. Laws on the independence of essential functions, such as the allocation of train paths and the charging for rail infrastructure use from the provision of rail transport services, as well as on the allocation of railway infrastructure capacity and the levying of charges for the use of railway infrastructure are still missing. Community legislation on the interoperability of conventional railway systems has not been transposed yet either. On administrative capacity, all the institutions needed to implement the relevant *acquis* are in place. The capacity of the Railway Inspectorate within the GTI should be further strengthened by increasing staff so as to be able to make progress with harmonising legislation and to handle upcoming regulatory tasks. As regards further restructuring of MAV, the Hungarian Government has not yet decided whether there is a need to separate infrastructure and commercial activities into independent companies. The infrastructure and operation accounts have already been separated. The licensing of railway undertakings, the issuing of safety certificates, the allocation of capacity and infrastructure user charges, and market supervision are to be carried out by independent organisations.

With regard to the inland waterways sector, alignment has been completed with the exception of the establishment of the Inland Waterway Fund. As for administrative capacity, the organisation of the Shipping Department within the GTI and the other authorities will have to be reinforced by new staff, and the funds required for the operation will have to be increased. Budgetary funds should be provided for this development of the administrative organisation. The purchase of a second inspection vessel is envisaged.

Concerning air transport, all administrative structures are now in place. A key question remains the financial prospects of the national carrier, MALEV, which continues to be a loss-making enterprise. New staff will have to be recruited for the Civil Aviation Authority in view of the increasing tasks of the body.

In the field of maritime transport, although Hungary is a landlocked country, alignment with the *acquis* on Port State control is almost complete. Transposition has to be finalised as regards legislation on passenger boats, Ro-Ro vessels, shipping vessels longer than 24 metres and the registration of persons travelling on passenger boats.

Conclusion

In its 1997 Opinion, the Commission concluded that, subject to a number of conditions, the transport sector was unlikely to pose any major problems to Hungary as regards the adoption of the *acquis*. It requested that the operation of the domestic road haulage market be improved, progress be made with technical checks on passenger cars and the arrangements on financial transparency and access rights in the rail sector be clarified. The Commission encouraged Hungary to devote adequate attention in the pre-accession

period to making the necessary resources available to lay the foundations for the Trans-European network. The Commission added that it would also be advisable that Hungary's administrative structures, and in particular bodies supervising areas such as safety, be rapidly reinforced.

Since the Opinion, Hungary has made steady progress in aligning legislation. Its legislation in the transport sector is now to a great extent in line with the EC *acquis*; the relevant framework laws are in place and only a limited amount of implementing legislation remains to be implemented. Hungary has also gradually reinforced its administrative capacity, but needs to make further efforts.

Negotiations on this chapter have been provisionally closed. Hungary has been granted transitional arrangements on maximum authorised weights and dimensions (until 31 December 2008), on vehicle taxes for vehicles exclusively engaged in domestic transport (until 31 December 2005), on road freight cabotage (for a maximum of 5 years after accession), on full access to the Trans-European Rail Freight Network (until 31 December 2006) and on noisy aircraft (until 31 December 2004). Hungary has agreed to a transitional arrangement put forward by the EU concerning the gradual reciprocal access to the cabotage market in the road haulage sector. The country is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts now need to focus on adopting the remaining legislation in the road and rail sectors and in inland waterways. As regards administrative capacity, particular attention will need to be paid to further strengthening the General Transport Inspectorate and its sub-Inspectorates, especially for the rail and road sectors.

Chapter 10: Taxation

Progress since the last Regular Report

Since the last Regular Report, Hungary has made limited progress with aligning its tax legislation with the *acquis*. The modernisation of Hungary's tax administration has continued.

In the area of **indirect taxation**, no progress can be reported regarding VAT. As concerns excise, the gradual increase of duty levels continued. In particular, the level of duty on lower-taxed fruit and wine brandy was increased, while the duty on sparkling and still intermediate alcoholic products was brought up to the EC minimum. Furthermore, the specific duty on cigarettes of the price category most in demand was increased as of January 2002, as well as the *ad valorem* duty on fine cut tobacco.

There are no developments to report in the area of **direct taxation**.

As regards **administrative co-operation and mutual assistance**, some progress was made in November 2001 with the amendment of the rules on taxation and on mutual assistance for the recovery of claims, which will only enter into force upon accession.

As concerns administrative capacity, Hungary has continued to modernise its tax administration. The legal framework for the establishment of the Central Liaison Office was adopted in November 2001. The Office will operate within the Tax and Financial

Control Administration. In addition, a new central Excise Directorate was set up in order to reinforce the effectiveness of the excise administration. Infrastructure and information technology were further improved.

Hungary has taken significant steps to prepare for interconnectivity by starting to develop an in-house VAT Information Exchange System application and by preparing for the installation of CCN/CSI (Common Communications Network/Communication System Interface). Preparatory activities have also been launched for the development of the SEED (System for Exchange of Excise Data) database.

Overall assessment

In the area of indirect taxation, alignment has to be completed regarding VAT (reduced rates, refund for foreign taxable persons not established in Hungary and the abolishment of the zero-rate) and excise duty (introduction of a single rate for fruit brandies and other spirits in line with the EC minimum level).

With regard to direct taxation, further alignment is still needed in order to bring the Hungarian legislation fully into line with the *acquis*, in particular with regard to the abolition of the withholding tax applied to dividends distributed to EU-based parent companies of Hungarian subsidiaries. The review of legislation by the Commission to ensure compliance upon accession with the Code of Conduct for Business Taxation is in process. The Commission's initial technical assessment of potentially harmful measures applied in Hungary is ongoing. With regard to administrative capacity, Hungary has strengthened and modernised its tax administration: both the Office in charge of direct taxes and VAT (APEH) and that in charge of excise duties (VPOP) have adequate legislative and administrative structures as well as adequate resources to ensure effective collection, enforcement and control of taxes. Preparations have started for the implementation upon accession of the Central Liaison Office and the Excise Liaison Office.

Hungary still needs to finalise work to ensure that the computerised tax information system is fully operational ahead of accession, including links with the customs information system and interconnectivity with EC systems.

Conclusion

In its 1997 Opinion, the Commission concluded that the *acquis* in respect of direct taxation should present no significant difficulties. It further noted that, as regards indirect taxation, provided that sustained progress continued in these areas, Hungary should be able to comply with the *acquis* concerning VAT and excise duties within the next few years. The Commission added that it should be possible to start participating in mutual assistance as the tax administration developed its expertise in this respect.

Since the Opinion, Hungary has gradually continued its alignment with the *acquis*, although a number of weaknesses remain to be addressed. Hungary has also made progress with developing the necessary administrative capacity to implement the *acquis* in this area, but further progress is still needed to ensure its proper and effective functioning upon accession.

Negotiations on this chapter have been provisionally closed. Hungary was granted transitional periods until 31 December 2007 to continue applying a reduced VAT rate not lower than 12% on the supply of certain heating products, on district heating services and restaurant services. Hungary was also granted a transitional period until 31 December 2007 to apply a lower excise duty rate (not lower than 50% of the standard rate) to alcoholic products distilled under the “hire distilling” scheme in distilleries producing more than 10 Hl of pure alcohol a year, but not more than 200 Hl. In April 2002, Hungary requested the re-opening of the chapter. Hungary is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary’s efforts now need to focus on finalising alignment – except for areas where transitional arrangements were agreed – in the areas of VAT and excise, including intra-Community transactions, and on further pursuing the measures taken to modernise and reinforce the tax administration.

Chapter 11: Economic and Monetary Union

Progress since the last Regular Report

A detailed assessment of the various aspects of Hungary’s economic policy has been given above, in the Chapter discussing the economic criteria (B-2). Therefore, the present section is limited to a discussion of those aspects of the Economic and Monetary Union *Acquis* – as defined by Title VII of the EC Treaty and the other relevant texts – which candidate countries should implement before accession, i.e. the prohibition of direct public sector financing by the central bank, the prohibition of privileged access of the public sector to financial institutions, and the independence of the national central bank. As to the process of liberalisation of capital movements, upon the completion of which compliance with the EMU *acquis* is conditional, this aspect has been covered above, in the section on *Chapter 4 – Free movement of capital*.

Since the last Regular Report, Hungary has not made significant progress in the area of Economic and Monetary Union, given that Hungarian legislation is largely aligned with the EMU-related *acquis*.

This concerns in particular the areas of **prohibition of direct public sector financing by the central bank** and **prohibition of privileged access of the public sector to financial institutions**, where alignment with the *acquis* has been completed.

As regards the **independence of the central bank**, in July 2002 the Parliament adopted an amendment to the Act on the NBH, which is in line with the *acquis*. The amendment mainly concerns the determination of the exchange rate regime and the definition of the organs of the NBH, the General Assembly, the Monetary Council, the Boards of Directors and the Supervisory Board and their scope of authority.

Overall assessment

Hungary will participate in EMU upon accession with the status of a country with a derogation under Article 122 of the EC Treaty, and it will need to implement the necessary changes to its institutional and legal framework by the date of accession.

Hungary's legislation is largely in line with the provisions of the *acquis* as regards the prohibition of direct public sector financing by the central bank.

In the area of central bank independence, Hungarian legislation is also in line with the provisions of the *acquis*.

Conclusion

In its 1997 Opinion, the Commission stated that the Hungarian Central Bank was formally independent from the government. In practice, however, the appointments of new governors had coincided with changes in the government. Since the launch of the stabilisation package in March 1995 the objective of the Central Bank has been to curb inflation. Finally, in the Opinion it was stressed that a (then) recent amendment to the Law on the Central Bank had almost eliminated any differences between this Law and the Treaty provision concerning the prohibition of budget deficit financing by the Central Bank. The Commission concluded that Hungary's participation in the third stage of EMU as a non-participant in the Euro area should pose no problems in the medium term, provided that central bank legislation was made fully compatible with EC rules.

Since the Opinion, progress was initially slow, but major steps forward have been taken over the past two years, and Hungary has in the meantime achieved a high level of alignment with the EMU-related *acquis*.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this area and is generally meeting the commitments it has made in the accession negotiations in this domain.

In order to complete preparations for membership, Hungary's efforts should now focus in particular on further reinforcing its administrative capacity in this area.

Chapter 12: Statistics

Progress since the last Regular Report

Hungary has continued to make further progress in the reporting period. As regards **statistical infrastructure**, there were no recent changes.

No particular developments can be reported either concerning national **classifications**, which are implementing European economic classifications and nomenclatures and were already put in place.

No recent changes have been made in the area of **demographic and social statistics**, which are already well developed and compliant with EC standards.

As regards statistics at **regional** level, no further progress can be noted, since a large amount of regional statistics has been made available. Fine-tuning concentrated, in the reporting period, on the delivery of the full set of variables of the regional accounts.

As to **macro-economic statistics**, financial accounts, Government finance statistics and especially public deficit and debt statistics started to be developed.

In the sector of **business statistics** a series of actions was undertaken for further streamlining. Continuous work was also undertaken on the Business Register.

As regards **transport statistics**, new surveys for international road freight transport have been introduced.

As for **external trade**, the introduction of INTRASTAT, which will measure the trade between the Member States, was identified as a top-priority. A detailed implementation plan was set up for its introduction.

As regards **agricultural statistics**, no further progress could be noted in this sector, since alignment with the *acquis* has been largely completed.

Overall assessment

Statistical infrastructure and legal and organisational elements are in place including the required human resources.

In the area of national classifications, the focus should now be on continuous updating according to the development of European standards.

Demographic and social statistics are well developed, as is illustrated by the successful implementation of the Population Census of 2001, which now provides data at all relevant regional levels. The Labour Force Survey is well designed and close to full harmonisation. Concerning health, safety and consumer protection statistics, further methodological development is under way. The Survey on income and living conditions is under preparation by adding the necessary questions to the current Household Budget Survey.

The overall level of compliance in macro-economic statistics is good. Business statistics are also largely compliant. The degree of compliance of short-term statistics is equally high.

Transport statistics are well developed and statistics on external trade with third countries are well established.

Concerning agricultural statistics, they are produced in co-operation between the Ministry of Agriculture and Rural Development and the Central Statistical Office. Important statistics like the Farm Structure Survey, Crop Production and Livestock are completely harmonised.

Priorities of the coming years are preparation for the INTRASTAT system and the further development of macro-economic statistics, in particular financial accounts, debt and deficit statistics and coverage of national accounts. In agriculture, Hungary's further efforts should focus on agro-monetary statistics and on animal product statistics. In transport statistics, the survey on carriage of dangerous goods needs to be implemented in 2003. The continuous improvement of co-ordination and strategic planning within the statistical system is also an important issue that needs to be addressed. The HCSO (Hungarian Central Statistical Office) should strengthen its role in the Statistical Council, an advisory body to the office, and should generally sharpen its profile as the co-ordinator of the Hungarian Statistical System.

Conclusion

In its 1997 Opinion, the Commission concluded that, provided that continuing progress was made, Hungary should have been able to comply with EU requirements for official statistics within the following few years.

Since the Opinion, Hungary has made very good progress, in particular in developing the necessary administrative capacity. Hungary's legislation is now largely in line with the *acquis* in most statistical fields.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this field. Hungary is generally meeting the commitments it has made in the accession negotiations in this area.

In order to complete preparations for membership, Hungary's efforts now need to focus on the further development of macro-economic statistics, on the preparation for INTRASTAT and on the implementation of agriculture and transport statistics.

Chapter 13: Social policy and employment

Progress since the last Regular Report

Considerable progress has been made in this area since the last Regular Report.

After the entry into force of the amendments to the **Labour Law** in July 2001, legal approximation continued with the transposition of the Insolvency Directive in the second half of 2001. New staffing and training courses have been provided in the course of 2001 and 2002. A one-year training programme for labour law judges, aimed at facilitating effective enforcement of labour rules, is also under implementation.

In the field of **equal treatment of men and women**, Hungary has transposed a large part of the *acquis*. EC legislation on equal treatment in agriculture and self-employment and on equal access to employment and vocational training was transposed in the second half of 2001. Hungary has also been undertaking efforts to promote mainstreaming, to train the legal professions, to raise awareness and to tackle inequalities, in particular on the labour market.

In the area of **health and safety** at work, substantial progress was made with the transposition of the EC legislation regarding work on board fishing vessels, safety and health for workers at the workplace, personal equipment, screen equipment, temporary or mobile construction sites and safety and health requirements for the use of work equipment by workers at work. Also, the institutional framework has been strengthened. Following the change of Government in May 2002, related competencies are now shared between the new combined Ministry of Health, Social and Family Affairs and the Ministry of Labour and Employment Affairs.

The National Labour Inspectorate was designated as the national focal point for the European Agency for Health and Safety. Stricter rules on labour protection supervision have been introduced. The Inspectorate will be boosted by 80 new officials in 2002. Training activities will continue throughout 2002.

In the area of **social dialogue**, the new Government has started to restore confidence and trust between the social partners and to create a more favourable climate. Improvement of the social dialogue is now a priority, and one of the Government's first resolutions expresses its commitment to restructure and improve the system of social dialogue and the effective involvement of the social partners in the decision-making process. The declared aim of the Government is, therefore, not only to consult the social partners but also to reach agreements in the negotiations. To that end, the social partners and the Prime Minister signed the Agreement on Restructuring the Social Dialogue System. The National Interest-reconciliation Council (NIRC) was established in July 2002 as the legal successor of the National Labour Council. The work of the Council will be supported by a number of special fora such as the National ILO Council, the Council for European Integration and the new Sectoral Council, as well as by several technical committees.

Hungary continued to take steps in respect of **public health** policies, strategies and programmes. The 10-year "For a Healthy Nation" public health action programme approved in June 2001 is currently under implementation. Steps have been taken to improve the administrative capacity through the reorganisation of existing structures. Progress has also been made on health information and monitoring. In June 2002, the Parliament adopted a decision on certain long-term tasks in relation to the national public health situation. It invited the government to update and extend the 10-year action programme by 15 December 2002. The tobacco legislation has been partially transposed during the reporting period. The relevant enforcement agencies made essential efforts to ensure implementation of tobacco legislation. As regards the implementation of measures on surveillance and the control of communicable diseases, the National Centre of Epidemiology at the National Public Health and Medical Officers' Service has been designated as a counterpart for epidemiological surveillance and for the control of communicable diseases. The Centre is preparing for full participation in the activities of the Community network.

As regards **Employment Policy**, the Joint Assessment on Employment Policy Priorities for Hungary (JAP) was signed in November 2001. As part of the monitoring process of the Employment Policy Review, the Hungarian Government submitted a progress report on implementation of the priorities identified in the JAP to the Commission in May 2002. This report represents an important step in assessing the extent to which Hungary is progressing towards its objectives of labour market reform and adaptation of its employment system in order to prepare for full participation in the European Employment Strategy upon accession. The situation in the labour market remained substantially stable with an unemployment rate of 5.7% at the end of 2001. 45% of all unemployed are long-term unemployed; long-term unemployment is thus still around 2.5%. The newly established Ministry of Employment and Labour will assume responsibility as the Managing Authority for the Human Resource Development Operational Programme.

As concerns the **European Social Fund (ESF)**, the establishment of the ESF Inter-ministerial Task Force and the role of the National Development Plan Thematic Working Groups on Human Resources Development and Regional Development further improved the co-ordination of ESF-related policies and activities.

As a follow-up to the Gothenburg European Council, where the EU invited the candidate countries to translate the EU objectives into their national policies, the Commission and Hungary have initiated a joint co-operation exercise to prepare for future participation in

the EU **social inclusion** process after accession. This exercise consists in joint identification of the social exclusion challenges and relevant policy responses. In this context, the Hungarian Central Statistical Office co-operates with Eurostat to produce data on poverty and social exclusion. Preliminary figures suggest that overall income disparities seem to be relatively moderate, with a poverty rate after social transfers of 9%. However, for members of the Roma community, the poverty risk is very high. A political state secretary has been appointed with specific responsibility to deal with social inclusion under the competence of the newly created Ministry of Health, Social and Family Affairs.

As regards other areas of **social protection**, implementation of the National Programme for People with Disabilities has produced initial results in the areas of work environment, communications, transportation, health care, education and training, employment, sports and leisure time, and social welfare.

In the field of **anti-discrimination**, additional financial resources have been allocated to Roma programmes, and the staff of the Office for National and Ethnic Minorities has been increased. An Inter-Ministerial Codification Committee on Anti-Discrimination recommended the adoption of a new comprehensive anti-discrimination law to ensure the full enforcement of the anti-discrimination provisions contained in the EC Treaty. In June 2002, the Government announced the creation of a new anti-discrimination bureau to combat labour discrimination against women, disabled people, Roma and other minority groups.

Overall assessment

In the area of labour law, the overall level of legal approximation is rather high. However, further efforts are needed and related changes would require modifications to the Labour Law, which were promised by the new Government when coming into power in May 2002. The preparatory work accomplished so far provides a firm basis for completing the entire labour law approximation by the end of 2002. The Directives on part-time work and transfers of undertakings, which were scheduled for transposition in 2001, have not yet been transposed. The approximation of the labour law should be completed by the end of 2002 with the transposition of the fixed-term work Directive, the European Works Council Directive, the new working time Directive and the sectoral working time Directive. Hungary will also need to transpose the Directives on information and consultation of workers and on workers' involvement in the European Company.

With respect to equal treatment for women and men, Hungary is well advanced regarding transposition and implementation. However, further efforts are needed for awareness-raising campaigns, the training of judges and lawyers and the setting-up of a body for the promotion of equal treatment.

Regarding health and safety at work, through the important progress made in the transposition of the *acquis* in 2002, legal alignment is almost complete. However, the new provisions on safety and health for workers at the workplace and on the use of work equipment by workers at work will only enter into force at the time of accession. The remaining *acquis* will be transposed and implemented by the time of accession. Work remains to be done with respect to the effective implementation of the *acquis* in this area.

In this respect, attention should continue to be paid to small and medium-sized enterprises.

In the area of social dialogue, with the new Government a substantial improvement and climate of confidence could be noted, and the goodwill to actively promote sound developments in social dialogue seems to be restored. Autonomous bipartite social dialogue needs to be reinforced at sectoral and enterprise level, and its coverage extended, both in terms of enterprises and of percentage of the labour force covered by collective agreements.

In public health, the ten-year public health programme sets the necessary framework for developing the sector, but should be more focused on structural adjustments and ways to increase efficiency. Efforts to reinforce administrative capacity should be pursued. Furthermore, Hungary will have to align its tobacco legislation with the requirements of the Tobacco Directive. With regard to communicable disease surveillance and control, Hungary has the necessary capacity to undertake the measures needed to fulfil and implement EC requirements. These include the modernisation of training for epidemiologists, continuous professional training, the strengthening of the county public health institutes and close integration of parallel surveillance programmes for specific diseases. Work to develop a health monitoring system to obtain health data and indicators comparable to the EU system, which started in 1998, should be continued. Efforts to improve the health status of the population need to be pursued.

Regarding employment, the signature of the Joint Assessment of the Employment Policy Priorities of Hungary (JAP) by the European Commission and Hungary represents an important step in the preparations for accession. Progress in the implementation of these policies is assessed regularly. It will be important to ensure effective monitoring of the phasing-in of the priorities and commitments contained in the JAP. Hungary's policy response to meeting the challenges of labour market transformation and human resource development needs to be accelerated. Employment policies should aim at increasing the overall employment rate, in particular for women, addressing regional mobility and reviewing the tax and benefit systems to increase incentives for inactive people to seek and accept job offers. The Public Employment Service needs to be further strengthened, in particular its role as a provider of placement, guidance and counselling for the supply and demand sides of the labour market. The continued modernisation of IT systems is an important part of this strategy. The effectiveness of inter-ministerial co-operation should continue to be strengthened through the newly established Ministry of Employment and Labour, which will assume responsibility as the Managing Authority for the Human Resource Development Operational Programme.

The role of the ESF National Implementing Agency, in operation since June 2001, still remains to be clarified in the framework of the future intermediate body and implementation arrangements being established.

A national integrated strategy on promoting social inclusion, taking into account the EU objectives, needs to be developed. As poverty and social exclusion are multidimensional by nature, it is important to promote an integrated approach mobilising various governmental bodies and all relevant stakeholders in the process. It is also crucial to improve and develop social statistics systems on poverty and social exclusion in line with the EU commonly agreed indicators on social inclusion.

