

# KOPINT-DATORG

## Discussion Papers

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### Maturity and Tasks of Hungarian Industry in the Context of Accession to the EU

#### Summary Report of a KOPINT-DATORG Project

KOPINT-DATORG  
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**KOPINT-DATORG**  
**Discussion Papers**

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Maturity and Tasks of Hungarian Industry in the Context of  
Accession to the EU

Summary Report of a KOPINT-DATORG Project

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KOPINT-DATORG Discussion Papers often represent preliminary or incomplete work, circulated to encourage discussion and comment. Citation and use of such a paper should take account of its provisional character.

Comments are welcome.

## I. Antecedents

The *objective* of the project launched by IKIM, the Hungarian Ministry of Industry, Trade and Tourism, in spring 1997 was to gather together a think tank of experts of industrial companies, professional associations and interest representation organisations, economics researchers and prominent representatives of the professions concerned in 16 industrial-branch-specific sections covering 66 special industrial branches to audit their respective professional areas, through collective thinking/brainstorming and debates, from the point of view of the requirements and tasks of, and recommended preparatory industrial policy for, EU accession. The underlying idea was to create a long-missed forum for actors of the real sphere of the economy to communicate their problems, proposals and opinions to decision-makers in an organised way. Accordingly, the main goal was to bring *professional interests* to the surface, to identify crucial problems and have "lobby documents" (in the positive sense of the word) be made. It was hoped that, despite the time limits and the "forced march" aspect of the process implied by the fast-approaching initial date of the negotiations, there would be sufficient time for a dialogue to evolve and consensus be reached on central issues, in which case the project could provide the negotiating delegation up-to-date real-life argumentative material.

In the framework of **Phase I** of the Project, *vertical* surveys were made, to make the best use of the involvement of industrial experts and meet the requirement to audit the vocational areas concerned. The proposal material<sup>1</sup> forwarded to decision makers confirmed the idea that *successful preparation for the negotiations and the accession requires the active involvement of producer organisations*. The project identified numerous partial problems that had been ignored before and allowed industrial experts to join the review and assessment of tasks associated with the programme of legal harmonisation in administration at the last minute. They drew up proposals addressed first of all to the negotiating delegation and second to economic and industrial policy, but they also worded their own, special-branch and company-specific, tasks dictated by the need to boost competitiveness. One of the essential lessons and most noteworthy messages of Phase I was that, *for a most significant part of the industrial companies, the forum represented the first opportunity to confront future tasks implied by law approximation and realise the relevance of the, sometimes shocking, lack of information on the topics involved, and this is what put the process of problem-oriented but, given the project framework, limited, collective thinking into motion*.

Vertical audits put the emphasis on sub-areas of sector- and special-branch-specific strategic development in the perspective of EU accession (technical development, endowment

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<sup>1</sup> Towards EU Accession ... Industrial audit and industrial policy tasks. IKIM Project. Proposals. KOPINT-DATORG, 1 September 1997. MS.

with production factors, output trends, foreign trade, competitiveness, tasks originating from law approximation etc.). The topics in question called attention to experiences of the integration process so far and to the competitiveness of the areas under scrutiny (i.e. its EU maturity), to development alternatives independent of EU accession and related to it; they highlighted advantages and drawbacks, the system of requirements for the domestic economic environment and perceptible and/or foreseeable sources of danger. Although answers to the questions differed considerably in depth and detail and also soundness, they nevertheless allowed to draw many an important economic policy conclusion already at that time. Sector studies pointed out that accession would lead to the revaluation of the economic efficiency of extra-EU trade relations, highlighted the weight of environmental protection policy and market protection problems and formulated many conclusions for industrial policy, from the need to improve the flow of information and the activity of the professional trade unions and chambers to various tasks aimed at boosting competitiveness. The resulting work materials were distributed to the higher authorities concerned, and the experiences were discussed by the regular conferences of the Programme Council.