As regards other areas of social protection, sustained efforts are required to implement the reforms that have been introduced, including the health care reform, which will help further improve the level and efficiency of social protection. The strategic aims of the National Programme for People with Disabilities should be pursued further, in particular the goals of facilitating their social integration and fighting all forms of discrimination. Although the Government has taken steps to tackle the problem of access to public buildings, the implementation of related measures is slow.

Further efforts are also needed to ensure alignment and enforcement of the *acquis* on anti-discrimination. Even if anti-discrimination rules and principles already exist in Hungary, there is currently no institutional system to enforce the anti-discrimination legislation. Also, as to the recommendations of the Inter-Ministerial Codification Committee on Anti-Discrimination to adopt a new comprehensive anti-discrimination law, the Government still needs to present its draft law to the Parliament. Discrimination in the field of employment is still widespread, in spite of the relatively extensive system of anti-discrimination sanctions under the new Labour Code. An adequate system of sanctions needs to be developed.

Conclusion

In its 1997 Opinion, the Commission concluded that Hungary was likely to be able to take on the *acquis* in the social area in the medium term, provided that it pursued work in terms of adoption and application of the EC *acquis*. Issues requiring attention included the health system, tobacco legislation, long-term unemployment and social security and welfare.

Since the Opinion, Hungary has made good overall progress, especially in the last two years, in aligning with the *acquis* in all areas. In particular, good progress has been made in the spheres of labour law, equal treatment between men and women, health and safety and the adoption of a public health programme. The main part of Hungary's legislation in this area is now in line with the *acquis*.

Negotiations on this chapter have been provisionally closed. Hungary has been granted a transitional arrangement for the implementation of EC legislation on tobacco, in particular the maximum tar yield of cigarettes, until 31 December 2005. Hungary is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts should now focus on completing transposition (on part-time work, transfers of undertakings, and anti-discrimination) and effectively implementing the *acquis* in the areas of public health, health and safety at work and anti-discrimination, on developing social dialogue in line with the EC practice, and on further strengthening the National Labour Inspectorate, in terms of both staffing and technical facilities.

Chapter 14: Energy

Progress since the last Regular Report

Since last year's Regular Report, Hungary has made progress in preparing for accession in the field of energy, although alignment with the *acquis* in both the electricity and gas

sector has been slower than originally envisaged. However, a major positive development is the adoption of the Electricity Act as an important step towards integrating Hungary into the internal EU electricity market.

With regard to **security of supply**, Hungary adopted new legislation on security stockpiling of imported crude oil and petroleum products in 2001. The modified provisions will partly enter into force in 2002 and partly at the time of Hungary's accession to the EU.

As regards the issues of **competitiveness and the internal energy market**, the most important development of the reporting period was the adoption of the Electricity Act in December 2001. The Electricity Act aims to align Hungary's legislation with the *acquis* and constitutes an important development in the energy sector. It provides for a minimum opening of 33% of the market by the beginning of 2003, corresponding to approximately 200 eligible customers. Customers with an annual consumption exceeding 6.5 GWh can select their electricity providers for 50% of their needs. This limitation, as well as a limitation related to electricity imports, will remain in place until accession. However, certain provisions of the new law – especially those related to the status and independence of the Hungarian Energy Office, which is the market regulator, and those of the independent system operator MAVIR Rt. – already entered into force in February 2002. The Electricity Act also provides for regulated third party access to the grid, for the unbundling of activities and for establishing new capacity through an authorisation procedure.

No progress was made in the *gas* sector, where alignment with the *acquis* has not yet been completed. However, a new system of gas price regulation took effect in July 2002.

With respect to solid fuels, the share of coal in energy supply declined from about 27% in 1998 to about 16% in 2001. In addition, the Government closed a further two mines in the reporting period.

Responsibility for energy policy lies with the recently established Ministry of Economic Affairs and Transport, where a separate Directorate-General deals with energy policy. Within this Directorate-General, a separate division is responsible for energy regulatory matters. The Ministry regulates the prices for electricity and for natural gas, with annual tariff schemes being adjusted in January for electricity and in July for gas. The Energy Directorate-General of the Ministry of Economic Affairs and Transport and the Hungarian Energy Office currently share the regulatory tasks concerning electricity, gas, quality of public services and consumer protection. New institutional functions were delegated to the Hungarian Energy Office (HEO), including the monitoring of trade and foreign trade to ensure that the level of services within the electricity and gas industries is not impaired by the liberalisation process.

The HEO is an agency of the state administration with independent responsibilities and jurisdiction on a national level, controlled by the Government and supervised by the Minister of Economic Affairs and Transport. The new legislation further strengthened the functional and financial independence of the HEO. Its main responsibilities are licensing, price regulation and consumer protection. Its president is appointed for a period of six years, during which he/she can only be removed under strict conditions. Furthermore, its financial independence is ensured by the fact that the Office covers its operating costs from licensing duties.

At present the Hungarian Energy Office has a staff of 88, as compared to 83 in 2001. In 2001, the HEO issued 112 resolutions, 50% of which were related to the supply of electricity. The Energy Interest Reconciliation Council, which is a tri-partite consultative body embracing the regulator, the consumers and the suppliers of the industry, meets on a regular basis to discuss problematic issues.

As regards **energy efficiency and renewable energy**, alignment with the *acquis* was continued in the reporting period by the adoption of additional legislation on the energy labelling of a number of household products. Furthermore, an energy efficiency programme was introduced in 2001 with the main objectives of promoting the use of renewable energy sources and improving public energy awareness. The original amount of HUF 2.5 billion (€ 9.7 million), foreseen for the implementation of the programme in 2002, has recently been doubled to meet the increased demand. In 2001, some 4612 applicants received direct subsidies of HUF 3.8 billion (€ 14.8 million) for energy efficiency projects within the framework of the Széchenyi Plan. The total share of renewable energy in the energy balance is 3.6%. The aim of the Hungarian government within the framework of the Hungarian Energy Conservation Programme and Action Plan is to reach a share of renewable energy consumption of at least 6% by 2010.

The main administrative body in this area is the Energy Centre, which deals with energy efficiency, renewable energy, environmental protection, labelling and energy statistics. The staff of the Centre was considerably increased in 2002 from 20 to 65 (40 permanent staff and 25 contracted staff).

In the field of **nuclear energy**, Hungary operates one nuclear power plant located at Paks. There are four VVER 440/213 type units in operation.

As regards nuclear safety, Hungary has made progress in the strengthening of the independence of the regulatory body. However, the amendments to the relevant legislation have not yet been adopted by Parliament. With regard to the specific recommendation in the June 2001 Council Report on Nuclear Safety in the Context of Enlargement that Hungary complete the regulatory assessment of the bubbler condenser containment function under design basis accidents, Hungary, together with the Czech Republic and Slovakia, is financing a set of additional experiments to support this review. The evaluation of the results is due to be presented by December 2002 to all three regulatory authorities. As regards the Council Report's recommendation for Hungary to complete, within the legal framework, the strengthening of the independence of the Hungarian National Atomic Energy Authority (HAEA) from the promotion of energy of nuclear facilities, no progress has been made during the reporting period.

Overall assessment

With regard to security of supply, current levels of oil stocks exceed EC requirements. The strategic oil stocks are held and managed by the Association of Crude Oil and Oil Products Stockpiling.

As regards the internal energy market, with the exception of the internal gas market, the legislative framework is in place. The adoption of the new Electricity Act, which is an important step towards alignment with the Electricity Directive, needs, however, to be followed up with appropriate implementing legislation. In the field of electricity, the

legislative framework for the internal market is thus now in place, including the mechanism for efficient regulation in this area.

The rapid adoption of the Gas Act, which is delayed in Parliament, is, together with the adoption of implementing legislation, required to bring Hungarian legislation gradually into line with EC requirements.

Further efforts are needed to improve energy efficiency and to encourage the use of renewable energy. The adoption of the energy efficiency programme is a significant step in the right direction. The programme should be fully implemented.

As for administrative capacity, the regulatory functions are in place, notably the Hungarian Energy Office, and seem, for the time being, appropriate both in terms of staffing and organisational independence. However, a further strengthening of the office might be needed in the future, given the increased obligations and responsibilities deriving from the liberalisation of the gas and electricity markets. In addition, the Energy Centre is well placed and has, after the considerable increase in staff in 2002, sufficient administrative capacity to carry out the promotional activities on energy efficiency and renewable energy.

The European Union has repeatedly emphasised the importance of a high level of nuclear safety in candidate countries. In June 2001 the Council of the European Union took note of a Report on Nuclear Safety in the Context of Enlargement. This Report contains recommendations to all candidate countries to continue their national safety improvement programmes, including the safe management of spent fuel and radioactive waste and the safety of their research reactors.

During the first half of 2002, a special Peer Review on nuclear safety assessed the progress made by candidate countries in implementing all recommendations. This exercise under the auspices of the Council resulted in a Status Report, published in June 2002, which concludes that Hungary has accepted and addressed all the recommendations contained in the Report on Nuclear Safety in the Context of Enlargement of June 2001. Most recommendations have been adequately addressed. With regard to one specific recommendation concerning completion of the full verification of the containment bubbler-condenser systems for the Paks NPP units 1-4, Hungary has indicated adequate measures, but the Status Report emphasises that Hungary is expected to ensure that they are implemented.

As regards administrative capacity, the Hungarian National Atomic Energy Authority (HAEA) seems, for the time being, to have sufficient staff available. It exercises its functions as the competent regulatory authority and maintains a register on nuclear and radioactive material. However, its independence from the promotion of nuclear energy facilities still needs to be strengthened.

Long-term solutions for spent fuel and nuclear waste will continue to need attention.

Hungary will need to ensure compliance with Euratom requirements and procedures. In this respect, due attention must be given to preparing for the implementation of Euratom Safeguards, in particular regarding the reporting of nuclear material flows and inventories directly by the persons or undertakings operating nuclear installations or storing nuclear material. It should be noted that Hungary has concluded a Full Scope Safeguards Agreement with the IAEA.

Conclusion

In its 1997 Opinion, the Commission concluded that, provided efforts were maintained, Hungary should be in a position to comply with most of the then existing EC energy legislation in the next few years. It added, however, that matters such as the adjustment of monopolies, access to networks, energy pricing, state interventions in the solid fuels and uranium sectors, and the development of energy efficiency needed to be closely followed. The Commission further pointed out that, although no major difficulties were foreseen regarding compliance with Euratom provisions, nuclear safety standards should be tackled appropriately in order to bring the nuclear power plant to the safety level required. It further stated that longer-term solutions for waste would need attention.

Since the Opinion, steady progress has been made, notably with regard to the internal energy market, particularly the electricity sector, the promotion of renewable energy, nuclear issues, and the gradual development of administrative capacity. The preparations for the internal gas market have not proceeded as quickly as foreseen. Overall, Hungary has achieved a good level of alignment with EC requirements in this sector, with regard to both legal transposition and administrative capacities.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this chapter. Hungary is meeting the majority of the commitments it has made in the accession negotiations in this field. However, delays have occurred as regards the adoption of the Gas Act. This issue needs to be urgently addressed. Delays in the Electricity Act, the adoption of which was foreseen for the end of 2000, have been made up; the Act was adopted in December 2001.

In order to complete preparations for membership, Hungary's efforts now need to focus on ensuring full and timely implementation of legislation in this area, in particular with regard to the internal energy market (notably gas), on the improvement of energy efficiency and on maintaining the administrative capacity in the sector, in particular the Hungarian Energy Office, the Energy Centre and the National Atomic Energy Authority.

Chapter 15: Industrial policy¹³

Progress since the last Regular Report

Since last year's Regular Report, Hungary has made further progress with the development of its industrial policy.

As in the previous reporting period, implementation of the **industrial strategy** has focused on promoting Hungarian industry and domestic and foreign investment. The implementation of the Széchenyi Plan has focused on measures aimed at promoting networking between multinational companies and local enterprises, innovation and reducing the imbalance in industrial development between different regions, *inter alia* by improving infrastructure. The impact has so far been positive: In 2001, HUF 118.9 billion (€ 463 million) out of the aggregate HUF 167.1 billion (€ 651 million) of funds requested were awarded. These grants were expected to generate investment to the value of HUF

13 Developments concerning Industrial policy should be seen in relation to the overall enterprise policy, including the SME policy (see Chapter 16 - Small and medium-sized enterprises).

463 billion (€ 1.8 billion), creating 34 057 new jobs in 2001. However, only one third of the Széchenyi Plan funds allocated by the Ministry of Economic Affairs has actually been disbursed, due to the prevalent post-financing system. A supplementary plan, the Széchenyi Plus Programme, was launched in October 2001, with road construction and state support for housing construction as its largest components. In August 2002, the Government announced the freezing of a large part of the Széchenyi Plan programmes. The Széchenyi Plan will be revised to concentrate the funds on SME development and EU pre-accession projects, and will be integrated into the National Development Programme by 2004.

The Ministry of Economic Affairs and Transport, as the central body responsible for the formulation and co-ordination of industrial policy, involves the line ministries responsible for managing specific industrial branches in the formulation of enterprise policy. The key implementing agencies influencing industrial policy in Hungary are the Privatisation Agency, the Competition Office, the Hungarian Development Bank, the Investment and Trade Development Co-operation Agency with its nine regional offices (FDI and export promotion), the Hungarian Foundation for Enterprise Promotion (MVA), and the SME Agency with its network of 20 local enterprise agencies. The business community and social partners are involved in the policy-making process.

The **privatisation** process is almost complete, and more than 80% of GDP is generated by the private sector. However, the steel sector, with Dunafer as Hungary's main steel producer, is still subject to privatisation and restructuring. The Hungarian Privatisation Agency (APV Rt.), currently under reorganisation, only carried out six privatisation transactions in five companies during the period under review. However, another agency, the Hungarian Development Bank, was increasingly active in asset management and privatisation deals. With its new president, APV Rt. plans to operate as a holding company managing all state enterprises.

In 2001 Hungary witnessed further growth in both domestic and foreign investments. In 2001 the real growth rate of fixed capital formation was 3.1%, and the share of gross fixed capital formation in GDP reached 23.4%.

Overall assessment

Hungary has successfully implemented an industrial policy based on market-driven principles, liberalisation and deregulation. It has also been attracting high levels of foreign direct investment (FDI) and technology-intensive industry to the country, which mainly exports to the EU. The Széchenyi Plan and Széchenyi Plus Programme were important steps towards the elaboration of an integrated industrial strategy. Restructuring and privatising the highly indebted Dunafer steel plant remains a challenge that needs to be tackled.

An important dimension of industrial policy is the control of state aid (*see also chapter 6 – Competition Policy*).

Conclusion

In its 1997 Opinion, the Commission concluded that, given the extent of restructuring and modernisation efforts undertaken so far, there were good reasons to expect that most

sectors of Hungarian industry, and especially those benefiting from foreign investment, could in the mid term be competitive operators in the Single Market.

Since the Opinion, Hungary has made good progress in creating an appropriate market-based business environment, privatisation and restructuring. However, imbalances remain between regions, and between the modern, export-orientated multinational companies and local industry not directly affected by inward FDI. The principles of Hungarian industrial policy are now generally in line with the concepts and principles of EU industrial policy.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements. Hungary is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts now need to focus on the concrete and swift implementation of the medium-term economic development plan, the restructuring of the steel sector (Dunaferr) and the conclusion of the privatisation process, as well as the promotion of local-market-orientated small businesses.

Chapter 16: Small and medium -sized enterprises¹⁴

Progress since the last Regular Report

Since the last Regular Report, Hungary has made further progress with revising its SME policy and putting in place supportive mechanisms for business promotion. Efforts to improve the business environment have continued.

In April 2002, Hungary endorsed the European Charter for Small Enterprises as the basis for its action to support and develop small enterprises. The European Charter, adopted by the European Council in June 2000, is the reference document in the field of enterprise policy within the socio-economic strategy set up at the Lisbon European Council. The reporting process on the implementation of the European Charter in Hungary started in May 2002.

The implementation of the Széchenyi Plan, launched in 2001 as Hungary's main instrument for its **SME policy**, has started. Of the 21 tenders originally announced under the Plan, 20 were available to SMEs. In August 2002, the Government announced the freezing of a large part of the Széchenyi Plan programmes. The Széchenyi Plan will be revised to concentrate the funds on SME development and EU pre-accession projects.

The Ministry of Economic Affairs and Transport is the central body responsible for SME policy, and consults other ministries, chambers of commerce, interest representations and professional associations.

Access to finance remains the main obstacle to the development of Hungarian SMEs. However, good progress has been made in this area thanks to government support schemes for SMEs. In August 2002, the Ministry of Economy and Transport launched the

14 Developments concerning SME policy should be seen in relation to overall enterprise policy, including industrial policy (see Chapter 15 – Industrial policy).

Széchenyi Credit Card for small entrepreneurs, committing HUF 700 million (€ 2.73 million) for subsidising the interest rate and providing guarantee support for 2002. The aim of the card is to provide short-term loans to SMEs in a simple and easy way. Commercial banks are also beginning to show interest in financing SMEs.

Hungary made further progress with the improvement of the **business environment**. Several specific measures to simplify the administrative environment have been introduced. These include the facilitation of the transfer of ownership for small companies, the streamlining of the procedures to close down companies and the simplification of certain bookkeeping rules. Changes to taxation rules include preferential measures for small enterprises allowing them to deduct money on their investment and R&D activities and to benefit from tax allowances on the interest on loans.

No further progress can be reported as regards the **SME definition** applied by Hungary.

Overall assessment

At national and local level, the basic infrastructure for the implementation of SME policy is in place and many networks and business services are available. However, a large proportion of enterprises in Hungary lack information about *acquis* requirements, available support services and the means of accessing them. The various SME support services should be made more visible to the SME community in both developed and less advanced regions, as currently information services are scattered between different contact points and as most services are located in the capital and in county seats or bigger towns. Also, the services available are not sufficiently co-ordinated and there is a certain degree of overlap between instruments. The Secretariat for the Co-ordination of Enterprise Assistance for EU Integration, established at the Ministry of Economic Affairs in March 2001, has been reviewing the current programmes in favour of SMEs and the available funds in order to streamline assistance and advise the various bodies on the information needs of SMEs.

Efforts should be strengthened to prepare for the full use of the structural funds in the area of enterprise development. Some final adjustments to the SME definition are needed in order to bring it fully in line with the EC Recommendation.

Conclusion

In its 1997 Opinion, the Commission concluded that the on-going efforts to strengthen SMEs during the pre-accession period would need to be continued. However, no specific problems were foreseen in Hungary's integration in this sector.

Since the Opinion, Hungary has made steady progress. In the last two years, Hungary has targeted SME development as one of its strategic development objectives under the Széchenyi Plan. Today, Hungary's policy towards SMEs is generally in line with the principles and objectives of EU enterprise policy.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements. Hungary is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts now need to focus on the swift and client-friendly implementation of the SME support programmes and their improved co-ordination and on the elimination of overlaps. Increasing the visibility of the various services and programmes for SMEs and improving access to finance, especially micro-credit, remain crucial tasks.

Chapter 17: Science and research

Progress since the last Regular Report

Continued progress has been made in this area since the last Regular Report.

Supporting R&D and innovation has become one of the declared national priorities in the Hungarian National Development Plan. In this framework, new National R&D Programmes were launched in 2001 to support the implementation of comprehensive research, development and innovation projects with much higher grants. Significant salary increases were introduced for universities and R&D institutes in 2001. Budget resources for competition-based national R&D support schemes were increased in the 2001/2002 biannual budget.

In February 2002, the Hungarian Ministry of Economic Affairs and Transport launched a 10-year development plan, including sub-programmes such as the Human Resources sub-programme, which will focus on closer collaboration between universities and multinational enterprises. The sub-programme for R&D and Innovation Management aims at creating the infrastructure conditions for this.

In order to support companies in their efforts to increase their research activities, the government introduced some further tax benefits. In detail, up to 200% of a company's research expenditure has now become deductible from tax, which will be of particular use for SMEs, given that they are normally not in a position to conduct expensive in-house research.

During the reference period, Hungary has continued to be associated with the **Fifth EC Framework Programme** and with the Fifth Euratom Framework Programme. Hungary has expressed interest in being associated with the Sixth EC Framework Programme (2002-2006).

Overall assessment

The framework for co-operation in the field of science and technology (including National Contact Points) is well established. Although Hungary's participation in the relevant Community R&D programmes can be considered as successful, further efforts should be made to increase the participation of SMEs. The gross domestic expenditure on R&D is still relatively low and needs to be increased, which is envisaged by the Ministry of Education.

The departments in the Ministry of Education responsible for Research and Science policies provide sufficient and skilled staff. In general, Hungary has a long tradition of Research and Science and a well-functioning network of institutes, universities, academies and company R&D facilities. At some laboratories, the infrastructure necessary for the given research has been developed. However, in most of the

laboratories the state of equipment is dilapidated, and its use and maintenance pose a problem, which needs to be addressed. A programme for large instruments and measuring facilities for research institutes and research groups is provided by the Central Fund for Technological Development.

Conclusion

In its 1997 Opinion, the Commission concluded that for Hungary no major problems were expected in this field and that accession would be of mutual benefit.

Since the Opinion, Hungary has made continuous progress and strengthened the co-operation with the EU in this field.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this area and is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts now need to focus on further reinforcing research-related administrative capacity and infrastructure, as this is a key factor in ensuring Hungary's successful association with the relevant Community Framework Programmes.

Chapter 18: Education and training

Progress since the last Regular Report

Some further progress has been made in this area over the past year.

During the reference period, Hungary continued to participate in the second generation of the Leonardo da Vinci, Socrates and Youth **Community programmes** (*see section A.b – Relations between the European Union and Hungary*).

Regarding the **Directive concerning education of children of migrant workers**, the Ministry of Education launched a comprehensive programme with the aim of fully implementing the Directive. Within the framework of a national research project, a survey on migrant workers was completed in December 2001. Also, the Government undertook a number of actions in the reporting period in this sector with a view to increasing the level of education of socially disadvantaged children, with special emphasis on improving the integration of the Roma minority into society. Furthermore, in June 2002, a special Ministerial Commissioner in charge of matters relating to Roma and disadvantaged young people has been appointed by the Ministry of Education.

Some further progress has been made in the **reform of the Hungarian education and training system**. The Act on the entering and residence of foreigners, aimed at fully transposing and implementing the Directive on the right of residence for students, entered into force in January 2002 (*see Chapter 2 – Free movement of persons*).

The Act on Adult Education was approved by Parliament in December 2001, including implementing legislation. Based on the concept of lifelong learning, the new law takes into account the relevant experience of the EU countries and the recommendations and proposals of recent EU education policy documents. The main objectives of the new

framework legislation are: the creation of opportunities for every citizen to receive continuous training and education, the introduction on a wide scale of the use of the most advanced training programmes and methods, and the improvement of quality control procedures.

In addition, the “teacher’s career model”, which was drawn up in November 2001, states that the average net income of teachers per capita should reach 125% of the national average salary per capita by 2006 at the latest.

Overall assessment

Hungary has created the necessary financial and institutional conditions for effective participation in the relevant Community Programmes. Participation in the Community Socrates, Youth and Leonardo da Vinci programmes is satisfactory, and the existing national agencies are operational.

As regards the Directive concerning education of children of migrant workers, the Hungarian regulations in force are already in line with the *acquis*, and implementation is under way.

Legislation for vocational education and training systems is also in place, including the regulation governing the organisation, management and financing of vocational education and training.

The Ministry of Education has the overall responsibility for the sector of education and vocational training. The Ministry has a key role to play in the development of human resources, which has been identified as a major element of the strategy enabling Hungary to face successfully the economic, social and cultural challenges of the 21st century.

Conclusion

In its 1997 Opinion, the Commission concluded that, in the perspective of accession, no major problems were expected in this field for Hungary.

Since the Opinion, Hungary has achieved steady progress, including with regard to its participation in relevant Community programmes. Hungary’s preparations for accession are now at an advanced level.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this field. Hungary is generally meeting the commitments it has made in the accession negotiations in this domain.

In order to complete preparations for membership, Hungary's efforts now need to focus on further developing its administrative capacity in this domain.

Chapter 19: Telecommunications and information technologies

Progress since the last Regular Report

Since last year’s Regular Report, Hungary has made major progress in terms of both liberalisation of the telecommunications market and implementation of its regulatory framework.

Concerning **liberalisation of the telecommunications market**, Hungary opened the main fixed voice market in December 2001 with some temporary exceptions. In a few primary areas liberalisation will begin only from November 2002 on the expiry of local telephone concessions with exclusive rights. As regards the **regulatory framework**, with the entry into force of the new Communications Act in December 2001, the Hungarian telecommunications market is opened up for competition and the harmonisation of primary and secondary law with the *acquis* is almost completed.

As regards the institutional and administrative framework, the National Regulator is the Communications Authority (HIF), which is a central public administration agency with nationwide jurisdiction, independent of market players and functioning under the guidance of the Government and under the supervision of the relevant Minister.

With the new Government, responsibility for telecommunications has been shifted to the new Ministry for Information Technology and Communications. The only division remaining under the responsibility of the Prime Minister's Office will be the Division of Electronic Government. A National Information Society Strategy has been elaborated with the aim of promoting the development of the information society. An important implementing instrument of this strategy is the development of the Information Society and Economic Development Programme, which takes into account the priorities of the eEurope+ Action Plan.

As regards **postal services**, postal liberalisation is proceeding in line with the *acquis*. Only those services which are permitted by the EC Directive remained in the reserved category. The Communications Act of December 2001 is also aimed at ensuring universal service funding for postal services. The incumbent operator, Hungarian Post, which provides universal services and is entitled to the provision of reserved services, has started to introduce a cost-based price system and separate accounts.

Overall assessment

Hungary will need to transpose the updated telecommunications *acquis* before accession and to complete the implementation procedures as soon as possible afterwards. Some important adjustments are still needed in the field of carrier selection and transparency of the implementation of the interconnection *acquis*. In particular, it is important for the National Regulatory Authority to exercise its powers in a clear way in order to reduce the number of barriers to market entry that new entrants face. Also, the universal service provisions are not yet entirely in line with the *acquis*. Hungary still needs to implement several items of secondary legislation by the end of 2002 and has committed itself to do so in time. Amended implementing legislation will also have to be adopted for the Universal Telecommunications Service Fund. Hungary has not yet been able to evaluate the economic implications of fully implementing the universal service *acquis*, so as to achieve affordability. A decision on this point remains outstanding.

The Communications Authority has been established on a reasonably independent basis and seems to be adequately staffed. However, more attention should be paid to universal service issues. Full co-operative working relations with the Competition Authority are important to effective implementation of the *acquis*.

Much progress has been made in the telecommunications sector over the last few years and the infrastructure's size and degree of modernisation is a welcome achievement,

particularly in terms of the penetration of mobile and Internet services. Penetration in mobile services has exceeded 50%. There are three GSM operators but UMTS licences have yet to be issued. Fixed network modernisation is complete, but penetration peaked at 37% and is now slowly falling. Price rebalancing still has some way to go, and more emphasis on fair competition is needed. Universal service provisions still have to be fully enforced and aligned with the *acquis*. Hungary has not yet been able to evaluate the economic implications of fully implementing the universal services *acquis* so as to achieve affordability and a decision on this point remains outstanding.

As regards postal services, Hungary has made good progress but needs to complete the transposition and implementation of the *acquis*. New legislation has still to be adopted on the Universal Postal Service Fund.

Conclusion

In its 1997 Opinion, the Commission concluded that Hungary should have little difficulty in adopting the EC model of telecommunications liberalisation in the medium term because it had already implemented most of the *acquis*. It added that if foreign investment continued at its current pace and if a tariff-rebalancing scheme was introduced, the sector should be able to face full competition.

Since the Opinion, Hungary has made considerable progress, particularly in terms of liberalisation. The present level of alignment is good, however, Hungary will need to transpose the updated telecommunications *acquis* before accession and to complete the implementation procedures as soon as possible afterwards.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this area. Hungary is generally meeting the commitments it has made in the accession negotiations in this domain.

In order to complete preparations for membership, Hungary's efforts now need to focus on ensuring an affordable universal service, on continuing the enforcement of the regulatory framework for telecommunications and on completing alignment in the postal services sector.

Chapter 20: Culture and audio-visual policy

Progress since the last Regular Report

In the **audio-visual** sector, Hungary's legislative alignment with the *acquis* has improved significantly since last year's Regular Report.

In July 2002 the Hungarian Parliament finally approved the new Media Law, which had been pending since its submission in December 1999. Certain provisions, including on European works, will enter into force from the date of accession. Provisions on discrimination based on nationality will be abrogated at the same date; the rules on exclusive broadcasting rights will enter into force after a certain delay, but before the date of accession.

With the adoption of the new law, the *acquis* has been largely transposed into Hungarian legislation.

The Ministry of National Cultural Heritage and the Ministry of Justice are in charge of broadcasting legislation in Hungary. The National Radio and Television Board of Hungary (ORTT) is the national regulatory and monitoring body with monitoring and sanctioning powers. The ORTT Board is an independent legal entity reporting directly to Parliament. The original staff of 100 has been increased by two more lawyers.

In the field of **culture**, Hungary has been participating in the Culture 2000 framework programme since 2001.

Overall assessment

The entry into force of the entirety of the amended media law will bring a substantial degree of alignment with the audio-visual *acquis*. However, some issues remain to be clarified, in particular in the area of European works. In this respect, any necessary further adjustments to the Hungarian legislative or regulatory framework should be made before accession.

With the adoption of the new law, further strengthening of the National Radio and Television Board may be required. The independence of the regulatory authority continues to be respected, both financially and politically. However, transparency should be further increased, in particular concerning frequency allocation and distribution of the Broadcasting Fund, and efforts should also be made to improve reporting capacities on broadcasting activities.

Hungary is a party to the Council of Europe Convention on Transfrontier Television and its amending Protocol.

Conclusion

In its 1997 Opinion, the Commission concluded that, provided that progress towards legislative alignment - accompanied by the necessary structural adaptations - was pursued, Hungary should be able to meet EC requirements in the audio-visual sector within a few years.

Since the Opinion, Hungary has made significant progress, especially this year. Hungary's legislative alignment is now well advanced. The necessary administrative structures are in place.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this area. Hungary is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary should focus on ensuring effective regulation of the sector and completing the final legislative adjustments necessary to be fully in line with the *acquis*.

Chapter 21: Regional policy and co-ordination of structural instruments

Progress since the last Regular Report

Since the last Regular Report, progress has been made in preparing for the implementation of structural policies.

Concerning **territorial organisation**, Hungary confirmed to EUROSTAT in January 2002 the provisional NUTS classification designating the whole country as one single unit corresponding to NUTS level I, with seven regions corresponding to NUTS level II. This provisional NUTS classification was agreed with the Commission.

There have been no particular developments since the last Regular Report regarding the **legislative framework**.

With regard to **institutional structures**, Hungary has re-defined the responsibilities of various ministries in terms of programming and managing the Structural Funds and the Cohesion Fund. The responsibility for the co-ordination of programming and implementation of Structural and Cohesion Fund assistance has been transferred to a new structure within the Prime Minister's Office, the National Development Office. This office will co-ordinate the preparation of the National Development Plan and act as managing authority for the future Objective 1 Community Support Framework (CSF) and for the Cohesion Fund. The responsibility for regional development has been transferred to the Regional Development Office within the Prime Minister's Office. The ministries in charge of establishing the managing authorities of the various operational programmes have been formally designated and specific ministerial units/departments have been identified to that effect. Finally, the Ministry of Finance has been designated as single paying authority for the Structural Funds and the Cohesion Fund.

While the **programming** process started in January 2001, the preparation of the development plan and the operational programmes for Objective 1 have been considerably delayed in the reporting period. The first part of the plan, including the description of the current situation, the analysis of strengths and weaknesses and the development strategy, is under preparation and discussion with all relevant bodies and partners concerned. The approval by the Government of the development strategy and the resulting priorities took place in September 2002.

In the context of the recent reorganisation, Hungary has adopted measures to ensure a wider application of the **partnership principle**. A separate unit responsible for partnership, information and communication has been established in the National Development Office, reflecting the Government's willingness to give a higher profile to the association of the partners in the programming and implementation of Structural and Cohesion Funds assistance. In this context, the Regional Development Councils and Agencies play a pivotal role in organising the involvement of partners at regional and local level. A Reconciliation Council of Development Regions, consisting of the presidents of the Regional Development Councils, has been established as a consultative forum with a view to developing a common position of the regions on questions such as their involvement in the preparation and implementation of Structural Funds assistance.

With regard to **monitoring and evaluation**, preparatory work on the ex-ante evaluation of the first chapters of the development plan, and on a macro-economic impact study, has

been undertaken by the Ministry of Economy. The National Development Office, to which the overall responsibility for evaluation has been transferred, is setting up a monitoring and evaluation unit comprising seven experts. An evaluation sub-committee within the Interministerial Co-ordination Committee on Development Policy has also been established.

The software for the monitoring system for collecting, reporting and monitoring data under the pre-accession instruments (MEMOR) has been developed. The system also includes a Structural Funds module, which will be tested in 2002 and adapted to the requirements of monitoring Structural and Cohesion Funds assistance.

The financial control department of the Ministry of Finance has the overall responsibility for the regulation and development of the Public Internal Financial Control System, including the establishment of adequate **financial management and control** systems for Structural and Cohesion funds. Functionally separate internal audit units have been established within the line ministries. The Ministry of Finance has designated the Office of the National Authorising Officer as the unit in charge of setting up the single paying authority. This Office was reorganised in December 2001 and currently includes the National Fund through which pre-accession funds are channelled. Within the Hungarian Treasury System, three separate units have been established (Debt Management Agency, Public Finance Office and Treasury). The system for payments under the Structural and Cohesion Funds and for the matching national co-finance has been outlined.

The Ministry will also have overall responsibility for the on-the-spot checks and, in the performance of those tasks, will draw on the existing audit capacity within the ministries in which the managing authorities will be located as well as in the Government Control Office (GCO). The GCO has been designated as the body responsible for issuing declarations of winding-up of the assistance.

A system of multi-annual planning of budgetary expenditure, including provisions for transfers between budget appropriations, already exists in Hungary in relation to pre-accession funds. A draft methodology has been prepared concerning the verification of the additionality principle.

In relation to **statistical information**, the compilation of regional data for analysis, evaluation and monitoring has continued.

Overall assessment

Hungary has already organised its territory into units corresponding to the NUTS classification. As regards the legislation necessary to implement the *acquis* covered by this chapter, the Government is, however, committed to further amending the Act on Public Finance with a view to adapting its current framework for multi-annual budget programming as well as for transfers between budget lines in order to ensure the increased flexibility required for the efficient management of Structural Funds assistance.

Hungary has designated the bodies, which will be responsible for the implementation of the Structural and Cohesion Funds. However, the allocation of tasks has still to be completed, in particular as they relate to the designation of all the intermediate bodies, the functions they will perform on behalf of the respective managing authority and the definition of the system for reporting and monitoring on the performance of their tasks.

The capacity within the bodies identified as future managing and paying authorities, as well as of the line ministries and other intermediate bodies acting under their responsibility, needs to be further strengthened in the short term. Further steps must also be taken to ensure effective inter-ministerial co-ordination.

Further progress must be made with the technical preparation of projects eligible for Structural and Cohesion Funds assistance (project pipeline). The capacity of regional and local actors as well as other relevant partners to prepare, and implement projects, needs to be considerably strengthened. Hungary will also have to ensure that project selection and decision-making is managed within a framework established on the basis of transparency, efficiency and reliability in the implementation of programmes. It should also continue to work towards developing the structures and co-ordination mechanisms necessary to manage financial assistance from the European Social Fund in the context of the European Employment Strategy and the Social Inclusion process.

With regard to programming, the preparation of the development plan and the operational programmes has been considerably delayed over the reporting period. Considerable efforts on the part of all actors concerned, as well as strong and effective inter-ministerial co-ordination, will be needed in order to maintain the timetable in line with the commitments undertaken by Hungary during the negotiations for finalising the programming documents, without compromising the quality of the process or diminishing the sense of 'ownership' to be developed through close association of all relevant partners.

Work on ensuring compliance with the *acquis* requirements for monitoring and evaluation must continue, in particular as concerns the ex-ante evaluation of the development plan and draft operational programmes. To ensure effective and efficient implementation of the Structural Funds programmes, an effective system and capacity for monitoring and evaluation must also be established, both centrally and within the implementation structure being put in place.

Hungary continues to advance the process of establishing its financial management and control systems. In this context, it is finalising the specific procedures for financial control, auditing, and certification of expenses and correction of irregularities specifically applicable to the Structural and Cohesion Funds. However, the appropriate systems and procedures for financial management and control still need to be strengthened, in particular as regards the structure of the managing and paying authorities. The capacity of the internal audit units within the line ministries need to be strengthened through training and other measures in order to fulfil the specific requirements of the Structural Funds regulations.

The system envisaged for ex-ante checks on payments of national and Community funding to final beneficiaries still appears quite centralised and may need to be reviewed in order to process payments to final beneficiaries in a more efficient way.

Conclusion

In its 1997 Opinion, the Commission observed that Hungary was introducing the legal basis for a comprehensive regional policy, and commented that its administrative capacity to manage integrated regional development programmes seemed satisfactory. It also noted that Hungary needed to further develop institutional capacity and strengthen

co-ordination among ministries and between the central and the local level. The Commission concluded that, subject to the introduction of the remaining reforms, Hungary should be ready to apply Community rules and channel effectively the funds from EC Structural Policies.

Since the Opinion, Hungary has made steady progress in legislative terms, and, more recently, has moved forward with developing the necessary administrative capacity. With the Government decisions taken in June 2002, Hungary has established a more efficient institutional framework for programming and implementation of Structural and Cohesion Funds. This creates the conditions for substantial progress. However, the administrative capacity in all Ministries and bodies concerned still needs to be considerably improved in order for Hungary to be able to properly implement the Structural and Cohesion Funds upon accession.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements. Hungary is generally meeting the commitments it has made in the accession negotiations on this chapter.

In order to be ready for membership, Hungary's efforts now need to focus on finalising the programming documents and on developing the necessary implementation capacity in accordance with the timetable agreed through sustained action at all levels. Inter-ministerial co-ordination needs to be further strengthened and the correct application of the partnership principle ensured. Hungary has started to take measures in that respect. Ongoing efforts now need to be substantially stepped up

Chapter 22: Environment

Progress since the last Regular Report

Since the last Regular Report, Hungary has made good progress through the adoption of legislation in the air, water, industrial pollution control and genetically modified organisms sectors, and has improved its administrative capacity to implement and enforce the environmental *acquis*.

The **integration of the environment into other policies** and the promotion of sustainable development are ensured by the Hungarian National Environmental Council (NEC), consisting of representatives of the scientific community, NGOs and industry. The NEC is an advisory body to the government and has the right and the obligation to express its opinion on planned legislation and programmes in all fields. Furthermore, the Hungarian economic strategy and sectoral development programmes are being formulated taking into account environmental considerations.

In the field of **horizontal legislation**, the Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters (the Aarhus Convention) was promulgated into Hungarian legislation at the end of 2001. Furthermore, Hungary ratified the Kyoto Protocol in August 2002.

As regards **air quality**, Hungarian legislation has been harmonised with the Directives on non-road mobile machinery, and on consumer information on fuel economy and carbon dioxide emissions in respect of the marketing of new passenger cars, in July 2002.

In the area of **waste management**, alignment has further progressed with the adoption of legislation transposing the *acquis* on incineration of waste, packaging and packaging waste, waste from the titanium-dioxide industry and the lists of waste and hazardous waste. In order to ensure better enforcement of the legislation in this area, a legal act on waste management fines has been adopted. The law on waste and the law on packaging and packaging waste were adopted in May 2002.

In the field of **water quality**, new legislation has been adopted on the quality of drinking water, discharges of dangerous substances, on quality requirements of natural bathing waters, on the designation and operation of natural bathing places, on the designation of waste water agglomerations, on registration and reporting obligations regarding urban waste water and on sewage fines. In addition, Hungarian legislation has been further aligned with the *acquis* as regards measurement, control and information in respect of discharges of waste water and sewage, special rules on sewage, on emission limit values for waste water and sewage and the rules of application thereof.

No further legal developments can be reported in the field of **nature protection**. 53 sites have been identified by the Hungarian authorities as special protection areas (SPAs), and buffer zones will be created around these areas.

As regards **industrial pollution control and risk management**, legislation on the prevention of major accidents involving dangerous substances, aiming at aligning with the Seveso II Directive, entered into force in 2002. Furthermore, the National Board for Technical Safety was designated as the special authority concerning hazardous industrial plants. A special Integrated Pollution Prevention and Control (IPPC) Bureau has been established at the Institute for Environmental Management in the Ministry of Environment to assist with the implementation of the Directive (application of “best available techniques”, preparation of national guidance for different sectors, data collection, evaluation and reporting).

In the field of **genetically modified organisms and chemicals**, alignment with the *acquis* was continued with the adoption of a law on restrictions on the marketing and use of certain dangerous substances and preparations. A database has been set up at the Agricultural Biotechnology Centre, which includes information on all activities of genetically modified organisms (GMO). A Permitting Authority for GMOs was established at the Ministry of Economic Affairs.

With regard to **noise**, legislation on noise emission in the environment by equipment for use outdoors entered into force in January 2002.

As regards **nuclear safety and radiation protection** (*see also Chapter 14 - Energy*), a law on permitting transboundary shipments of radioactive waste was adopted and entered into force in April 2002.

Hungary has carried out a range of actions to develop its **administrative capacity** in the field of the environment. Water management (previously Ministry of Transport) and air quality monitoring (previously Ministry of Health) have been entrusted to the Ministry of Environment. Despite the apparent complexity of the Hungarian environmental administrative system, the necessary co-ordination and co-operation between the different Ministries, authorities and institutions involved is ensured to a large degree by detailed administrative acts, procedures and relatively well-established practices. This is

strengthened by the existence of an inter-ministerial working group meeting on a regular basis and dealing with all issues relating to the transposition and implementation of the environmental *acquis*.

Overall, the number of personnel dealing with environmental issues increased by 114 in 2001 and 251 in 2002. A further increase of 460 is envisaged for 2003. The staff of the Ministry of Environment (MOE) was increased by 102 in 2001 and 110 in 2002, while an additional 323 are foreseen for 2003. Hungary has also provided training for staff at all levels in nearly all sectors, with the exception of IPPC.

The present permitting system in Hungary is very complicated, and for a new installation to start operating up to fourteen different permits may be needed. With the introduction of IPPC, for which Hungary has opted for one integrated permit, the system will become simpler and hopefully more effective. The process to issue integrated permits for new installations (some 30 installations) according to national legislation started in June 2002, and for existing ones (some 970) is planned to start immediately after accession.

As regards planning and programming, a number of plans still have to be established such as the National Waste Management Plan, regional plans (by the Regional Environmental Inspectorates - REIs) and local plans (by the municipalities) and individual waste management plans (by the different operators), air quality action plans, and water pollution reduction programmes for the discharge of List II substances. A complex range of institutional responsibilities is involved in environmental monitoring. Accredited laboratories carry out the regular monitoring of water quality. Hungary currently possesses 43 automatic monitoring stations, monitoring the substances regulated by the daughter Directives, which are capable of being upgraded to monitor all fourteen substances of the Air Quality Framework Directive, and 331 manual ones measuring SO₂, Nox and dust. Four stations belong to the Meteorological Institute and three mobile ones are used by inspectors for inspection purposes. Eleven new automatic stations are still expected to be put into operation, three in the countryside and eight in Budapest.

Permitting and enforcement are not separated in Hungary; all licensing authorities have the responsibility of checking and enforcing their own prescriptions. The primary method of compliance checking is site visits, but self-monitoring is growing in importance. Inspections usually cover only one environmental medium. However, there have been some new initiatives to introduce multi-sectoral integrated inspections, sometimes carried out jointly with other authorities. The Ministry of Environment and Water Management and the National Environmental Inspectorate are urging the REI to include integrated inspections of bigger environment polluters in their annual work plans. As regards enforcement, an inspector can, in case of non-compliance, impose a penalty or an enforcement notice to remedy, change a process, decrease production or as a last resort shut down. Enforcement notices, administrative fines, personal fines, and reports to the Public Prosecution Offices are common forms of action.