In *Phase II*, 14 work groups were convened in order to have the assembled professional/vertical material sorted out and processed by "horizontal" subject matters. The selected topics, i.e. cross-sections, matched special sub-areas of industrial policy and items on the accession negotiation agenda. IKIM selected negotiation chapters of high industrial policy relevance. Expert teams consisting of the most renown representatives of the given area were asked, first of all, to clash hundreds of proposals in their own special area, to assess them by certain macroeconomic criteria, combine them with effect analysis and, in view of the results, scan them and supplement the necessary data and numerical values. Work groups had the task of comparing their own results with those of ISM, the Strategic Task Force for European Integration and of the work groups of EITB, the Inter-Departmental Committee on European Integration, and of declaring what they thought should be advocated at the negotiations and what they proposed the industrial policy of the preparation period should do and how in their opinion.

The three essential assessment criteria were as follows:

- short summary of the EU aspects of the topic,
- special emphasis on derogation requests and assistance tasks bound to come up at the negotiations and generation of the necessary professional argumentative material and
- wording of the tasks of industrial policy in the preparation period.

It follows from the above that the biggest professional challenge of the given work phase was to harmonise vertical priorities specified by special branches with horizontal ones adjusted not only to the contents of individual EU negotiation folders, but also to mainstream modern industrial policy. Let us quote specific examples for the sake of clarity: a strategic objective relating to downscaling in mining, for example, had to be assessed against the approved assistance policy of the EU; sector-specific market protection expectations to be adjusted to the established market protection system of the EU; environmental protection issues raised by the paper or chemical (or other) industries be integrated into the context of the relevant EU directives on waste management, waste water management etc.; EU maturity or competitiveness re-interpreted against standards of quality, research and development, consumer protection or the development level of small enterprises, etc. Work groups were expected to specify tasks originating from the adoption of EU legal regulations of relevance for the industry even if the special branch materials available to them were deficient in that respect.

Since the short deadline on work of merit made it impossible to establish comprehensive, iterative contacts among the 14 horizontal and 66 sectoral work groups including a total of more than 200 experts, however expedient that would have been otherwise, the following methodology was used. KOPINT-DATORG compiled a horizontally re-edited thematic volume for each study topic on the basis of the relevant sector papers, and put these at the new work groups' disposal, distributing them, simultaneously, to IKIM staff and to the Heads of Phase I Sections. Section heads were asked to assess industrial tasks in the context of their complex interrelationships with related areas, but were instructed to rely first and foremost on the sector papers, to express and interpret specific, special-branch-level pieces of information and establish co-operation in problem areas with producer organisations and with the sections concerned.

Dialogue between the 14 horizontal work-groups was occasional in this work phase. The main task was to establish *some* form of communication between the vertical and horizontal work groups (the result, however, was of appropriate quality in a few cases only). A feedback phase was included: section heads/theme leaders in control of work in the two phases, together with the competent IKIM staff and the heads of the EITB work groups concerned met to exchange opinions. On that occasion, representatives of the real sphere approved the bulk of the professional material prepared in Phase II and indicated that they wanted to be kept posted on fresh developments at the accession negotiations.

## II. Evaluation of the second phase of the Project

### 1. On “EU-maturity”

It is generally agreed that there is no simple and uniform approach allowing to assess summarily, perhaps rank, the “EU maturity” status of individual industries, or on the basis of which one could judge the “maturity” of industry either in comparison to other economic sectors or in general. Although nobody has ever tried to develop the content elements of “EU-maturity”, one can consider it practically from two basic aspects, namely from the points of view of *competitiveness* and the *volume of tasks, or costs requirements, related to the acceptance of the acquis*.

It is worth recalling the statement often carried by the press according to which 70% of the industry is “EU conform”, or “ready” for accession, claiming that some two-third of industrial exports go to EU markets. Disregarding, for the moment, the fact that industry supplies the internal market as well, not only export ones, and hence the ratio of 70% is incorrect anyway, this mix-up of facts blurs the distinction between evaluation based on law approximation and competitiveness criteria, respectively.

It must be emphasised, that – although it would be good – we have no synthetic indicators which could express maturity in every integration area with a single figure or at least briefly and illustratively, or even one that could assess in some concentrated way progress in law approximation or the industrial or sectoral aspects of competitiveness/marketability.

*On the basis of work performed to date, all we can say is that we start realising the complexity of the task, and that it is impossible to find simple solutions. Let us now present some key factors to support the statement made above.*

#### 1.1. “Maturity” from the aspects of competitiveness

*For assessing market competitiveness* – although competitiveness as such is a rather complex issue –, as a first approach, everybody tries to rely on foreign trade statistics, then draws the conclusion that the market integration of industry and its branches has been nicely progressing year after year and, as a consequence of the liberalisation programme co-ordinated within international frameworks, market integration will be most probably completed by the expected date of accession, whenever that happens after the turn of the millennium. This, in turn, means that by that time the selection among export, import and domestic sales shall be determined by profitability on the single internal market – *marketability* –, and domestic and foreign trade

carried out on individual national markets will differ only in certain technical conditions of *trade* (opening hours, certain consumer protection rules, etc.) still within national competence.

However, we have to remember experiences which suggest the break-up into two of industry, referred to quite often these days, on the one hand, and the existence of a rather general and intensive demand for protection on the other hand.

The “break up into two” of industry is evident not only in the well-known area, viz. marked disparities between the country’s industrial regions with differing standard of development: there are tremendous differences within individual branches and within regions, for instance in the area of research and development, in the standards of environmental protection, in the realisation of labour health care as a problem, in the area of strategic consciousness, etc., depending on whether we speak of large multinational companies producing exportable products, sectors with significant growth potential (machine industry, chemical industry) or of sectors in which weak, slowly progressing, less competitive, typically small and medium-sized companies in Hungarian ownership and turning towards the domestic market form the majority. It is a well known fact that industrial growth, a relatively recent phenomenon, is lopsided exactly for this reason, and for the time being its performance is also extremely concentrated. A favourable tendency is indicated by the results of the first quarter 1998 business survey of KOPINT-DATORG suggesting a good chance for growth in manufacturing to become more even as the small and medium-sized enterprises feel a relative improvement of their own position and they are now more optimistic in their expectations than they were before. The realistic assessment of the internal lack of balance in development and its equalisation are cardinal preconditions for increasing competitiveness and establishing lasting industrial growth.

However, there seems to be “some deficit in competitiveness”, or rather an urge to avoid competitive conditions, reflected by the fact that the real sphere – almost regardless of whether the given industrial sector operates with foreign or domestic capital – expects the Government to provide market protection during the preparatory period, an ill-defined, yet definite demand paying no heed to or ignorant of actual opportunities, but one that the authorities – although aware of that demand – cannot and/or will not meet. This is supplemented naturally by the fact that trade-policy-based market protection (adjusted to the EU system, and actually approximated in Hungary also) is identical in name only with the term “market protection” as generally interpreted *in the Hungarian public way of thinking*, as in fact the former employs “only” non-tariff (technical) limitations with the effect of market protection, in addition to the indirect protective effects of other policies (environmental, quality protection, etc.). A growing range of these latter policies has been put on the list of prohibitions in international trade agreements, while the thick web of “fine regulations” still creates an effective wall against the entry of weaker

market players to the markets of the developed countries – in certain cases against us. However, it follows from the nature of the matter that while *the subject of negotiations can only be the trade-policy market-protection system*, the preparatory period may provide sufficient scope for the development of other EU-conform policies and regulations including those against the black market, those related to intellectual property and investments affecting foreign trade, regulations on competition, certification of standards and quality, public procurement, etc., that have an indirect market protecting effect. However, as of now, we do not have sufficiently differentiated, substantial information to be used for their development; we do not have the necessary infrastructure or network of institutions to realise the concepts – and the establishment of such a network is rather time-consuming and costly.