Overall assessment

Hungary has achieved considerable alignment with the EC environmental *acquis*. In order to complete alignment, measures still need to be adopted in the fields of air quality (sulphur content of liquid fuels, ozone and tropospheric ozone, designation of zones and agglomerations), waste management (end of life vehicles), nature protection (birds and

habitats), chemicals and genetically modified organisms (biocidal products, asbestos, deliberate release of genetically modified organisms). The most important piece of legislation that has still not been adopted is the National Waste Management Plan (NWMP). Corresponding delays occurred as regards the establishment of regional and local waste management plans, the separate collection and sorting of municipal waste, and the programme for the separate collection and disposal of spent batteries and accumulators, which are all dependent on the NWMP. A comprehensive system on the selective collection of packaging waste from communal sources still needs to be established. The preparation of Air Quality Action Programmes and Pollution Reduction Programmes for List II substances relating to the Directive on the discharge of dangerous substances, and the implementation of the landfill Directive and the extension of the air quality monitoring network need particular attention. Also, Hungary has not yet joined the EU's early warning system, ECURIE, which provides for an early exchange of information in the event of radiological emergencies, and certain requirements on monitoring and surveillance of exposure to ionising radiation still need to be implemented.

The principle of integration requires continuous attention both at national and Community level. Hungary needs to continue integrating environmental protection requirements into the definition and implementation of all other sectoral policies so as to promote sustainable development.

Hungary's administrative capacity to implement the EC environmental *acquis* still requires close attention. As regards general co-ordination on environment protection issues, in December 2001 a new formal consultation mechanism was introduced, which improved and strengthened the role of the Ministry of Environment by extending its competencies. Following the changes introduced by the new government in May 2002, five ministries are involved in environmental issues, each of which has various implementing bodies at regional and national level. However, there continues to be no clear division of competencies between the ministries involved in environmental protection. The institutional set up consists of twelve REIs, 19 counties, seven regions and nine national parks.

The twelve REIs, structured on a regional basis, are the main competent authorities. The final concept on the future development of the Inspectorates (rationalisation, possible full independence from the Ministry), as laid down in the 2001 Government Decree on Public Administration, should be elaborated on the basis of existing plans. The division of tasks and competencies between the Chief Inspectorate and the Regional Inspectorates should be rationalised.

The Chief National Environment Inspectorate (NEI) has concluded formal co-operation agreements with the police, the consumer protection service, the Mining Office, the National Public Health Service and the water management authorities. However, further efforts are needed to enhance inter-institutional co-operation in environment matters.

The total staff today are 1 230 in the Inspectorates, 388 of which are inspectors. Some 60 new staff at Inspectorates are to be recruited in the course of 2002, 39 of whom will be recruited from the National Public Health Service (ANTSZ) for the additional task of air quality monitoring. Qualified staff are also to be recruited in 2002 to the National Park Directorates, the Ministry of Environment including the LIFE-office, ANTSZ (300), and the Technical Safety Inspectorate. However, staffing is not yet satisfactory, and should be

further enhanced. Additional training and equipment is also needed, in particular to implement the IPPC Directive, in order to be able to meet the increasing requirements before accession.

The currently rather complicated permitting system is likely to be facilitated by the future application of IPPC. In this respect, and given the accumulation of water competencies by the MOE, the currently separate water permits should be incorporated into the integrated one. In general, it seems that the current permitting procedures are well developed to achieve a high level of environmental protection and seek to ensure strict conditions for process operation. However, the institutional roles and consultation procedures are highly complex, and it is doubtful whether the resources involved in these procedures are optimal either for environmental protection or for the operator. The challenge of IPPC is that the REIs will need to take on yet more co-ordinating roles, and it may be necessary to review the overall national system at this time.

A complex range of institutional responsibilities is involved in environmental monitoring. This complexity results in duplication. This concerns in particular water quality monitoring, where similar activities may be undertaken by the REIs and the Regional Water Directorates. While all REI laboratories are accredited, the laboratories of other regional authorities are not all accredited, and the analyses they conduct may not be compatible with the REI laboratories. In other areas, no unified data register is in operation. Moreover, no adequate system of data supply is operational yet, which makes the exchange of information at international level difficult.

As regards planning, the necessary procedures for planning exist. Some efforts should be made to accelerate the establishment of: air quality plans for the reduction of exceedances in the zones where these are expected; waste management plans at regional and local levels; and pollution reduction programmes for List II substances. All these plans and programmes should be in place before accession, in order to be in application by accession or to serve as a basis for the corresponding permitting.

As regards inspections and enforcement, a range of inspection types are available, linked to strong conditions for assessing permits backed up by efficient monitoring. The frequency of inspections and staff capacity are in general sufficient, at least to cover present tasks. But integrated inspections need to be developed, which will probably result in an increased need for staff and certainly for adequate training. There is an imperative need to considerably strengthen the NEI in view of the considerable amount of cases it will have to handle in the future in its capacity as an appeal body, and the advice and assistance it would have to provide to the REIs both for complex permitting issues and integrated inspections. The inspection activity of self-governments needs to be reviewed. Greater flexibility needs to be available for non-compliance responses, and fines should be reviewed to become more deterrent and effective.

Furthermore, considerable investments need to be secured, also in the medium term, to ensure the implementation of the environmental *acquis*.

Conclusion

In its 1997 Opinion, the Commission concluded that full transposition of the environmental *acquis* in Hungary could be expected in the medium term. It added that effective compliance with a number of pieces of legislation requiring a sustained high

level of investment and considerable administrative effort (e.g. urban waste water treatment, drinking water, aspects of waste management and air pollution legislation) could be achieved only in the long to the very long term. The Commission noted that substantive compliance would depend on implementing changes in the structure of the enforcement system and its instruments, while at the same time applying the proposed national environment accession strategy. In addition, it depended also on an increase in public and private investment.

Since the Opinion, Hungary has achieved considerable progress in aligning with the EC environmental *acquis*, in particular over the past two years. Hungary has also maintained a significant investment level and has improved its administrative capacities.

Negotiations on this chapter have been provisionally closed. Hungary has been granted transitional arrangements with regard to the *acquis* on packaging and packaging waste (until 31 December 2005), on urban wastewater treatment (until 31 December 2005), on large combustion plants (until 31 December 2005) and on the incineration of hazardous waste (until 31 December 2005). Hungary is meeting the majority of the commitments it has made in the accession negotiations. However, delays have occurred in the areas of horizontal legislation (adoption of a national climate change strategy) and waste management (adoption of the National Waste Management Plan and of regional and local waste management plans, legislation on packaging and packaging waste and waste oils). These issues need to be urgently addressed.

In order to complete preparations for membership, Hungary's efforts need to focus on finalising transposition (in the sectors of air quality, waste management, nature protection and chemicals) and on strengthening the administrative capacity.

Chapter 23: Consumers and health protection

Progress since the last Regular Report

During the reference period limited progress was made in this sector.

No further progress in alignment with the *acquis* was made as concerns **safety-related measures**.

As regards **non-safety-related measures**, Hungary continued alignment in the areas of mail order, electronic trade and package tours in the reporting period.

No legal developments can be noted in the sector of **market surveillance**. As regards institution building, further progress has been made with respect to the Hungarian market surveillance system through the creation of a Market Surveillance Council in January 2002. This body constitutes a consultative and co-ordination forum for market surveillance authorities and the development of market surveillance strategies and is operated by the Ministry of Economic Affairs. Participants include, amongst others, representatives from the ministries involved in market surveillance activities, the Hungarian Customs and Finance Guard, the National Association for Consumer Protection, the EC Delegation and the General Inspectorate for Consumer Protection (GICP).

The GICP, which is under the responsibility of the Ministry of Economic Affairs, is, together with the regional inspectorates belonging to the Ministry of Interior, the central authority in charge of enforcing legislation on consumer protection. The GICP also manages the market surveillance activities in co-operation with other market surveillance authorities such as the Veterinary and Food Control Department of the Ministry of Agriculture, the Public Health Service of the Ministry of Health, the Hungarian Customs and Finance Guard and several NGOs. The GICP and the regional inspectorates verified over 30 000 trading units in 2001 supplying all types of food, consumer products and services. There was a major increase in the number of product prohibitions in 2001: 127 products were banned for reasons of safety, as compared to 73 in 2000. As a result of market surveillance work carried out by the GICP and the regional inspectorates, the distributors in a number of cases voluntarily withdrew the products against which it had issued a safety warning. 20 927 general complaints were introduced in total and 30 812 quality complaints were submitted to the relevant officials at the GICP and the county inspectorates.

A Central Market Surveillance and Information System (CMSIS) was established in 2001 and started to operate in early 2002. It is co-ordinated and managed by the GICP. Through the exchange of information, the CMSIS is closely linked to the TRAPEX (Transitional Rapid Information Exchange System on Dangerous Products), whose Co-ordination Secretariat operates within the GICP facilities in Budapest.

The TRAPEX system launched 142 non-food alerts in 2001. Hungary showed itself to be the most active country in the region on this issue.

The Government considerably increased its support for the operation and activities of civil organisations specialised in consumer protection. In 2001, these organisations were provided with more than HUF 73 million (around € 285,000) by the Hungarian government. In 2002, approximately HUF 96.6 million (around € 376,000) will be made available. In 2001, ten NGOs created the “National Federation of Associations for Consumer Protection in Hungary” (FEOSZ) with the aim of developing a common position in relation to consumer policy.

The Hungarian authorities supported the work of the arbitration bodies to the tune of HUF 28 million (around € 109,000). For 2002, the central budget contains an allocation of HUF 59 6 million (around € 232,000) for this purpose. The arbitration boards handled more than 450 cases and disputes in 2001.

Overall assessment

As regards safety and non-safety related measures, Hungary’s legislation is largely in line with the *acquis* on misleading advertising, consumer credit, indication of prices and package travel, holidays and tours. Further efforts are still needed, however, in particular in the areas of product safety, liability for defective products, distance contracts, injunctions for the protection of consumer interests, and certain aspects of the sale of consumer goods and associated guarantees in order to achieve full alignment on accession.

There has been good progress in creating the relevant policy and management structures and information systems directed towards effective implementation of the provisions of the General Product Safety Directive. Important efforts have been made as well to ensure

the effective operation of the TRAPEX alert system. However, sustained efforts are needed in the area of market surveillance, where additional staff, training, budgetary and IT resources are indispensable. Inspection capacities for products imported from third countries should also be improved. Also, the arbitration bodies require more budgetary resources and training.

Education and training on consumer protection at primary and secondary level should be introduced.

Further support for consumer organisations is needed in order to enable them to protect consumer interests effectively. More efforts should be made by the government to ensure that consumers' interests are treated as a horizontal issue in the decision-making process. Moreover, non-governmental organisations should be more actively involved in developing consumer product safety standards. Progress also remains to be made with enhancing consumers' and producers' awareness of their respective rights and responsibilities.

Conclusion

In its 1997 Opinion, the Commission concluded that, to the extent ongoing efforts were pursued, Hungary was likely to be in a position to take on the full consumer protection *acquis* in the medium term. It added that work should concentrate on completing, updating and unifying legislation, as well as establishing the necessary structures.

Since the Opinion, Hungary has continued to make good progress, and few problems have been encountered. Hungary's legislation is now largely in line with the *acquis* in most safety- and non-safety-related areas.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements and is generally meeting the commitments it has made in the accession negotiations in this domain.

In order to complete preparations for membership, Hungary's efforts now need to focus on completing the transposition and implementation of the *acquis* in this area, thereby ensuring that the administrative structures in place effectively fulfil their tasks in terms of market surveillance. Further support should be devoted to increasing consumers' and producers' awareness.

Chapter 24: Co-operation in the field of justice and home affairs

Progress since the last Regular Report

Since the last Regular Report, considerable progress has been registered in Hungary in numerous fields such as visa policy, the Schengen Action Plan and the fight against fraud and corruption.

Following the entry into force on 16 November 2001 of the Co-operation Agreement between Hungary and Europol, the **Data Protection** Supervisory Body of the International Law Enforcement Co-operation Centre (NEBEK) was set up, with five staff. After several months of the post being vacant, the new Parliamentary Commissioner for Data protection was finally appointed in December 2001 for a period of six years.

As to **visa policy**, new visa obligations were introduced for nationals of Cuba, the Seychelles and the Republic of South Africa. The visa requirement has been abolished for the special administrative regions of Macao (December 2001) and Hong Kong (February 2002). The new Act on the Entry and Stay of Foreigners, which entered into force in January 2002, provided the legislative framework for the introduction of a new visa sticker with higher security standards. These started to be issued as of September 2002. An electronic Consular Information System supporting the issuing of visas (recording and storing the visa applications, printing the issued visa stickers) has become operational at the Office of Immigration and Naturalisation. All consular missions are now connected to the Consular Information System. The establishment of the register on visas and visa applications is in progress.

At **external borders**, the infrastructure has been further modernised and upgraded in line with the Schengen/EU requirements. Infrared surveillance equipment, fast patrol boats, patrol equipment and criminal investigation devices have been deployed. Document-reading devices were also installed in the course of 2001. In addition, some 26 vehicles, dubbed Schengen standard buses, have been equipped with document-checking technology. Each of the buses contains a full complement of all the instruments used at border crossings, such as passport checking computers, carbon monoxide meters, Geiger counters and drug identification equipment. A total of 4 000 kits for use by border control personnel, each containing drug identification equipment, a patrol bag, a portable metal detector and a megaphone, were also made available. Remarkable progress has been made concerning the use of information technology, and further steps were taken with a view to future connection to the VISION system and the development of SIRENE.

Three border crossing points (Záhony, Tompa and Gyula) along the future external borders of Hungary have started to operate according to **Schengen**/EU requirements as a pilot project. Further contact points at Hungary's land borders with Austria, Slovakia and Slovenia are being established in order to facilitate border traffic and migration control. Over the last year some 87.5 million legal border crossings were registered including 30.7 million vehicles. 30 115 people were turned back for non-compliance with proper entry and travel residence conditions.

Also, the staff of the Border Guard was further increased and training in *acquis*-specific issues as well as in languages for the border guards continued. Training of 50 future liaison officers and 100 document experts qualifying for the Schengen list is underway.

In July 2002, Hungary submitted a revised Schengen Action Plan.

As far as **migration** is concerned, an amended Law on Entry and Stay of Foreigners entered into force in January 2002, which introduced the unified residence permit and simplified expulsion rules. Anyone wanting to stay longer than 90 days in the country can apply for a one-year extendible visa. Residence of unlimited duration will be granted after five years of stay in the country, instead of three as before, and people with at least eight years of immigrant status can apply for citizenship. This means that foreign nationals will be able to initiate naturalisation procedures 13 years after arriving in the country.

The new law also introduced stricter rules for taking action against those who "promote" illegal migration and illegal employment e.g. employers employing foreigners illegally.

On the administrative side, the Office of Immigration and Nationality (OIN) became the body responsible for migration matters, for which a central alien policing register was established in January 2002. Its new seven regional directorates (Budapest, Debrecen, Győr, Miskolc, Pécs, Szeged and Székesfehérvár) and fourteen customer offices have to deal with some 100 000 requests a year nation-wide. In addition, some 20 000 pending cases were taken over from the police and public administration offices and procedures slowed down in the first months of 2002.

The newly amended law on **asylum** entered into force in January 2002. It is largely in line with the *acquis* and well implemented. During the reference period, the overall living conditions in the reception facilities for asylum seekers were further improved and now broadly correspond to European standards and practices. In June 2002, a new refugee integration centre was opened with a capacity of 300 persons.

Hungary continued to be a target country for asylum seekers and the number of applications for refugee status rose in 2001 by about 22.5% compared to 2000. The number of registered refugees reached 9 554 in 2001 (7 799 in 2000), the largest number since the early 90s. The number of asylum seekers actually granted official refugee status, however, remains at a low level. In 2001, only 174 applicants were granted official refugee status and 297 the status “authorised to stay” (a humanitarian residence permit).

The Office for Immigration and Nationality (OIN) – besides the above mentioned migration matters - is also in charge of asylum applications.. The Headquarters of the Office reviews appeals against their decisions. Against these decisions an appeal to the Budapest Municipal Court can be made and in the last instance to the Supreme Court..

As preparation for the introduction of the Automatic Fingerprint Identification System (AFIS), a central unit has been established at National Police Headquarters. Workstations are to be set up at the regional directorates of the Office for Immigration and Nationality. The system in development is to be compatible with EURODAC.

A working group, composed of various ministries, the Office for Immigration and Nationality, the UNHCR, NGOs and refugee representatives, is currently developing a strategy for the integration of refugees. In the meantime, measures for the integration of refugees are supervised by the Office for Immigration and Nationality.

Hungary has concluded new readmission agreements with the Benelux countries and initialled a new one with Estonia and Slovakia. The re-admission agreement with Albania entered into force in December 2001. The agreements already in force with Romania and Croatia have been amended in order to ensure alignment with the requirements of the *acquis*.

With regard to **police co-operation and organised crime**, the police co-operation agreement between Hungary and the European Police Office (Europol) entered into force in November 2001. In April 2002, the International Law Enforcement Co-operation Centre became the single contact point for international co-operation for all Hungarian law enforcement agencies. Deployment of the liaison officers (one police and one customs officer) to Europol took place in April 2002. Following the entry into force in April 2002 of a new Witness Protection Law, a specific Unit (31 persons) has been established within the Police Operational Support Directorate.

Hungary continues to be primarily a country of transit and destination for trafficking in human beings. Trafficking is prohibited by law, and the respective sanctions have become stricter since April 2002 when the amendments to the Penal Code entered into force. Since the entry into force of the law on entry and stay of foreigners in January 2002, detected traffickers may be expelled from Hungary with immediate effect.

In February 2002, a substantial package of amendments to the Penal Code was adopted in order to align with the *acquis* and the UN Convention on Trans-national Organised Crime. These amendments came into force in April 2002. It covered the following main issues: introduction of the new concept of organised criminal group, the shift of the burden of proof in cases of forfeiture of assets, the criminalisation of obstruction of justice, of bribery and of participation in an organised criminal group, stricter provisions on trafficking in persons and the extension of criminal liability of foreign public officials for passive bribery.

A new agreement was concluded with FRY in November 2001 to improve the fight against cross-border crime.

Hungary signed the United Nations Convention for the Suppression of the Financing of **terrorism** in November 2001. Hungary is party to all other terrorism-related UN conventions. Hungary also joined the EU Common Positions on the fight against terrorism. In March 2002, new legal measures were taken to freeze financial assets of terrorist and terrorist organisations.

In order to ensure the effective implementation of the policy on counter-terrorism, a new unit has been established in the organised Crime Directorate of the National Police Headquarters. The Counter-Terrorist Subdivision is responsible for detecting and preventing terrorist related crimes and has a staff of 9. In order to develop the equipment used in the fight against terrorism, firearms and other equipment have been purchased.

In the context of the **fight against fraud and corruption** (*see also section .1.1. – Democracy and the rule of law*), in December 2001, a new law was adopted concerning the criminal liability of legal persons.. Under this law, penalties may be imposed upon a legal person in respect of crimes committed by a natural person for the benefit of a legal person. The law will come into force upon Hungary's accession to the EU.

Within the amended Penal Code, which entered into force in April 2002, more severe punishments and sentences for bribery have been introduced. Also, the rules on the immunity of persons elected to public office as well as on the possible confiscation of property gained through contacts with organised crime have been made more stringent. Active bribers (those giving the bribe) may be exempted from punishment if they provide information to the authorities and help to identify the passive briber. The conformity of this latter element with the Convention for the Protection of the European Communities' Financial Interests remains to be assessed. Officials may now be punished if they fail to fulfil their obligation of reporting the case to the competent authorities.

An anti-fraud interministerial co-ordination Committee was created in November 2001, which is to contribute to the safeguarding of the financial interests of the Community. In addition, in 2002 an amendment to the penal code was adopted, which makes fraud against the financial interests of the Communities a criminal offence.

On the institutional side, the Ministry of the Interior and the Ministry of Justice have the overall responsibility for the implementation of the anti-corruption strategy. In addition, various bodies have been set up to make the fight against corruption more effective. Notably, in the police force, a special anti-corruption unit was established in February 2002 to investigate allegations of corruption against police officers. The Prosecutor General's Investigation Office is in charge of files involving members of the Government, of Parliament, senior officials of the administration, or more generally, persons of public interest. (*see also political criteria*).

In the area of **drugs**, the implementation of the National Strategy to Combat Drugs and Drug Addiction continued. Progress was made in the areas of prevention, research, improved therapeutic capacities and the establishment of Co-ordination Fora on Drug Affairs in the Ministry of Health. The legal status of these fora is, however, not clearly defined, and the level of resources as regards staff and budget is poor. The amendment to the Code on Criminal Procedure, defines the production, supply, distribution, engagement in the trafficking of, importing, exporting or transiting through the territory of Hungary chemical materials used for the production or manufacture of narcotic drugs as a crime. A National Contact Point for Co-operation and Information Exchange was established.

In the context of the fight against **money laundering** (*see also Chapter 4: Free movement of capital*), a new law entered into force in January 2002. It contains provisions on the phasing out of anonymous saving deposit books, securities and the licensing of currency exchange. Only credit institutions and their agents are authorised by the Hungarian Financial Supervisory Authority to offer currency exchange services. The law also provides for the identification of the beneficial owners of bank accounts. In June 2002, the OECD Financial Action Task Force removed Hungary from its list of non-co-operative countries.

A Financial Intelligence Unit within the National Police Headquarters is responsible for analysing suspicious transactions (staff: 18). The number of suspicious transactions reported to the Financial Intelligence Unit has grown significantly over the last two years.

Hungary has promulgated agreements on **customs co-operation** with Argentina, the Federal Republic of Yugoslavia and Kyrgyzstan in 2001 and with Latvia in 2002.

With a view to Hungary's participation in European networks and institutions (European Judicial Network, EUROJUST), the Ministry of Justice and the Prosecutor General have been designated as contact points.

In March 2002 Protocols 1 and 2 to the European Convention for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment entered into force.

Overall assessment

As regards **data protection**, the provisions on the protection of personal data and disclosure of data of public interest will need to be fully aligned.

In the area of **visa policy**, legislation should be further aligned as regards EU visa obligations and EU visa-free travel.

The number of staff of the Aliens Policing Division of the Office for Immigration and Nationality has to be increased in order to ensure that visa applications are dealt with expeditiously.

As regards **external borders**, the law of January 2001 on the protection of the state border and the border guard aligned the Hungarian legislation to a large extent with the Schengen/EU *acquis* in this field. Hungary has made impressive progress in the implementation of the Schengen Action Plan and been very active in concluding bilateral agreements on border control, border surveillance and police co-operation. Hungary has not yet been able to conclude all necessary bilateral agreements.

Hungary is well advanced with up-grading border crossing points. The border guard is making good progress in recruiting more personnel and must maintain its efforts in line with its staffing strategy. Equipment is being improved in order to reach the necessary standard. Hungary must maintain its efforts on training the border guards. There is a need for a flexible training system, which will be able to implement ongoing training of personnel and respond to new training needs.

Regarding the development N.SIS and SIRENE, and preparations for the future connection to the VISION system, preparations should be continued.

Concerning **migration**, further re-admission agreements will have to be concluded (notably with Belarus, Pakistan, the Russian Federation, Peru), whilst some other agreements will have to be aligned (Ukraine, Slovakia, Slovenia).

All the provisions of the Law on Hungarians Living in Neighbouring Countries adopted in June 2001, including those concerning migration, will have to be applied in accordance with the *acquis* from the date of accession (*see also Chapter 27: Common Foreign and Security Policy*).

The new legislation on **asylum** is largely in line with the *acquis* and is, in general, well implemented. Officials dealing with asylum issues display a high level of professionalism. There is still a need to define better the criteria determining whether a person who has entered Hungary illegally should be kept in a reception centre or in a border guard detention centre. Care must be taken to ensure that persons who have entered Hungary illegally and been placed in border guard detention centres can obtain access to a lawyer and that applications by such persons for asylum are presented promptly to eligibility officers for consideration. The capacity of reception centres is generally adequate. Further training is necessary with regard to foreign languages, as well as in order to apply the criteria and mechanisms for determining the responsible member state (Dublin Convention), to implement EURODAC and to develop the integration capacity for refugees. Social integration measures should also be extended to persons granted “authorised to stay” status, who are currently excluded.

In the area of **police co-operation and the fight against organised crime**, the International Law Enforcement Co-operation Centre is capable of ensuring international police co-operation and the implementation of the Europol agreement. Additional staff from the Prosecutor General’s office and the tax administration should be assigned. Statistical instruments for measuring crime rate should be improved, while new methods of technical crime investigation, including development of forensic investigation should be further developed.

Hungary still needs to ratify the 2000 UN Convention against transnational organised crime (Palermo Convention) and its Protocols (the Protocol on firearms remains to be signed), as well as the 1999 UN Convention for the Suppression of the Financing of Terrorism. It needs to sign and ratify the Second Additional Protocol to the European Convention on Mutual Legal Assistance in Criminal Matters of November 2001 and to accede to those Conventions in Principle 2 of the EU Strategy on Organised Crime, to which Hungary is not yet party. Furthermore, the introduction of a uniform digital communications network should be completed.

So far, Hungary has concluded some 28 bilateral international agreements on combating cross-border organised crime.

In the area of the **fight against fraud and corruption**, the legal framework is almost entirely in line with the *acquis*. In particular, the introduction of asset statements for public servants is a significant step forward in the fight against corruption. More manpower has to be devoted to the fight against corruption. While the establishment of special units to investigate corruption within the police force and within the Prosecutor General's office are important step forwards, these would need more staff and training. In addition, co-operation between the various agencies should also be improved. Hungary should also pay more attention to the fact that prevention through transparency and accountability standards is as important as repressive tools.

Hungary has not yet signed the Council of Europe Civil Law Convention on corruption.

Anti-money laundering laws are efficiently implemented. In particular, the Hungarian Financial Supervisory Authority is a competent body, possessing adequate powers and sufficient staff. Its working methods are in line with European standards. It ensures strict enforcement of the rules concerning identification of customers, of bank account owners and of the nature of banking operations. It is also overseeing the withdrawal of anonymous passbooks, which was decided in December 2001. However, the rules determining which financial institutions are to be selected for investigation remain unclear. The Financial Intelligence Unit needs to be further upgraded with regard to staff and information technology equipment. There is also room for improvement as regards the co-operation with the Hungarian Financial Supervisory Authority.

In the field of **drugs**, the full implementation of the National Strategy to combat Drugs should be ensured, in particular by putting more emphasis on supply reduction aspects; more financing is also necessary for prevention programmes. Hungary also still needs to ratify the 1995 Agreement on Illicit Traffic by Sea.

In the area of **customs co-operation**, Hungary should in particular finalise preparations for the implementation of the Naples II Convention.

Regarding **judicial co-operation**, Hungary should take further measures to ensure implementation of the Community instruments in the area of judicial co-operation in civil matters, notably as regards mutual recognition and enforcement of judicial decisions. Direct contacts between competent judicial authorities should be made possible.

Hungary has ratified all **human rights legal instruments** which are part of the Justice and Home Affairs *acquis*.

Conclusion

In its 1997 Opinion, the Commission concluded that Hungary was well on track to meet the justice and home affairs *acquis* within the next few years, assuming that progress continued at the current rate and effective training and institutional development programmes were implemented in the key justice and home affairs institutions.

Since the Opinion, progress has been steady in terms of legal alignment and building up the necessary administrative structures. Hungary's legislation is almost entirely aligned with the *acquis*.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this area and is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete its preparations for membership, Hungary's efforts now need to focus on finalising alignment (data protection, visa policy), on further improving its implementing and management capacities and the human and material resources of its law enforcement agencies, and on meeting the practical requirements of Schengen. The efforts should in particular focus on ensuring the implementation of its Schengen Action Plan according to the announced time schedule.

Chapter 25: Customs union

Progress since the last Regular Report

Hungary has achieved further progress in the customs field since the last Regular Report.

In the area of the **customs acquis**, the provisions on customs warehousing, temporary importation, valuation and non-commercial consignments were further aligned with the *acquis* in January 2002. Since January 2002, Hungary has also modified its legislation for the transport of goods under the common transit simplified rail procedure. During the reporting period, Hungary continued to strengthen the **administrative and operational capacity** of the Hungarian Customs and Finance Guard. Hungary has in particular taken significant steps to revitalise the development of interconnectivity enabling systems. The Hungarian IT system (VAMKER - computerised customs declaration system) contains all the information relating to customs procedures. Preparations for joining the CCN/CSI system are under way.

A National Inter-Operability Implementation Strategy was finalised in January 2002, and additional staff (40) was appointed by the Ministry of Finance for the implementation of the strategy within the next two years.

The Chemical Testing Institute was empowered to take decisions in first instance. Its laboratory facilities were improved with a mobile laboratory service, and the staff level (27) seems sufficient to implement the obligations deriving from the Binding Origin Information/Binding Tariff Information system. Hungary and the Czech and Slovak Republics signed a tri-lateral co-operation agreement between customs laboratories in January 2002. As regards border management, following their modernisation several border points were opened in 2002 on the future external frontier of the EU at Letenye on the border with Croatia (March), at Rösztke on the border with Yugoslavia (April), at

Záhony on the border with Ukraine (July) and at Tartand and Gyula on the border with Romania (July).

In the framework of a Memorandum of Understanding between the Hungarian Customs and Finance Guard and the General Inspectorate for Consumer Protection, two working groups, on IT and market surveillance, were set up.

Training of customs staff on interception of nuclear and radioactive materials at border crossing points was carried out in the reference period.

Overall assessment

In general, Hungary is already well advanced in this area. Hungarian legislation has already to a large extent been aligned with the *acquis* since 2000. Hungary should continue its efforts to complete alignment in the area of customs free zones, the number of which needs to be reduced significantly. Adaptation of the preferential rules of origin used under Hungary's Generalised System of Preferences (GSP) to those of the Community will only take place at the time of accession.

As regards the administrative and operational capacity to implement the *acquis*, Hungary continued to train customs officers and to upgrade the relevant equipment. It already has experience in applying provisions and procedures that are similar and in some cases identical to those of the Community.

As with most other candidate countries, however, certain commercial policy measures will not apply until accession. This has consequences for the context in which the provisions in areas such as non-preferential origin, inward and outward processing are applied. For example, in Hungary, the Binding Origin Information system is currently only used for preferential origin, whereas in the Community it is also used for non-preferential origin. Systems like quotas, suspensions and the integrated tariff, which are not currently managed electronically in Hungary as in the Community, are being computerised.

Continuous efforts are still needed in these fields, including language training and training on the relevant areas of copyright and phyto-sanitary legislation. Concerning the further development of the IT systems, major problems remain to be addressed. However, subject to work proceeding as planned, Hungary should be in a position to meet its obligations in a relatively short term.

Conclusion

In its 1997 Opinion, the Commission concluded that Hungary was making a major effort to align its organisation and staff to the duties that have to be carried out by a modern customs organisation. The Commission added that, if Hungary reinforced its efforts, particularly in relation to project management in the computerisation area, Hungary should be ready to fulfil the responsibilities of an EU customs administration within the next few years.

Since the Opinion, Hungary has achieved steady progress in aligning with the *acquis* in this area has also gradually developed and reinforced the necessary administrative capacity. The alignment of the customs legislation with the *acquis* is now almost

completed and administrative capacity is at a relatively advanced stage, although a number of issues remain to be tackled in this regard.

Negotiations on this chapter have been provisionally closed. Hungary has been granted a transitional period until the end of the third year following the date of accession or 31 December 2007, whichever is the earlier, for compliance with the Common External Tariff as regards the opening of a yearly tariff quota for aluminium, not alloyed. Hungary is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts should now focus on ensuring full interconnection of its national systems with the EC customs IT systems, and on strengthening the customs services' capacity to combat fraud and economic crime, in close co-operation with other enforcement bodies. As regards the alignment with the *acquis*, Hungary has to take the necessary steps to prepare for the application of measures and provisions that will be introduced only at the date of accession, including in relation to free zones.

Chapter 26: External relations

Progress since the last Regular Report

Since the last Regular Report Hungary has continued to align with the *acquis* on the common commercial policy and to co-ordinate its positions and policies within the World Trade Organisation (WTO) with the EU, in particular with regard to the Doha Development Agenda negotiations.

As regards the **common commercial policy**, upon accession Hungary will be required to align its tariffs with those of the EC. Hungary's applied tariffs currently average 11.7% (MFN) on all products, 30.9% on agricultural products, 14.8% on fishery products and 7% on industrial products. By comparison, EC tariffs currently stand at 6.3% on all products, 16.2% on agricultural products, 12.4% on fishery products and 3.6% on industrial products.

As regards **bilateral agreements with third countries**, Hungary has concluded a free trade agreement with the Federal Republic of Yugoslavia, which entered into force in July 2002. In January 2002, Hungary concluded a non-preferential agreement with the United States, which foresees a reduction of tariffs, in some cases to the level of the EC's common external tariff, for seventy products on an MFN basis. This agreement was negotiated without the EC being sufficiently consulted or fully informed in advance.

Hungary, as a member of the Central European Free Trade Agreement (CEFTA), signed the Additional Protocol no. 10 on the liberalisation of agricultural and food trade and no. 11 related to rules of origin of goods in November 2001.

With regard to **development policy**, co-operation and assistance, Hungary is an active member of the OECD and is adapting its development practices to the principles laid down by the Development Assistance Committee. Preliminary work has started to set up the organisational and institutional framework necessary for development co-operation within the Ministry of Foreign Affairs in the second half of 2002. A detailed budgetary plan for the Fund of the International Development Co-operation is under preparation and

will probably be approved as part of the State Budget for 2003. For the implementation of **humanitarian aid** initiatives, the authorities continue to co-operate with Non-Governmental Organisations established in Hungary. Total bilateral and multilateral external assistance given by Hungary to developing countries in 2001 amounted to € 29 million (€ 20.5 million for official aid (OA) and € 8.5 million for official development assistance (ODA)).

Overall assessment

The EU and Hungary have established a framework for co-operation regarding WTO issues both at ministerial and at departmental level. Hungary has been supportive of EU policies and positions within the WTO framework, in particular also during the preparation for and the launching of the Doha Development Agenda. This close co-operation should continue. Close co-operation is also needed and should continue to ensure the smooth alignment of Hungary's GATS commitments with the EC's commitments and MFN exemptions, and appropriate steps have been defined to this extent. Hungary is an observer to the WTO plurilateral agreement on trade in Civil Aircraft. With regard to the WTO Agreement on Trade in Textiles and Clothing (ATC), co-ordination has taken place within the third stage of integration under the ATC to align Hungary's integration programmes with those of the EC.

Besides the new agreements mentioned above and the Europe Agreement, Hungary has concluded bilateral agreements with EFTA, Turkey, Israel, Estonia, Lithuania, Latvia and Croatia. Hungary is also a CEFTA member. Hungary needs to ensure that the Union is kept fully informed both about existing trade agreements and about any negotiations aimed at the conclusion of new trade agreements with a third country. Prior to accession, Hungary will need to renegotiate or renounce all international agreements concluded with third countries, including the Friendship and Navigation Treaty with Japan, that are incompatible with its future obligations as an EU Member State.

Concerning the licensing of traded goods, the Licensing and Administrative Office within the Ministry of Economic Affairs and Transport continues to be in charge of, *inter alia*, the issuing of export licenses for arms.

Hungarian legislation on export control of dual-use goods has been amended, and alignment to the list of dual use goods under control is under elaboration. Full alignment to the *acquis*, in particular the general export authorisations, can only take place upon accession. Hungary keeps the industry regularly informed of developments in this field and has developed bilateral contacts with the EU Member States to exchange best practices on export control issues.

Export credits are in line with EC rules. However, further efforts are required to strengthen the institutions in the field of foreign trade licensing.

Hungary's alignment with and future participation in the common commercial policy is administered by the Ministry of Foreign Affairs. Its role was further strengthened on an administrative level when, in May 2002, the State Secretary in charge of EU accession was also assigned the task of trade policy. However, inter-institutional consultations on the creation of administrative capacities in light of EU accession have not yet resulted in the promised action plan. Further efforts are needed to ensure that the administrative capacities with a view to Hungary's participation in EU committees and working groups

for development co-operation are in place upon accession. The administrative infrastructure, which needs to be in place with respect to customs services, is discussed in the chapter on customs union (*see Chapter 25 – Customs union*).

Development and humanitarian aid are administered by the Ministry of Foreign Affairs. Hungary still needs to progressively shape a development policy in accordance with EC lines.

Conclusion

In its 1997 Opinion, the Commission concluded that Hungary was well placed to be able to meet Community requirements in this field.

Since the Opinion, Hungary has made good progress. It has now reached a good level of alignment with the *acquis* in this area.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements. Hungary is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts now need to focus on finishing the process of legislative alignment, including bringing its bilateral agreements with third countries into full conformity with its EU membership obligations, as well as on ensuring appropriate administrative capacity to fully implement and enforce the EC *acquis* in this field upon accession. This includes the shaping of a development policy that is in accordance with EC lines. Hungary will also need to put in place the necessary administrative structures, which will allow its participation in EC committees and working groups. Further progress is also required in the field of foreign trade licensing.

Chapter 27: Common Foreign and Security Policy

Progress since the last Regular Report

As in the previous year, Hungary confirmed again its good track record in Common Foreign and Security Policy.

Hungary has shown a keen interest in continuing its active participation in **political dialogue** with the EU, including ESDP developments. It has actively participated in exchanges in this context with the EU and, for ESDP, in both EU+15 format meetings (i.e. with non-EU European NATO members and candidates for accession to the EU) and EU+6 format meetings (i.e. non-EU European NATO members). Hungary has participated in all the relevant meetings including at the level of Political Directors, European Correspondents and Working Groups.

As regards **EU statements and declarations**, Hungary continued to align itself regularly with EU declarations, common positions, joint actions and other CFSP instruments to which it was invited to associate itself, including negative measures. In particular, Hungary aligned with the EU Action Plan of September 2001 and the four Common Positions on combating terrorism. With the adoption of a new law on the fight against terrorism in December 2001 it has taken the appropriate measures to implement these

positions (*see also chapter 24 - Justice and Home Affairs*). In November 2001 Hungary ratified the Rome Statute establishing the International Criminal Court. Hungary confirmed its preparedness to contribute both to EU Rapid Intervention Force missions and to EU civilian instruments for crisis management. In this context, it offered 671 soldiers as well as equipment to the Rapid Reaction Force. Furthermore, it has committed itself to making 107 policemen available to the European Union's crisis management contingent of 5 000 to be set up by 2003.

Hungary participated in the Capabilities Improvement Conference of November 2001 and the EU +15 +6 Defence Ministers' meeting in May 2002. It has shown an active interest in participating in the forthcoming EU Police Mission (EUPM) in Bosnia and Herzegovina.

On the regional level, in 2001 Hungary co-chaired the Working Table on security issues in the context of the Stability Pact for South-Eastern Europe. As of June 2001, Hungary assumed the rotating presidency of the Visegrád Group, but dialogue was limited due to disputes on the Hungarian "status law" and the Czechoslovak Presidential Decrees of 1945. A meeting of the Prime Ministers, planned to take place in Budapest in March 2002, was cancelled, but the dialogue was re-established by the new Hungarian government in May 2002. At this occasion, the Hungarian Government expressed its willingness to further enhance the dialogue with the neighbouring countries. In this respect, the new "Visegrád Scholarship programme" will give a new impetus. The V4 started to improve co-operation with the Ukraine.

Hungary made considerable efforts to support international peacekeeping missions. It participated in a series of NATO, KFOR, SFOR and other peacekeeping and observer operations. So far, 460 Hungarian policemen have participated in peacekeeping missions; 40 of them are still serving under the flags of the United Nations and the OSCE in Bosnia and Herzegovina and on the Sinai Peninsula.

Bilateral relations remained equally constructive with most of its neighbours. However, some political tensions arose with Romania and Slovakia concerning the Law on Hungarians living in Neighbouring Countries ("status law"), which entered into force in January 2002. This law had been adopted in June 2001 without due consultation of Hungary's neighbours. It was designed to foster the position of the Hungarian minorities abroad and granted them, on the basis of registration, in Hungary, certain rights and privileges in the areas of education and culture. Following the recommendations of the Council of Europe's Commission for Democracy through Law ("Venice Commission") on the roles and tasks of kin-states and home-states in minority protection, Hungary adopted in December 2001 and January 2002 legislation implementing the status law, which is broadly compatible with these recommendations. As agreed in a Memorandum of Understanding between Hungary and Romania, the law should have been revised in certain points in June 2002, but no progress can be reported in this respect. As regards Slovakia, an agreement on the application of the law is still pending. Hungary committed itself to repeal before accession any provision, which would not be compatible with EC law. (*see Chapter 27 - Common Foreign and Security Policy*).

Overall assessment

On the regional level Hungary continued to participate actively in regional co-operation schemes and forums. It takes part in the Southeast European Co-operative Initiative

(SECI), the Central Europe Initiative (CEI), the Stability Pact for South-Eastern Europe, and the Visegrád dialogue. Hungary is also supportive of the democratic forces in Yugoslavia in the framework of the Szeged Process as well as by creating preferential export credit allowances. The Szeged Process has set itself a new objective of promoting European integration perspectives via the enhancement of regional co-operation.

Hungary has subscribed to the content and principles contained in the EU Code of Conduct on Arms Exports, and it continues to make more efforts to ensure the full implementation of the Code's criteria. The Hungarian Ministry of Foreign Affairs has an administrative set-up, which is basically compatible with EU CFSP structures. It has a European Correspondent, but no Political Director yet. However, there is an equivalent post whose holder assumes the Political Director's tasks in co-operation meetings with the EU. The ministry is connected to the Associated Correspondents' Network information system through which the EU communicates within the CFSP with the associated partners.

Conclusion

In its 1997 Opinion, the Commission concluded that the assessment of Hungarian foreign and security policy to date led to the expectation that as a member it could effectively fulfil its obligations in this field.

Since the Opinion, Hungary has made considerable progress in aligning its foreign policy with the Union's Common Foreign and Security Policy. Alignment is to a large extent complete.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements in this area and is generally meeting the commitments it has made in the accession negotiations in this field.

In order to complete preparations for membership, Hungary's efforts now need to focus on ensuring that its foreign policy orientation remains in line with the Union's developing foreign and security policy, adopting the legislation on economic sanctions and finalising the development of the necessary administrative structures. In particular, Hungary should ensure that its national policies and practice conform to the EU's common positions, should defend these positions in international fora, and should ensure that all sanctions and restrictive measures can be duly implemented. As regards the "status law", the Commission will continue to monitor the situation and will request Hungary to bring the law – at the latest upon accession – in line with the anti-discrimination provisions enshrined in the EC Treaty.

Chapter 28: Financial control

Progress since the last Regular Report

Since last year's Regular Report, Hungary has made little progress in this area.

In the area of **Public Internal Financial Control (PIFC)**, Hungary has overhauled its system for budget execution. Through amending the Public Finance Act, the Hungarian State Treasury Ltd. (HST) has been split into three separate units, (a) dealing with appropriations and commitments of the State Budget and supervising the territorial state

budget offices, (b) managing the state/government debt, and (c) executing payments under the state budget. This is part of a general reform in public finances designed to separate regulatory and cash transfer functions and to make Hungary's public finances more transparent. Furthermore, the amendment of the relevant government decree, which came into force in January 2002, stipulates, *inter alia*, a series of improvements concerning the supervision of budgetary commitments at the level of spending centres.

No further progress was achieved in the field of internal audit.

As regards **external audit**, no further developments regarding legal alignment can be reported, since the relevant legislation is already largely in line with the *acquis*. The administrative capacity of the Hungarian State Audit Office (SAO) has been further strengthened. A total number of 322 persons participated in financial control training between 2000 and March 2002. The SAO is currently preparing a new strategy targeting further methodological development, including training of auditors. In accordance with a parliamentary decision, the SAO informs Parliament on a regular basis on the state of follow-up of its recommendations by relevant government bodies. All SAO reports are sent to Parliament and made public.

Hungary has made some progress in the area of **control over structural action expenditure**. An amendment to the decree on financial planning, utilisation and control of the pre-accession instruments came into force in January 2002. It defines the audit trail, and contains the obligation to establish internal audit units that operate as independent units within the implementing organisations and to elaborate audit plans. The amendment also specifies the sanctions to be applied in case of misuse of funds. Hungary has made progress towards the establishment of the Extended Decentralised Implementation System (EDIS). In December 2001 the Government Control Office (GCO) carried out a systems audit on the financial management system for pre-accession funds. The gap assessment exercise, which is the first step leading to EDIS, has been completed in February 2002. Every institution covered by the gap assessment has elaborated its action plan for filling the gaps identified. The establishment of a financial control system for the accreditation of the SAPARD Agency is in the last phase .

In November 2001, the anti-fraud co-ordinating service was set up as a separate unit within the Ministry of Finance's Department for Legal Affairs and Co-ordination. It is responsible for the co-ordination of all legislative, administrative and operational activities related to the **protection of the financial interests of the European Communities**. In addition, a Standing Inter-Ministerial Committee was set up in order to facilitate co-ordination with other Hungarian institutions involved in the protection of the Communities' financial interests. While both bodies were set up as of January 2002, they have not yet become fully operational.

Overall assessment

With regard to Public Internal Financial Control (PIFC), Hungary needs to redefine its present internal audit functions and structures according to international practice and separate any managerial functions (like inspection and monitoring) from the audit function. To that end, the Ministry of Finance has decided to rewrite the relevant decree incorporating clear definitions of managerial accountability and the role of functionally independent internal audit services. It will also have to clarify the various interpretations of audit co-ordination in current laws and regulations to establish a clear hierarchy in

guidelines relating to internal audit harmonisation in the entire public sector. The Ministry should consider embedding the newly defined audit function (with the main principles of modern internal audit and functional independence) into the Act on the Public Finance System.

Hungary will have two separate and fully-fledged systems for internal audit, one centralised, managed by the Government Control Office under the Prime Minister and one decentralised in the Budget Chapters and subordinated institutions, managed by the Ministry of Finance. This may lead to lack of clarity and direction gaps. The Ministry, which is also responsible for the co-ordination between both internal audit systems, should ensure that the set of criteria for appropriate audit rules and methodology be applied to both systems. All aspects of the concept of functional and political independence for the internal audit function in both systems need to be reconsidered and further developed. Finally, harmonised implementation guidelines, in particular financial management and control manuals, internal audit manuals and charters should be elaborated. In-house training facilities for PIFC should be streamlined and provided on a regular, sustainable basis within a well-defined framework.

In the area of external audit, Hungary largely meets internationally accepted standards. The independence of the State Audit Office (SAO), including its financial independence, is fully ensured by the existing legislation. The SAO has a wide audit mandate, including public finance, social security, local governments and EC resources down to the end users. However, the SAO's audit does not yet cover the attestation of financial statements of accountable entities in line with international auditing standards. In general, the SAO has competent staff with good levels of higher educational and professional experience. It has issued a series of audit manuals relating to various types of audits based on INTOSAI (International Organisation of Supreme Audit Institutions) standards.

With regard to the control of structural action expenditure, further efforts need to be made in order to enhance Hungary's capacity to manage pre-accession funding and future structural funds, in particular through the establishment of clear public internal financial control rules and procedures, together with a substantial reinforcement of Hungary's administrative capacity in this regard. Hungary should maintain the current pace to complete the remaining steps leading to EDIS in the first part of 2003 in order to allow EDIS accreditation to be achieved in the second part of 2003.

With a view to ensuring the suitable protection of Communities' financial interests, Hungary needs to refine the legislation necessary to allow the competent authorities to carry out on-the-spot checks, if necessary jointly with the relevant EC bodies, and to effectively exchange information regarding irregularities and investigations with OLAF and between the different competent Hungarian institutions and bodies. Furthermore, Hungary needs to provide an amendment of the national legislation with a view to the effective prevention and recovery of irregular payments and sanctions connected to irregularities affecting the protection of the Communities' financial interests. With respect to ISPA, Hungary has made significant efforts in setting up an adequate management and control system that can ensure proper implementation of ISPA assistance. In general, good progress has been made, but further efforts are needed to meet the requirements for internal financial control and internal audit.

Conclusion

In its 1997 Opinion, the Commission concluded that Hungary, in the medium term, should be able to fulfil its obligations in relation to the financial control structures without any problems, provided that measures currently envisaged were put in place.

Since the Opinion, steps forward have been taken, but sustained efforts in this area are required, especially concerning the redefining and upgrading of the internal audit function in its PIFC systems. Alignment with the *acquis* in this sector and the implementation of an EC-compatible PIFC have not yet been completed.

Negotiations on this chapter have been provisionally closed. Hungary has not requested any transitional arrangements and is generally meeting the commitments it has made in the accession negotiations in this area.

In order to be ready for membership, Hungary now needs to focus its efforts on implementing sound financial control systems by completing legislative alignment (protection of EC financial interests and implementation of PIFC) and completing and strengthening the required institutional structures. In order to tackle the weaknesses in the PIFC sector, Hungary is in the process of redefining its internal audit functions and structures according to international practice and to redraft the respective legislation. Efforts need, however, to be considerably stepped up.

Chapter 29: Financial and budgetary provisions

Progress since the last Regular Report

Hungary has made some progress in this area since the last Regular Report.

As regards the **national budget and EC co-financed measures**, amendments to the Laws on Budget and on Public Finances entered into force in October 2001, strengthening the provisions on budgetary planning discipline and sanctions for inappropriate spending. They also further increase the responsibilities for the management of public funds and their control.

As regards the **own resources system**, new legislation came into force in July 2002 on the transitional sugar regime based on sugar and isoglucose quotas. The Agricultural Intervention Centre is responsible for managing and controlling the quota system, including regular on-the-spot checks at the sugar producing companies, which have to provide monthly statistics on their production, sales, and stock levels.

For the purpose of calculating the GNP resource, further progress was made with the implementation of the ESA 95 methodology. As regards administrative capacity, Hungary has continued modernising its tax administration and improving its infrastructure and information technology. For the purpose of own resources, appropriate steps have been taken to ensure adequate co-ordination between the various authorities involved in the application of the own resources system.

Overall assessment

The legal framework for budgetary management and for the transparency and efficiency of financial flows to and from the EC budget is largely in place. Also the technical and administrative capacity with regard to the operational management of own resources is in place, except for sugar levies. For the latter, national procedures and competencies on how sugar levies are to be forwarded to the Commission's account are still to be defined.

Overall preparations for the application of the *acquis* on own resources are progressing well, although there is room for further improvement.

As regards traditional own resources, the necessary institutions for establishing, accounting for and recovering customs duties and sugar levies are in place. Hungary still needs to further develop certain reporting and accounting requirements (the 'A' and 'B' accounts) and designate the competent authorities for producing the 'A' and 'B' account statements.

As regards VAT, Hungary has achieved a good degree of alignment, although a number of issues (reduced rates, the refund system to foreign taxable persons and the abolition of the zero-rate) still remain to be tackled. The provisions on intra-Community supplies and acquisitions are to be inserted in the national VAT Code. Hungary will need to continue to make substantial efforts to be able to calculate the weighted average rate (WAR) in accordance with ESA 95 and to determine the impact on the VAT base of the requested special arrangements in relation to the *acquis* (the various corrections to receipts and financial compensations in base). Hungary should continue to participate in the VAT simulation exercise, which is the key tool for effectively testing Hungary's capability in the field of the VAT resource.

As regards the GNP resource, Hungary's statistical system is broadly in line. Hungary is already able to calculate GNP according to ESA 95, but further adjustments will be necessary, in particular as regards the exhaustiveness of the non-financial national accounts.

As regards the administrative capacity necessary to co-ordinate financial relations with the EC, a special Unit for EU Affairs within the Fiscal and Financial Policy Division of the Ministry of Finance (staff: 5) co-ordinates the appropriate implementation of EC legislation relating to own resources. This unit has prepared a manual on own resources based on the checklist of administrative conditions in the area of the European Communities' own resources. After accession, the Unit's role will consist in co-ordinating the calculation, control and payment of own resources, as well as co-ordinating contacts with and reporting to the EC in this area. Administrative preparations for the State Budget Office, which will be responsible for the own resources accounts, have started, with the structural and operating rules still to be fixed. The account in the name of the Commission will be established in the Hungarian State Treasury. The transfers will be carried out using the SWIFT system. The procedural rules on the crediting of traditional own resources (TOR) have still to be prepared.

The other institutions involved in the own resources system include the Hungarian Tax Authority (for collection of VAT), the Financial and Customs Guards (for collection of customs duties), and the Central Statistical Office (for calculating the GDP/GNI and the country's weighted average rate).

Conclusion

In its 1997 Opinion, the Commission concluded that Hungary would have to overhaul its current customs system in order to ensure that own resources were established, monitored and made available in line with Community regulations. In addition, for the purposes of accurately calculating the GNP resource, considerable improvement would have to be made to the national accounts to ensure that they were reliable, homogenous and complete. Improving the statistics would also be essential for drawing up the VAT own resources base, which would mean bringing Hungary's VAT system fully into line with the Community directives.

Since the Opinion, Hungary has made considerable progress in this area, in particular as regards the national budget and EC co-financed measures. It has also created the main necessary administrative structures. The legal framework for budgetary management and for the transparency and efficiency of financial flows to and from the EC budget is largely in place.

Negotiations on this chapter continue. Hungary is generally meeting the commitments it has made in the accession negotiations in this area.

In order to complete preparations for membership, Hungary's efforts now need to focus in particular on modifying its accounting system in line with EC requirements, and putting in place the national procedures and competencies for the sugar levies. Further efforts are necessary in the field of the VAT base, GNP, particularly exhaustiveness of national accounts and further implementation of the ESA 95 methodology and traditional own resources, notably as regards the tariff structure.

3.2. Translation of the *acquis* into the national languages

Applicant countries are required to translate the various legal texts constituting the *acquis* into their national languages by the time of their accession. Primary and secondary legislation alone represents a considerable volume of texts, roughly estimated at 60 000-70 000 pages of the Official Journal. In the framework of the translation of the *acquis*, the Court of Justice has defined a set of key judgements to be translated as a priority (representing about 15 000 pages). To help the candidate countries in this process, assistance is being provided under the Phare programme. With the help of TAIEX, a dedicated database has been set up to act as a repository of all translated acts and as a tool through which candidate countries forward their translations to the Commission and the Council. The legal revisers of the Commission and the Council vet the submitted texts; they meet regularly and liaise with representatives of the centralised Translation Coordination Units in each country.

The number of linguist lawyers employed by the Ministry on a permanent basis has been increased from nine to 14, and four new posts have been announced. Considerable efforts have been made to increase the number of finalised EC terms in the course of the consolidation procedure carried out by the terminology group. As a result, 5 600 terms have been approved and become available through the website of the Ministry of Justice.

In 2001 HUF 480 million (around € 1.87 million) were allocated from the Central Budget for the translation and revision of Community legislation. In spite of the delay with translation projects due to unsuccessful public procurement procedures, the 2003

deadline set for terminating the translation of the *acquis* can still be adhered to, provided that sustained efforts are made.

As at September 2002 some 35 000 pages of revised text were registered in the dedicated Commission database, in addition to 16 500 unrevised pages. Sustained further efforts are required in this area

Continued attention needs to be paid to the training of conference interpreters.

3.3. General evaluation¹⁵

Since the Opinion, Hungary has made continuous progress in aligning with the *acquis* in all areas. Implementation of the new legislation has been proceeding well in most sectors. Considerable efforts have been made by the country since 1997 to improve its administrative capacity needed for a satisfactory implementation of the *acquis*.

Over the past year, Hungary has further advanced in a number of areas, such as social policy, justice and home affairs, telecommunications, culture and audio-visual and energy with regard to the adoption and the enforcement of the *acquis*. Among the sectors in which only limited progress was made in the reporting year as regards administrative capacity figure agriculture and regional policy. However, administrative capacity was further improved in many other sectors, thereby increasing the level of preparations to effectively implement and enforce Community legislation.

Overall, Hungary has achieved a high degree of alignment with the *acquis* and is also well advanced with regard to achieving adequate administrative capacity to implement the *acquis*. However, further efforts remain to be made for Hungary to be fully capable of enforcing it by accession. Detailed plans have been agreed, in particular in the negotiations and in the Action Plan, to cover the remaining gaps.

Continued good progress could be noted in the *internal market* sector. As described in last year's report, the major part of the *acquis* has been adopted, and administrative structures are in place. Since transposition of the *acquis* is very advanced as regards the *free movement of goods*, attention is now focusing on enforcement, for example on the effective establishment of the Food Safety Agency as well as on market surveillance. The necessary infrastructure for standardisation and certification is in place. Progress could be noted with the adoption of legislation on procurement in the motorway construction sector. However, further efforts are needed to align with the *acquis* on public procurement in particular as far as its correct application is concerned. In the field of *services*, Hungary's legislation is largely aligned. On data protection, however, legal alignment has to be completed and the appropriate administrative structures strengthened. Following the adoption of legislation on the fight against money laundering, Hungary was removed from the OECD Financial Action Task Force list of non-co-operative countries in June 2002. Also in the sector of *free movement of capital*, new legislation on land was adopted. However, further adaptations are still required. Administrative capacity to ensure the due supervision of financial services is adequate. In the field of *company law*, Hungarian legislation is largely in line with the *acquis*. While Hungary has a relatively good enforcement record, border control measures need to be strengthened

15 See "Towards the Enlarged Union: Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries", COM (2002) 700.

with respect to intellectual property rights and the fight against piracy and counterfeiting further intensified. In *competition policy*, further efforts are still necessary to align State aid schemes, in particular the fiscal aid schemes. Both anti-trust and State aid enforcement bodies continued to work satisfactorily.

In *taxation*, Hungary's legislation is to a large extent aligned with the *acquis*. However, transposition of the *acquis*, notably as regards VAT and excise duty, has to be completed. Efforts should be continued to ensure that the computerised tax information system is fully operational ahead of accession. In *customs*, legislation is largely aligned with the *acquis*. Further efforts were made as regards customs warehousing, temporary importation, valuation and non-commercial consignments. Hungary continued to strengthen the administrative and operational capacity of the Hungarian Customs and Finance Guard and undertook significant steps to revitalise the development of interconnectivity enabling systems. Efforts should be continued to ensure interconnectivity with EC computerised systems in the customs area.

With regard to *industrial policy* and *small and medium-sized enterprises*, the Széchenyi Plan will now concentrate on SME development and EC pre-accession projects and be integrated into the National Development Programme.

Good progress was again made in the area of *environment*, notably through the adoption of legislation in the air, water, industrial pollution control and genetically modified organisms sectors. However, the National Waste Management Plan still needs to be adopted. Administrative capacity in this sector was improved, *inter alia*, by changes in ministerial responsibilities, but due attention should be given to this issue in the future. In addition, environmental investments need to be further increased.

As to *agriculture*, Hungary has a steady basis upon which to implement the *acquis*. However, the preparation of key management instruments such as the paying agency and the Integrated Administration and Control System (IACS) has been delayed, and a number of decisions on the distribution of responsibilities are awaited. As regards IACS, serious efforts are needed to ensure that a fully functioning system will be soon in place. Delays have also occurred in making the SAPARD Agency operational. Steady progress could be noted in the veterinary and phytosanitary fields, but the upgrading of Border Inspection Posts and of establishments needs appropriate attention. Ongoing efforts need to be substantially stepped up. Legal alignment proceeded in the area of *transport*, in particular in the road and rail sectors. Although some additional steps have been taken, the restructuring of the rail sector should be completed to fully implement the market access *acquis*. In addition, institution-building efforts have to be further enhanced in this sector.

Considerable progress was made in the *energy* sector with the adoption of the electricity law, which paved the way for the liberalisation of the Hungarian market. However, no similar progress was made in the gas sector. Administrative capacity is at an advanced level. Good progress could be noted in the *audio-visual* sector through the adoption of the media law, but further efforts are needed to achieve full alignment.

Considerable progress was made in the area of *social policy and employment*, notably with the adoption of further implementing legislation to the Labour Law. As to social dialogue, the new Government introduced confidence-building measures and decided to set up a National Interest-Reconciliation Council to enhance real dialogue. The capacity

to implement the *acquis* on occupational safety and health, including the strengthening of labour inspectorates, has been increased, but needs further attention.

In relation to *regional policy*, it was decided in June 2002 to establish a more efficient institutional framework for programming and implementation of structural and cohesion funds. However, the capacity of the managing and paying authorities has to be strengthened. Further progress is also needed as regards the technical preparation of projects eligible for Community funding. While progress was made in establishing financial management and control systems, the programming process suffered from delays in the reporting period. Hungary's preparations for the structural instruments have to be substantially stepped up.

Considerable progress was made in the *telecommunications* sector, where the Hungarian market was opened for competition with the adoption of the communications law. Efforts need to focus on ensuring affordable universal service.

In the area of *Justice and Home Affairs*, significant progress was achieved through further alignment with the *acquis* in the fields of visa policy, migration and asylum. The fight against fraud, corruption, money laundering and organised crime was made more efficient through the adoption of additional legislation and reinforced institutional structures. A revised Schengen Action Plan addresses the main issues of the *acquis*.

In the area of *common foreign and security policy*, Hungary still needs to find an agreement with Slovakia and Romania on the implementation of the Law on Hungarian minorities living in neighbouring countries. Also, the law needs to be aligned with the *acquis* upon accession.

As to *financial control*, enhanced efforts are needed in the sector Public Internal Financial Control, both in terms of legal alignment and administrative capacity. In order to tackle the weaknesses identified, Hungary is in the process of redefining its internal audit functions and structures according to international practice and to redraft the respective legislation. Efforts need, however, to be considerably stepped up.

Hungary has continued to make progress in building up its administrative capacity to apply the *acquis* in most areas. However, further efforts will have to be made in particular in areas such as agriculture, transport, regional policy, environment and financial control. Further action is also still required in establishing the necessary administrative capacity to ensure the sound, efficient and controllable management of EC funds.

In the accession negotiations, 26 chapters have been provisionally closed. Hungary is generally meeting the commitments it has made in the negotiations. However, delays have occurred with regard to the transposition of parts of the veterinary *acquis*, legislation on the size control of imported fish, the adoption of the gas law and several pieces of environmental legislation (national climate change strategy, National Waste Management Plan, regional and local waste management plans, packaging and packaging waste and waste oils). These issues need to be addressed.

Bearing in mind the progress achieved since the Opinion, the level of alignment and administrative capacity that Hungary has achieved at this point in time, and its track record in implementing the commitments it has made in the negotiations, the Commission considers that Hungary will be able to assume the obligations of

membership in accordance with the envisaged time frame. In the period leading up to accession, Hungary needs to continue its preparations in line with the commitments it has made in the accession negotiations.

C. Conclusion¹⁶

In its 1997 Opinion, the Commission concluded that Hungary fulfilled the political criteria. Since that time, the country has made considerable progress in further consolidating and deepening the stability of its institutions guaranteeing democracy, the rule of law, human rights and respect for the protection of minorities. This has been confirmed over the past year. Hungary continues to fulfil the Copenhagen political criteria.

Public administration reform at central level has been completed to a large extent. In this respect, the 2001 Law on Civil Servants, partly enforced in 2002, was an important step forward in the consolidation of the legal framework for civil servants. Following a complex review of the salary structure, the gap between earnings in the public and private sector was further reduced. A financial reform of the local self-governments is still outstanding.

Within the judiciary, the constitutional and legislative guarantees of judicial independence are well-established in Hungary and the system of judicial self-administration functions efficiently. The decisions to introduce the Regional Courts of Appeal and to strengthen the judiciary's financial independence are important steps as regards the improvement of the judicial capacity.

In line with its anti-corruption strategy, the Hungarian Government has continued to adopt a series of legal and practical measures to fight corruption, which remains a cause for concern. It is important that the new decisions be implemented quickly to better address the situation.

Hungary continues to respect human rights and freedoms. In the area of public service media, political parties are again fully represented in the Supervisory Boards of Trustees. New steps were taken to improve social dialogue.

With a view to addressing the difficult situation of the Roma, the implementation of the 1997 medium-term programme continued. The institutional framework has been further strengthened and a new monitoring system introduced. Still, Roma policy is not well integrated into general social development strategies and exists as a separate and parallel project. Roma continue to suffer discrimination. The Government is currently revising its Roma policy. The envisaged adoption of a comprehensive long-term strategy and comprehensive anti-discrimination legislation would be major steps forward in this regard.

The 1997 Opinion already acknowledged the comprehensive reform efforts undertaken by the Hungarian authorities to transform their economy. Since the Opinion, and against a challenging international economic environment, economic performance has improved. Macroeconomic stability has been achieved, reforms have continued while the Hungarian authorities' commitment to the economic requirements of EU accession has been sustained.

16 See "Towards the Enlarged Union: Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries", COM (2002) 700.

Hence, it is concluded that Hungary is a functioning market economy. The continuation of its current reform path should enable Hungary to cope with competitive pressure and market forces in the Union.

Improvements can be made to macroeconomic management by reducing the general government deficit, thus preventing fiscal policy to become pro-cyclical and supporting a further reduction of the inflation rate. A more fundamental reform of the health care sector now needs to be embarked on. Wage developments will have to be brought in line again with productivity growth in order not to compromise the country's competitiveness.

Since the Opinion, Hungary has made continuous progress in aligning with the *acquis* in all areas. Implementation of the new legislation has been proceeding well in most sectors. Considerable efforts have been made by the country since 1997 to improve its administrative capacity needed for a satisfactory implementation of the *acquis*.

Over the past year, Hungary has further advanced in a number of areas, such as social policy, justice and home affairs, telecommunications, culture and audio-visual and energy with regard to the adoption and the enforcement of the *acquis*. Among the sectors in which only limited progress was made in the reporting year as regards administrative capacity figure agriculture and regional policy. However, administrative capacity was further improved in many other sectors, thereby increasing the level of preparations to effectively implement and enforce Community legislation.

Overall, Hungary has achieved a high degree of alignment with the *acquis* and is also well advanced with regard to achieving adequate administrative capacity to implement the *acquis*. However, further efforts remain to be made for Hungary to be fully capable of enforcing it by accession. Detailed plans have been agreed, in particular in the negotiations and in the Action Plan, to cover the remaining gaps.

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Good progress was again made in the area of *environment*, notably through the adoption of legislation in the air, water, industrial pollution control and genetically modified organisms sectors. However, the National Waste Management Plan still needs to be adopted. Administrative capacity in this sector was improved, *inter alia*, by changes in ministerial responsibilities, but due attention should be given to this issue in the future. In addition, environmental investments need to be further increased.

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Considerable progress was made in the area of *social policy and employment*, notably with the adoption of further implementing legislation to the Labour Law. As to social dialogue, the new Government introduced confidence-building measures and decided to set up a National Interest-Reconciliation Council to enhance real dialogue. The capacity to implement the *acquis* on occupational safety and health, including the strengthening of labour inspectorates, has been increased, but needs further attention.

In relation to *regional policy*, it was decided in June 2002 to establish a more efficient institutional framework for programming and implementation of structural and cohesion

funds. However, the capacity of the managing and paying authorities has to be strengthened. Further progress is also needed as regards the technical preparation of projects eligible for Community funding. While progress was made in establishing financial management and control systems, the programming process suffered from delays in the reporting period. Hungary's preparations for the structural instruments have to be substantially stepped up.

Considerable progress was made in the *telecommunications* sector, where the Hungarian market was opened for competition with the adoption of the communications law. Efforts need to focus on ensuring affordable universal service.

In the area of *Justice and Home Affairs*, significant progress was achieved through further alignment with the *acquis* in the fields of visa policy, migration and asylum. The fight against fraud, corruption, money laundering and organised crime was made more efficient through the adoption of additional legislation and reinforced institutional structures. A revised Schengen Action Plan addresses the main issues of the *acquis*.

In the area of *common foreign and security policy*, Hungary still needs to find an agreement with Slovakia and Romania on the implementation of the Law on Hungarian minorities living in neighbouring countries. Also, the law needs to be aligned with the *acquis* upon accession.

As to *financial control*, enhanced efforts are needed in the sector Public Internal Financial Control, both in terms of legal alignment and administrative capacity. In order to tackle the weaknesses identified, Hungary is in the process of redefining its internal audit functions and structures according to international practice and to redraft the respective legislation. Efforts need, however, to be considerably stepped up.

Hungary has continued to make progress in building up its administrative capacity to apply the *acquis* in most areas. However, further efforts will have to be made in particular in areas such as agriculture, transport, regional policy, environment and financial control. Further action is also still required in establishing the necessary administrative capacity to ensure the sound, efficient and controllable management of EC funds.

In the accession negotiations, 26 chapters have been provisionally closed. Hungary is generally meeting the commitments it has made in the negotiations. However, delays have occurred with regard to the transposition of parts of the veterinary *acquis*, legislation on the size control of imported fish, the adoption of the gas law and several pieces of environmental legislation (national climate change strategy, National Waste Management Plan, regional and local waste management plans, packaging and packaging waste and waste oils). These issues need to be addressed.

Bearing in mind the progress achieved since the Opinion, the level of alignment and administrative capacity that Hungary has achieved at this point in time, and its track record in implementing the commitments it has made in the negotiations, the Commission considers that Hungary will be able to assume the obligations of membership in accordance with the envisaged time frame. In the period leading up to accession, Hungary needs to continue its preparations in line with the commitments it has made in the accession negotiations.

D. Accession Partnership and Action Plan for strengthening administrative and judicial capacity: Global assessment

Hungary's progress and overall state of preparation in respect of the Copenhagen criteria has been examined and conclusions drawn above. The present section assesses the extent to which the priorities of the Accession Partnership have been met and the measures foreseen under the Action Plan implemented according to schedule. It should be noted that both the Accession Partnership and the Action Plan have a time perspective of two years covering 2002 and 2003, providing for another 15 months for priorities to be met. Furthermore, much has already been achieved based on previous Accession Partnerships. The present one focuses on remaining specific and well-circumscribed topics identified as requiring more work to prepare Hungary for membership. Therefore the analysis below only focuses on these specific topics and does not give an overall picture of the state of preparation of Hungary in each domain.

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 Regular Report;
- the financial means available to help candidate countries implement these priorities;
- the conditions which will apply to this assistance.

The Accession Partnerships are revised on a regular basis, to take account of progress made, and to allow new priorities to be set. The Council adopted a revised Accession Partnership for Hungary in January 2002, based on a proposal from the Commission.

The revised Accession Partnership has served as the point of departure for the Commission and Hungary to develop jointly an Action Plan to strengthen Hungary's administrative and judicial capacity.

The purpose of the Action Plan is to identify jointly the next steps required for Hungary to achieve an adequate level of administrative and judicial capacity by the time of accession, and ensure that all necessary measures in this regard are taken, providing Hungary with targeted assistance in areas that are essential for the functioning of an enlarged Union.

Developing adequate administrative and judicial capacity for EU membership is a demanding and wide-ranging task, which requires detailed preparations in each and every domain covered by the Union's policies and legislation. In preparing individual Action Plans, the Commission has taken a comprehensive approach. All priorities from the revised Accession Partnerships, which relate to the development of administrative and judicial capacity have been included in the Action Plans. Each of these priorities is treated separately in the Action Plans, and specific measures have been designed to address each of them.

In the following, progress in addressing each of these priorities is reported. For ease of reference and to avoid repetitions, wording from the *Accession Partnerships* is rendered in Italics. As regards the measures foreseen by the Action Plan, implementation is checked against timetables and reported.

Political criteria

Several important steps have been taken over the past year to continue implementation of judicial reform. As foreseen by the Action Plan, a decision was taken in June 2002 to establish five Regional Courts of Appeal, which will *reduce the backlog of cases at the Supreme Court* in respect to appeals in last instance. Further *efforts to modernise the judiciary* were made with an overall increase of staff at all court levels. Furthermore, the development of the Court Information System progressed and is now operational at 18 county courts, the Budapest municipal court, the Supreme Court, and the National Council of Justice. The *training of judges* in Community law, which started in September 1999, continued, and by March 2002 around 75% of the judges had received training and 60 judges had become national trainers. Concerning *free legal aid*, the existing provisions are rather restricted for *criminal cases*, contrary to the principles generally applied. If convicted, the accused must pay all the costs of the proceedings. As foreseen in the Action Plan, the Government has prepared a draft law to modify the rules on legal aid to bring them in line with European standards. However, the draft has not yet been submitted to Parliament. So far, the *budgetary situation* of the judicial system has hardly changed and resources remain limited. To address the situation, a new law, which will empower the National Council of Justice to submit its proposal for the 2004 budget directly to Parliament, is currently being processed by Parliament.

In line with the long-term *anti-corruption strategy* adopted in 2001 and following the Action Plan, a number of new measures have been taken during the reference period. In particular, the legal framework has been further improved with the adoption of revised laws on public procurement, criminal affairs, money laundering and taxation. Practical measures concerned the introduction of a bonus system and a salary increase for the customs services, which should also have a positive impact. Finally, asset declarations became compulsory for senior civil servants as well as for the President of the Republic, judges, ombudsmen and certain other institutions and professions. On the institutional side, the Ministry of Interior and the Ministry of Justice share overall responsibility for the implementation of the anti-corruption strategy, and various additional bodies were set up to make the fight against corruption more effective.

In line with the Action Plan priority, the Hungarian Government has continued to make efforts to address the difficult situation of the Roma minority. Budgetary resources for the *implementation of the medium-term programme* have been further increased. In the area of education, new teaching material was prepared, but this does not address the issue of *transferring Roma children out of the mainstream system into special education facilities*. According to estimates, there are still around 150 schools in Hungary where special Roma classes are maintained. Further progress was made to ensure a proper *impact assessment* with the introduction of a new monitoring system. In the fight against *discrimination*, a special Anti-Discrimination Network of legal aid offices was set up by the Ministry of Justice in co-operation with the National Roma Self-Government and the Office for National and Ethnic Minorities. The Network, established in late 2001, offers free counsel and representation to individuals claiming discrimination. However, the scope of the operation of this Network is rather restricted and covers only issues related to discrimination against persons belonging to national and ethnic minorities. Furthermore, the fact that this system does not cover the costs of the legal proceedings, which must be paid by the plaintiff if the case is not upheld, acts as a disincentive. The legal framework for anti-discrimination is still fragmented and appropriate sanctions are missing. During the reference period, a new comprehensive anti-discrimination law was

prepared and submitted to Parliament. Its adoption would be a major step forward in the regard and should address the Action Plan priority. Concerning the establishment of an *effective system for addressing complaints of police misconduct*, no progress can be reported. The relevant Action Plan measures were not properly implemented.

Overall, the priorities falling under the political criteria have been partially met. The implementation of the measures under the Action Plan is partially on track.

Economic criteria

Delays have occurred with regard to the *development and the implementation of a comprehensive public health care reform* that ensures a high level of health protection at a sustainable cost to the government budget with a view to guaranteeing medium-term sustainability of public finances. However, some progress has been made with regard to improving the IT infrastructure of the National Health Fund Administration, as well as with regard to the legal framework for hospitals and general practitioners. The new government's programme declared health care reform a main priority. *Government accounting at local level and timeliness of data provision to central authorities* have been further improved both in legal terms and with regard to administrative capacity. Since January 2002, local governments have been obliged to present a preliminary annual financial report of the preceding year by 15 January at the latest to the Ministry of Finance. However, the legal rules regulating the reporting and bookkeeping obligation of public finance institutions need further adaptations, as the Action Plan requires. *Railway restructuring* has been continued with a view to reducing the medium-term impact on public finances by means of an amendment to the railway act, which regulates the conditions for access to the railway network and which entered into force in January 2002. As regards the establishment of the necessary *conditions for an efficient agricultural land market*, this matter has been partially addressed, as outlined in the Action Plan. New legislation on agricultural land was adopted in December 2001, but the new government presented a new land package in July 2002, modifying the 1994 legislation further and clarifying, *inter alia*, the priority list with regard to the purchase and lease of land. However, further modifications are needed. The National Land Fund has been established as the managing institution. Hungary continued to *promote the development of small and medium-sized enterprises*, among others by means of the Enterprise Development Programme, a sub-programme of the Széchenyi Plan. However, access to finance still remains the main obstacle to the development of Hungarian SMEs, but some progress has been made through government support schemes for SMEs.

Overall, the Accession Partnership priorities in the economic sector have been partially met. The implementation of the measures under the Action Plan is largely on track.

Ability to assume the obligations of membership

Chapter 1: Free movement of goods

Alignment of legislation concerning both the *New Approach Directives* and the *traditional sectoral legislation* has continued and is now almost complete. *Legislation on the provision of information on technical standards and regulations* has been partially aligned, with full conformity scheduled for 2003. However, the *implementation of protection of pharmaceutical test data* has still to be ensured. *Implementation of the food acquis* has progressed satisfactorily, and the introduction of *HACCP (Hazard Analysis*

and Critical Control Points) principles is being promoted across the entire food chain, according to the schedule foreseen in the Action Plan. The responsibilities of the Food Safety Authority, established according to the Action Plan, will need to be defined quickly in order to ensure effective implementation of this part of the *acquis* and to co-ordinate the activities of the many bodies involved. Otherwise *market surveillance and conformity assessment structures*, whose reinforcement is foreseen in the Action Plan, are developing satisfactorily. The adoption of legislation on *public procurement* in July 2002 in the area of motorway construction has gone a long way to increasing transparency and to aligning with the *acquis*. However, all remaining shortcomings concerning motorway construction as well as those in the area of public procurement in general have still to be addressed. Administrative capacity in this area has been strengthened, but further efforts will be required. Steps have begun to check that legislation is in compliance with *Articles 28-30 of the EC Treaty* and this work will need to be completed. Overall, the priorities in this area have been met to a large extent. The implementation of all items highlighted in the Action Plan are on track.

Chapter 2: Free movement of persons

Hungary has now achieved almost full alignment with the *acquis* on the *mutual recognition of professional qualifications and diplomas*, and the *required administrative structures, education and training* are in place. It is considered that Hungarian professionals can, from accession, meet the requirements laid down by the directives. The *reinforcement of the administrative structures for the co-ordination of social security*, foreseen in the Action Plan, is behind schedule. The priorities in this area have been met to a large extent. Regarding the Action Plan, implementation of measures is partially on track.

Chapter 4: Free movement of capital

Hungary is meeting its obligations under this chapter. It has been removed from the *FATF (Financial Action Task Force) list of non-co-operative countries* and has established a satisfactory timetable for the *phasing out of anonymous savings books*. Further *strengthening of the police's financial intelligence unit*, as foreseen in the Action Plan, has been decided, but the staff increases have not yet been fully implemented. Thus, the priorities in the field of free movement of capital have been largely met. Implementation of the Action Plan is progressing well.

Chapter 5: Company law

Enforcement of intellectual property rights is being strengthened and is considered satisfactory. The Action Plan foresees training activities for judges *and all relevant enforcement bodies*, which are on track. Further efforts are, however, needed to strengthen *customs bodies*, thereby ensuring efficient border control measures. Overall, the priorities in the area of company law have been met to a large extent. Implementation of the measures under the Action Plan is on track.

Chapter 6: Competition

The legislative framework in the *anti-trust sector* has been further improved and further steps to the *full enforcement of the rules in the anti-trust sector* have been undertaken. However, the same cannot be said for the *State aid sector*, where the *alignment of incompatible aid schemes, in particular of fiscal aids*, has still not been properly

addressed. *Awareness of the rules among all market participants and aid granters* has been further increased and should continue to be increased. The *training of the judiciary on competition* matters has been intensified, but needs to be further enhanced. The Accession Partnership priorities in this sector have thus been only partially met. The implementation of the Action Plan is partially on track and partially delayed (alignment of state aids sector).

Chapter 7: Agriculture

The *reinforcement of the administrative structures needed for rural development programmes* is lagging behind, due to late decisions on the competencies of the future managing authority. The important priority of *upgrading the capacity of the agricultural administration and completing the preparations for the practical implementation of the common agricultural policy* has been addressed to a very limited extent and therefore needs urgent attention. Although the measures foreseen in the Action Plan for *completing the establishment of a vineyard register* are scheduled for 2003, preparations are ongoing and seem to be on track with the plans. Little progress can be reported on the *overall upgrading of food processing establishments with a view to meeting EC food safety standards*. Review of legislation to ensure *transposition, implementation and enforcement of the acquis in the veterinary and phytosanitary field* is progressing slowly, and some commitments foreseen in the Action Plan are delayed, namely the adoption of a number of implementing decrees concerning the veterinary *acquis*. As regards the *animal identification and registration systems*, some progress can be reported towards meeting the relevant priorities, but the implementation of some measures under the Action Plan, in particular concerning controls and sanctions, is slightly delayed. Concerning the *developments at the veterinary and phytosanitary border inspection posts*, the measures foreseen in the Action Plan are scheduled for end 2002, so no progress can be reported. Overall, the Accession Partnership priorities in this area have been met to a limited extent. Implementation of the measures under the Action Plan is only partially on track.

Chapter 9: Transport Policy

Legal alignment in the road transport sector has continued, in particular as regards the *control of driving time restrictions*. New legislation *on taxation with a view to respecting the minimum levels foreseen by the acquis* has not yet been adopted, and Hungarian legislation has not yet been fully harmonised with the *acquis* on *weights and dimensions*. *Administrative capacity* in the road sector, which was also addressed in the Action Plan, has been improved by an increase of staff in the General Transport Inspectorate (GTI) and by training provided by the GTI in different sectors, but needs further strengthening. Administrative capacity should also be further improved in inland waterways. *Alignment in the railway sector*, as required by the Accession Partnership, has been continued, but the *restructuring of MÁV* has been proceeding rather slowly. *Staff of the Railway Authority* has been increased by three in accordance with the Action Plan. *Alignment with the air transport acquis* has continued, but further efforts are needed, notably concerning *market access*. Progress was made in all sub-sectors as regards *the setting up of the required administrative and management bodies and the strengthening of the existing ones*, notably the GTI, as was also required by the Action Plan. However, the progress achieved is not sufficient to be able to cope with the challenges of accession, in particular administrative capacity in the rail and air transport sectors needs to be further strengthened. The Accession Partnership priorities in this sector have thus been only

partially addressed. Regarding the Action Plan, implementation of the measures has started, but needs to be accelerated.

Chapter 10: Taxation

Alignment of legislation has continued in the area of *excise duty*, although some more progress is still needed. No progress can be reported on *VAT*, where alignment has not yet been completed. As regards administrative capacity, Hungary has continued modernising its tax administration and improving infrastructure and *information technologies*. Hungary has also taken significant steps to prepare for *interconnectivity and interoperability* between the Hungarian system and the EU. Further efforts will be necessary to ensure that the computerised tax information system is fully operational ahead of accession, including links with the customs information system and interconnectivity with EC systems, which is a particularly urgent priority within the Action Plan. Review of legislation by the Commission to ensure compliance with *the Code of Conduct for Business Taxation* is in process. As foreseen in the Action Plan, preparations have started for the implementation of the *Central Liaison Office* and the *Excise Liaison Office*. The priorities in the field of taxation have been partially met. The measures of the Action Plan are on track.

Chapter 13: Social policy

Alignment with and proper implementation of the social acquis are proceeding well, in particular in the field of health and safety at work, where substantial progress was made with the transposition of the EC legislation in many areas. The *related administrative and enforcement structures, including labour inspectorates*, have been considerably strengthened. A new comprehensive law was prepared with regard to the *adoption of the anti-discrimination acquis*, as foreseen in the Action Plan. However, the law has not yet been adopted by Parliament. The legal framework for anti-discrimination in general is still fragmented. *Transposition and implementation of the public health acquis* is going well, and further measures have also been taken with regard to *surveillance and control of communicable diseases* (designation of the National Centre of Epidemiology at the National Public Health and Medical Officers' Service as Hungarian counterpart for epidemiological surveillance and for the control of communicable diseases) and *the health monitoring and information system* (e.g. setting up of a National Health Data Bank). Implementation of the *acquis in the field of tobacco*, as required by the Action Plan, has not yet been completely finalised. Implementation of the measures of the Action Plan to complete the health monitoring and information system is behind schedule. The new government started to increasingly *support social partners' capacity-building efforts*, in particular with a view to their *future role in the development and implementation of Community employment and social policy, including the European Social Fund*. Particular attention has been recently paid to *enhancing the social partners' capacity to conduct social dialogue*, which is a priority of the new government, and to *ensuring due process also in the tripartite social dialogue*. The social partners and the Prime Minister signed an Agreement on Restructuring the Social Dialogue System, and the National Interest-reconciliation Council (NIRC) was established in July 2002 as the legal successor of the National Labour Council. For the time being, no *national strategy on social inclusion* exists in Hungary. However, a number of preparatory steps have been taken, such as the signature of a "Joint Memorandum on Social Inclusion" with the Commission in July 2002, which sets the future priorities and measures in this field, also with a view to the future participation in the *European strategy on social inclusion*. The

Accession Partnership priorities have been met to a large extent. As regards the Action Plan, implementation of the majority of the measures foreseen in the Action Plan is on track, while work on a few subjects has to be accelerated.

Chapter 14: Energy

Progress was made in aligning with the *internal energy market* through the adoption of the *Electricity Law* in December 2001. However, the *Gas Law* is still pending at Parliament. The *remaining price distortions in the market* still need to be eliminated. The *regulator, the Hungarian Energy Office*, has been strengthened as regards staffing, as also outlined in even more detail in the Action Plan, but further efforts are needed. *Energy efficiency* and the promotion and use of *renewable energy sources* have been enhanced. Furthermore, *the relevant institution* in this area (Energy Centre) has been considerably strengthened in terms of staff – an issue that was required to be addressed under the Action Plan. However, continued efforts are needed. Hungary has accepted the recommendations of the *Council Report on Nuclear Safety in the Context of Enlargement*, and is currently implementing them, as was requested by the Action Plan. Work has been continued in order to assure a *high level of nuclear safety* at the Paks Nuclear Power Plant. Overall, the priorities in the energy sector have been met to a large extent. The implementation of the Action Plan is on track.

Chapter 19: Telecommunications and information technologies

Transposition and implementation of the *acquis* has been continued by the implementation of the new telecommunications law adopted in December 2001. However, a number of issues remain to be addressed, e.g. the requirements of carrier selection for local calls, local loop unbundling, compensation for universal service, implementation of interconnection *acquis*, number portability and leased lines regulation, in order to ensure that the liberalised market actually functions. The Accession Partnership priorities in this sector have only been partially addressed.

Chapter 20: Culture and audio-visual policy

A considerable step forward has been made as regards *alignment with the acquis on "television without frontiers"* by the adoption of the media law. However, further adjustments to the legislative and regulatory framework will be needed to assure full compliance with the *acquis*. The Accession Partnership priority has been met to a large extent.

Chapter 21: Regional policy and co-ordination of structural instruments

Hungary had difficulties in *ensuring effective inter-ministerial co-ordination and appropriate partnership* in programming and implementation. The *preparation of the development plan and the operational programme* has been severely delayed and the *structures required for implementation* have just been designated and require considerable and immediate strengthening. In line with the timetable provided in the Action Plan, Hungary has committed itself to *revise the system of payments and to align financial management and control procedures* by the end of the year. Detailed *tasks to be performed by the line ministries and other bodies under the responsibility of the managing authorities* have not yet been defined. In relation to the *evaluation and monitoring system*, progress has been made in *establishing a system for the computerised exchange of data* but the *ex ante evaluation process*, foreseen in the Action Plan, is

behind schedule. Initial steps, in line with the commitments taken in the Action Plan, have been taken to assist local bodies in starting *project pipeline* development. Overall, Hungary has met the priorities of the Accession Partnership in the area of Regional Policy only to a very limited extent. It has accumulated delays in the time schedule set in the Action Plan for the implementation of the measures foreseen.

Chapter 22: Environment

The priority of transposing the *acquis* on *packaging and packaging waste* and *control of major accident hazards involving dangerous substances* has been met. The implementation of the *acquis* as regards *air quality*, also mentioned in the Action Plan, has been continued by ensuring air monitoring in accordance with the *acquis*, while no sufficient progress could be noted in the implementation of the *management of municipal and hazardous waste*, due to failure to adopt the National Waste Management Plan. Pollution reduction programmes on *the discharge of dangerous substances in the aquatic environment* still need to be established, as outlined in the Action Plan. The *administrative capacity and co-ordination*, in particular concerning the *Environmental Inspectorates* (both at the central and at the regional level, have been strengthened in accordance with the requirements of the Action Plan, but further sustained efforts are needed. The *human resources* of the competent authorities in the sector of *chemicals* have also been increased, as required by the Action Plan. The *integration of environmental protection requirements into the definition and implementation of all other sectoral policies* with a view to promoting sustainable development has continued. On *industrial pollution control and risk management*, progress has been limited with regard to implementation, especially in relation to integrated permitting. Thus, the priorities in the field of environment have been partially met. The implementation of the Action Plan is partially on track.

Chapter 24: Co-operation in the field of Justice and Home Affairs

As foreseen in the Action plan, Hungary has made important progress in the *implementation of the Schengen Action Plan* by starting to negotiate agreements with neighbouring states, employing more personnel and improving training. At *external borders*, the infrastructure and equipment has been further modernised and up-graded in line with the Schengen requirements and with the Action Plan. The electronic Consular Information system supporting the issuing of visas has been completed and all consular missions are on-line. Preparations for joining the *Schengen Information System* are under way. The existing databases, which will form the basis for the National Schengen Information System, have been transferred to the Ministry of Interior, but further work is necessary. In July 2002, Hungary submitted a revised *Schengen Action Plan*, which covers the remaining tasks. *Internal co-operation between police, other law enforcement agencies and the judiciary* has been further improved in line with the Action Plan priority. In April 2002, the International Law Enforcement Co-operation Centre became the single contact point for international co-operation for all Hungarian law enforcement agencies. Deployment of the liaison officers to Europol took place in April 2002.

As a result of the Action Plan Hungary strengthened its *fight against organised crime and money laundering* with the consolidation of the legal framework. In the context of *fighting fraud, corruption and money laundering*, a new law entered into force in January 2002, which contains provisions on the phasing out of anonymous saving deposit books, securities and the licensing of currency exchange. A Financial Intelligence Unit within

the National Police Headquarters is responsible for analysing suspicious transactions (staff: 18). The number of suspicious transactions reported to the Financial Intelligence Unit has grown significantly over the last two years.

In the area of *drugs*, the National Focal Point was established in the Ministry of Health, and the investigative powers of the Customs and Finance Guards were extended. The implementation of the national drug strategy is underway, addressing the Action Plan priorities. In the area of *judicial co-operation*, the Chief Prosecutor's Office was designated as the single contact point.

The Accession Partnership priorities in this area have been met to a large extent. The implementation of the Action Plan is mainly on track.

Chapter 25: Customs Union

The alignment in the area of *customs free zones* with the provisions of the *acquis* has not been completed and requires further efforts. The administrative capacity has been further strengthened and *customs officers* have been *trained*, as foreseen in the Action Plan, although the training needs to be increased. As regards the *computerisation process of the Hungarian customs administration*, which the Accession Partnership considered to be in need of urgent action, Hungary has taken significant steps to revitalise the development of interconnectivity-enabling systems. The Hungarian IT system contains all information relating to customs procedures. The preparations for joining the CCN/CSI are under way. A national Inter-Operability Implementation Strategy was finalised in January 2002 and additional staff was recruited for its implementation over the next two years. Further substantial efforts still need to be made to prepare the ground for a well functioning EC-compatible IT system, which is an urgent Action Plan priority. Overall, the priorities in the area of customs union have been partially met. The implementation of the Action Plan is on track.

Chapter 28: Financial Control

The managerial accountability in budget spending centres needs to be further enhanced. *The administrative framework for internal audits at the level of internal audit services in budget spending centres* has to be further strengthened and *their functional independence* still needs to be ensured. As regards *the protection of the Communities' financial interests*, an anti-fraud co-ordinating service has been established inside the Ministry of Finance, and a Standing Inter-Ministerial Committee has been set up in order to facilitate co-operation with other Hungarian institutions. However, neither body is fully operational yet. The measures foreseen in the Action Plan to further reinforce the legislation in order to *strengthen the fight against fraud, notably in the area of VAT* are scheduled for 2003, so no progress can be reported at this stage. *Efforts to ensure the correct use, control, monitoring and evaluation of EC pre-accession funding* have been made as scheduled in the Action Plan. Thus, the priorities in the field of financial control have only partially been met. However, implementation of the Action Plan is mainly on track.

Annexes

***Human Rights Conventions ratified by the Candidate Countries,
15 September 2002***

<i>Adherence to following conventions and protocols</i>	BG	CY	CZ	EE	HU	LV	LT	MT	PL	RO	SK	SI	TK
ECHR (European Convention on Human Rights)	X	X	X	X	X	X	X	X	X	X	X	X	X
Protocol 1 (right of property)	X	X	X	X	X	X	X	X	X	X	X	X	X
Protocol 4 (freedom movement et al.)	X	X	X	X	X	X	X	X	X	X	X	X	O
Protocol 6 (death penalty)	X	X	X	X	X	X	X	X	X	X	X	X	O
Protocol 7 (ne bis in idem)	X	X	X	X	X	X	X	O	O	X	X	X	O
European Convention for the Prevention of Torture	X	X	X	X	X	X	X	X	X	X	X	X	X
European Social Charter	O	X	X	O	X	X	O	X	X	O	X	O	X
Revised European Social Charter	X	X	O	X	O	O	X	O	O	X	O	X	O
Framework Convention for National Minorities	X	X	X	X	X	O	X	X	X	X	X	X	O
ICCPR (International Covenant on Civil and Political Rights)	X	X	X	X	X	X	X	X	X	X	X	X	O
Optional Protocol to the ICCPR (right of individual communication)	X	X	X	X	X	X	X	X	X	X	X	X	O
Second Optional Protocol to ICCPR (death penalty)	X	X	O	O	X	O	X	X	O	X	X	X	O
ICESCR (International Covenant on Economic, Social and Cultural rights)	X	X	X	X	X	X	X	X	X	X	X	X	O
CAT (Convention against Torture)	X	X	X	X	X	X	X	X	X	X	X	X	X
CERD (Convention on the Elimination of All Forms of Racial Discrimination)	X	X	X	X	X	X	X	X	X	X	X	X	O
CEDAW (Convention on the Elimination of All Forms of Discrimination against Women)	X	X	X	X	X	X	X	X	X	X	X	X	X
Optional Protocol to the CEDAW	O	X	X	O	X	O	O	O	O	O	X	O	O
CRC (Convention on the Rights of the Child)	X	X	X	X	X	X	X	X	X	X	X	X	X

X = Convention ratified

O = Convention **NOT** ratified

BG=Bulgaria; CY=Cyprus; CZ=Czech Republic; EE=Estonia; HU=Hungary; LV=Latvia; LT=Lithuania; MT=Malta; PL=Poland; RO=Romania; SK= Slovak Republic; SV=Slovenia; T=Turkey

Statistical data

	1997	1998	1999	2000	2001
Basic data	in 1000				
Population (average)	10,291p	10,267p	10,238p	10,211p	10,190p
	in km²				
Total area	93,030	93,030	93,030	93,030	93,030

National accounts	1000 Mio Forint				
Gross domestic product at current prices	8,541	10,087	11,393	13,151	14,876
	1000 Mio ECU/euro				
Gross domestic product at current prices	40.4	41.9	45.1	50.6	58.0
	ECU/euro				
Gross domestic product per capita a) at current prices	4,000	4,200	4,500	5,100	5,700
	% change over the previous year				
Gross domestic product at constant prices (nat. currency)	4.6	4.9	4.2	5.2	3.8
Employment growth	0.0	1.4	3.1	1.0	:
Labour productivity growth	4.6	3.4	1.1	4.2	:
	in Purchasing Power Standard				
Gross domestic product per capita a) at current prices	9,200	9,900	10,600	11,400	11,900
Structure of production	% of Gross Value Added b)				
- Agriculture	5.9	5.5	4.9	4.3	:
- Industry (excluding construction)	28.1	28.2	27.7	28.7	:
- Construction	4.6	4.6	4.7	4.6	:
- Services	61.4	61.7	62.9	62.4	:
Structure of expenditure	as % of Gross Domestic Product				
- Final consumption expenditure	72.3	72.4	74.0	72.9	74.9
- household and NPISH	50.3	50.8	52.4	52.1	52.5
- general government	21.9	21.7	21.6	20.8	22.4
- Gross fixed capital formation	22.2	23.6	23.9	24.2	23.4
- Stock variation c)	5.5	1.3	1.5	1.7	3.8
- Exports of goods and services	45.5	50.6	53.0	61.2	60.5
- Imports of goods and services	45.5	52.7	55.5	65.3	62.6

Inflation rate	% change over the previous year				
Consumer price index	18.5	14.2	10.0	10.0	9.1

Balance of payments	in Mio ECU/euro				
-Current account	-840	-2,059	-1,969	-1,627	-1,248g
-Trade balance	-1,726	-2,110	-2,059	-2,303	:
Exports of goods	17,386	18,505	20,533	27,590	:
Imports of goods	19,112	20,615	22,592	29,892	:
-Net services	2,025	1,592	1,317	1,942	:
-Net income	-1,264	-1,675	-1,556	-1,708	:
-Net current transfers	124	133	329	441	:
-of which: government transfers	-4	-41	-8	-14	:
- FDI (net) inflows	1,928	1,815	1,873	1,837	2,730

Public finance	in % of Gross Domestic Product				
General government deficit/surplus	-6.8	-8.0	-5.3	-3.0	-4.1p
General government debt	64.2	61.9	61.0	55.4	53.1p

Financial indicators	in % of Gross Domestic Product				
Gross foreign debt of the whole economy e)	52.9	47.9	50.3	44.6	:
	in % of exports				
Gross foreign debt of the whole economy e)	116.3	94.7	95.0	72.5	:

Monetary aggregates	1000 Mio ECU /euro				
- M1	6.8	7.1	8.4	9.0	11.3
- M2	17.7	18.2	20.9	22.5	28.4
- M3	17.9	18.3	21.1	22.8	28.9
Total credit	26.3	25.9	25.0	27.2	32.3
Average short-term interest rates	% per annum				
- Day-to-day money rate	20.8	18.0	14.8	11.1	10.9
- Lending rate	23.0	20.1	17.2	13.1	12.5
- Deposit rate	17.6	15.4	12.6	9.2	9.0
ECU/EUR exchange rates	(1ECU/euro=Forint)				
- Average of period	211.65	240.57	252.77	260.05	256.59
- End of period	224.71	252.39	254.70	265.00	245.18
	1995=100				
- Effective exchange rate index	59.9	53.1	49.6	47.0	47.4
Reserve assets	Mio ECU/euro				
- Reserve assets (including gold)	7,634	8,107	10,883	12,065	12,252
- Reserve assets (excluding gold)	7,608	8,081	10,855	12,036	12,221

External trade d)	Mio ECU/euro				
Trade balance	-1,881	-2,407	-2,799	-4,308	-3,552
Exports	16,876	20,505	23,487	30,525	33,983
Imports	18,757	22,912	26,286	34,833	37,535
	previous year=100				
Terms of trade	101.2	101.3	98.4	97.3	99.7
	as % of total				
Exports with EU-15	71.2	72.9	76.2	75.1	74.3
Imports with EU-15	62.8	64.1	64.4	58.4	57.8

Demography	per 1000 of population				
Natural growth rate	-3.8p	-4.2p	-4.7p	-3.7p	-3.4p
Net migration rate (including corrections)	1.7E	1.7E	1.6E	1.6E	1.3E
	per 1000 live-births				
Infant mortality rate	9.9	9.7	8.4	9.2	8.2p
Life expectancy :	at birth				
Males:	66.4	66.1	66.3	67.1	:
Females:	75.1	75.2	75.1	75.6	:

Labour market (Labour Force Survey)	% of population				
Economic activity rate (15 - 64)	57.1	58.4	59.6	59.9	59.7
Employment rate (15-64), total	52.0	53.2	55.4	55.9	56.3
Employment rate (15-64), males	59.6	60.0	62.4	62.7	63.3
Employment rate (15-64), females	44.8	46.8	48.8	49.4	49.6
Average employment by NACE branches	in % of total				
- Agriculture and forestry	7.8	7.3	7.0	6.5	6.1
- Industry (excluding construction)	27.3	28.6	27.6	26.8	27.3
- Construction	5.9	6.2	6.7	7.0	7.2
- Services	59.0	57.9	58.7	59.8	59.4
	% of labour force				
Unemployment rate, total	9.0	8.9	6.9	6.6	5.7
Unemployment rate, males	9.9	9.6	7.5	7.2	6.3
Unemployment rate, females	7.9	8.1	6.2	5.8	4.9
Unemployment rate of persons < 25 years	16.9	15.2	12.3	12.3	10.5
	as % of all unemployed				
Long-term unemployment share	48.7	50.8	47.9	47.8	44.8

Infrastructure	in km per 1000 km²				
Railway network	83	85	85	85	:
Length of motorways	381	448	448	448	448

Industry and agriculture	previous year=100				
Industrial production volume indices	111.1	112.5	110.4	118.1	104.1
Gross agricultural production volume indices	96.2	97.9	103.9	93.7	113.2p

Standard of living	per 1000 inhabitants				
Number of cars	227.0	220.0	225.0	235.0	244p
Main telephone lines	304.8	334.7	359.3	347.1	319.7
Number of subscriptions to cellular mobile services	69.5	102.2	161.3	306.9	487.1
Number of Internet subscriptions	:	:	14.5	23.0	29.6

p=provisional figures

- Figures have been calculated using the population figures from National Accounts, which may differ from those used in demographic statistics.
- Including FISIM.
- These figures include changes in inventories, acquisitions less disposals of valuables and the statistical discrepancy between the GDP and its expenditure components.
- For 1996-1998 period, data were converted by using monthly average exchange rates. From 1999, the conversion is based on the average rates of exchanges of Eurostat.
- Series break after 1997.
- The population data have changed, because on the basis of the 2001 Population Census Hungary has subsequently and with a retroactive effect amended the data of the previous years as a result of which the rates of the natural increase and the balance of migration have also changed.
- Source: Website of the National Bank

Methodological Notes

Inflation rate

As part of the preparations for the common currency the EU Member States (MSs) have designed a new *consumer price index* in order to comply with the obligations of the EU Treaty. The aim was to produce CPIs comparable between Member States. The main task was to harmonise methodologies and coverage. The result was the Harmonised Index of Consumer Prices (HICP). A similar exercise has been started with Candidate Countries (CC). In respect to enlargement, it is equally important that their economic performance is assessed on the basis of comparable indices. Some progress has already been made towards adapting the new rules. Since January 1999 CCs report monthly to Eurostat so-called proxy HICPs that are based on national CPIs but adapted to the HICP coverage. They are not yet fully compliant with the HICPs of the MSs. In the table, the proxy HICPs are back-calculated to 1995 (rates from 1996).

Finance

Public finance: The government deficit and debt statistics of the Candidate Countries are provisional, in the sense that they do not yet fully comply with EU methodological requirements. Broadly speaking, the general government deficit / surplus refers to the national accounts concept of consolidated general government net borrowing / net lending of ESA95. General government debt is defined as consolidated gross debt at end-year nominal value. The series are available from 1997; the 1996 data are an approximation derived from the IMF's GFS methodology.

Gross foreign debt is of the whole economy, covering both short- and long-term, but excluding equity investment and money market instruments. The source for stock of outstanding debt is OECD, while the source of GDP is Eurostat. For the ratio of gross foreign debt to exports, the national accounts definition of exports of goods and services is used (source: Eurostat). The data for 2000 are Eurostat estimates, based on joint OECD/IMF/BIS/World Bank series.

Monetary aggregates are end-year stock data, as reported to Eurostat. Generally, M1 means notes and coin in circulation plus bank sight deposits. M2 means M1 plus savings deposits plus other short-term claims on banks. M3 means M2 plus certain placements in a less liquid or longer-term form. Not all countries produce an M3 series. Total credit means loans by resident monetary financial institutions (MFIs) to non-MFI residents.

Interest rates: Annual average rates based on monthly series reported to Eurostat. Lending rates refer to bank lending to enterprises for over 1 year. Deposit rates refer to bank deposits with an agreed maturity of up to one year. Day-to-day money rates are overnight interbank rates.

Exchange rates: ECU exchange rates are those that were officially notified until 1 January 1999, when the ECU was replaced by the euro. Euro exchange rates are reference rates of the European Central Bank. The effective exchange rate index (nominal), as reported to Eurostat, is weighted by major trading partners.

Reserve assets are end-year stock data, as reported to Eurostat. They are defined as the sum of central bank holdings of gold, foreign exchange, SDRs, reserve position in the IMF, and other claims on non-residents. Gold is valued at end-year market price.

External trade

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 licences, 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. Value of external trade turnover includes the market value of the goods and the additional costs (freight, insurance etc.).

Trade classification. The customs documentation is the statistical data source of external trade turnover. The data are collected according to the Combined Nomenclature. The earlier data are updated on the basis of the later processing.

The term FOB means that all costs incurred in transport up to the customs frontier are charged to the seller. The term CIF means that the purchaser pays the additional costs. Imports are recorded on CIF basis on the date of custom clearance. Exports are recorded on FOB basis with the date on which the commodities cross the state border.

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 has been changed.

Imports and exports with EU-15. Data declared by the Republic of Hungary.

Demography

Net migration rate. Crude rate of net migration (recalculated by EUROSTAT) for year X, is: $\text{population (X+1)} - \text{population (X)} - \text{Deaths (X)} + \text{Births (X)}$. This assumes that any change in population not attributable to births and deaths is attributable to migration. This indicator includes therefore also administrative corrections (and projection errors if the total population is based on estimates and the births and deaths on registers). Figures are in this case more consistent. Further, most of the difference between the Crude rate of net migration provided by a country and the one calculated by Eurostat is caused by an under reporting or delay in reporting of migration.

Labour force

The European Labour Force Survey is conducted in spring each year in accordance with Council Regulation (EEC) No. 577/98 of 9 March 1998. A detailed description of the sampling methods, the adjustment procedures, the definitions and the common Community coding currently used in the labour force survey is presented in the publications ‘Labour Force Survey – Methods and definitions, 1998’ and ‘Labour Force Survey in central and east European countries – Methods and definitions, 2000’.

All definitions apply to persons aged 15 years and over, living in private households. The concepts and definitions used in the survey follow the guidelines of the International Labour Organisation. Persons carrying out obligatory military service are not included.

Persons in employment were those who during the reference week did any work for pay or profit for at least one hour, or were not working but had jobs from which they were temporarily absent. Family workers are included.

As from 2001 (Commission Regulation (EC) No 1897/2000 of 7 September 2000), *unemployed* persons comprise persons aged 15 to 74 who were:

- (a) without work during the reference week, i.e. neither had a job nor were at work (for one hour or more) in paid employment or self-employment;
- (b) currently available for work, i.e. were available for paid employment or self-employment before the end of the two weeks following the reference week;
- (c) actively seeking work, i.e. had taken specific steps in the four weeks period ending with the reference week to seek paid employment or self-employment or who found a job to start later, i.e. within a period of at most three months.

Comparability with results prior to 2001: unemployment results used to refer to persons aged 15 and more. Persons who found a job to start later used to be considered as unemployed with the unique condition to have no job in the reference week.

Duration of unemployment is defined as:

- (a) the duration of search for a job, or
- (b) the length of the period since the last job was held (if this period is shorter than the duration of search for a job).

The active population is defined as the sum of persons in employment and unemployed persons.

Inactive persons are those who are not classified as persons in employment nor as unemployed persons.

Employment rates represent employed persons aged 15-64 as a percentage of the same age population.

Unemployment rates represent unemployed persons as a percentage of the active population aged 15 years and more.

Economic activity rates represent the active population aged 15-64 as a percentage of the population of the same age.

Infrastructure

Railway network. All railways in a given area. This does not include stretches of road or water even if rolling stock should be conveyed over such routes; e.g. by wagon-carrying trailers or ferries. Lines solely used for tourist purposes during the season are excluded as are railways constructed solely to serve mines; forests or other industrial or agricultural

undertakings and which are not open to public traffic. The data considers the construction length of railways.

Length of motorway. Road, specially designed and built for motor traffic, which does not serve properties bordering on it, and which:

(a) is provided, except at special points or temporarily, with separate carriageways for the two directions of traffic, separated from each other, either by a dividing strip not intended for traffic, or exceptionally by other means;

(b) does not cross at level with any road, railway or tramway track, or footpath;

(c) is specially sign-posted as a motorway and is reserved for specific categories of road motor vehicles.

Entry and exit lanes of motorways are included irrespectively of the location of the signposts. Urban motorways are also included.

Industry and agriculture

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 includes the data of all industrial enterprises. The indices by branches refer to enterprises with more than 10 employees.

Gross agricultural production volume indices. Indices were calculated using the fixed price basis applied for national accounts. Until 1996 the prices of 1991, and from 1997 the prices of 1995 serve as fixed price basis in the calculation.

Standard of living

Number of cars. Passenger car: road motor vehicle, other than a motor cycle, intended for the carriage of passengers and designed to seat no more than nine persons (including the driver).

The term "passenger car" therefore covers microcars (need no permit to be driven), taxis and hired passenger cars, provided that they have less than ten seats. This category may also include pick-ups.

Connected main line actually operating or temporarily suspended, main lines that connect terminal equipment to a switching exchange. These include private and institutional main lines, lines of public payphones and telecommunications service lines. Mobile phone lines are excluded. Connected main lines can be classified as dwelling, business and public main lines. ISDN channels are excluded.

Note: Since the passing of the Hungarian Telecommunication Law, the Hungarian Central Statistical Office (like the countries of the EU) has been collecting data on the main lines. Before 1993, the new Telecommunication Law, statistics surveyed main stations.

Number of Internet connections. Data collection of Internet connections started in 1999.

Sources

Total area, infrastructure, industry and agriculture, external trade, labour market: National sources.

National accounts, inflation rate, balance of payment, public finance, finance, demography: Eurostat.