The “heritage” of COMECON trade, which continues to decisively affect the *integration-related maturity* of industry, acts as a burden on the trade policy to be considered in relation to accession in several respects. Here and now we mention only two of the relevant factors:

a) Several signals coming from large companies suggest a strong demand for EU-conform promotion of post-Soviet trade by state instruments. According to the views of the competent working group, the state can provide only the framework conditions for a successful eastern (and southern ) expansion; their utilisation requires active company behaviour, initiatives and co-operation between the government and the corporate sector. One can also add that, for the current Hungarian trade policy, export motivation is rather limited, but its existing EU-conform facilities still offer real possibilities to be exploited.

b.) The EU protects its market with all possible means, including high external duties, dumping claims, safeguard procedures, exemptions from GSP treatment, etc., from products manufactured not under market economy conditions and especially from mass products originating from the CIS countries. Hungarian interests in this area are rather mixed, depending on whether in the given case the issue concerns raw materials processed by us or goods competing with our products.

The industrial sectors developed *by specialisation*, beneficiaries of former central development programmes (mainly aluminum production and petro-chemistry-based chemical industry) procure the major part of their *raw materials* from the successor states of the former Soviet Union. Regarding products for which the external EU duties will be higher than the relevant Hungarian tariffs, in order to prevent the deterioration of competitiveness, the working group dealing with customs tariffs recommended the submission of requests for the neutralisation of duties, to moderate EU dis-preference in relation to products coming from CIS countries.

The picture is totally different for mass products with low added value – iron, steel, cement, fertiliser, etc.– *competing* with Hungarian products. Mainly because of the deficiencies of trade policy and the statistical infrastructure/institutional background, the affected domestic actors do not really trust EU market protection which is rather active in this direction. For this reason, the companies concerned urge actions in the interest of priorities for protection at product level, their continuation and possibly their extension in number in national frameworks. It is a matter of decision whether the negotiating delegation is ready to represent special interests, which depends on the impulses they may get in Brussels suggesting guarantees that the problem can be managed within the framework of the EU market protection system.

1.2. “Maturity” from the aspects of law approximation

It is more difficult to assess the situation briefly *in relation to the adaptation of individual chapters of the acquis* and their cost consequences, as every chapter poses different tasks, possibilities for subsidies and has different cost requirements.

Within the framework of law approximation, public administration work has been going on in an organised way for years. The relevant “maturity” of industry could also be defined by the extent to which we succeeded to establish "EU conformity" of the Hungarian legal material, i.e., the ratio of legislation already adapted and adaptable by the time of accession compared to the volume of regulations in the case of which it will be rational to come forward with derogation requirements. The general picture projected by the vertical sector studies suggests that the approximation of legal regulations has been going on as scheduled in the programme and the number of derogatory demands is not significant compared to the adapted/adaptable legal material, and is limited to some areas. The problems are rather related to the establishment of a proper institutional background, partly because of the resistance to re-organisation of existing institutions and partly because of the time, cost and expertise requirements of the process.

However, the horizontal working groups have pointed out that this picture is somewhat misleading. The real question, one that must be raised more emphatically when assessing “maturity”, is to what extent the companies of the real sphere are capable to meet the requirements set by the relevant EU legal regulations, and by Hungarian legal regulations adapted to them. From this aspect, the position of industrial branches is *currently* differentiated primarily in relation to tasks linked to environmental protection, labour health care and traffic and transportation. Although the working groups have been trying to make the first, prudent and uncertain, assessments, occasionally based on sources in literature, we cannot possibly know the annual and total costs of the various solution options. Especially in the area of environmental

protection, there are many disputed issues on which no consensus has been formed for the time being.

Given the fact that, in accordance with the considerations discussed above, the industry's "EU maturity" carries a different meaning in the contexts of progress in the approximation of legislation on the one hand and the relevant adaptability of the real sphere of the economy on the other, we have to review the challenges of the preparation period also from the perspective of the conformity of the subjects announced for discussion (derogation requirements) with the requirements of the capacity for adaptation.

The derogation demands raised by the Hungarian government to the Commission were determined by the actual status of law approximation, the signals received from the real sector and the expected adaptability problems. It is also known that, in principle, the range of issues to be negotiated (requested derogation) is not completely closed, if only for the fact that EU legislation is also changing. After the start of the negotiation period, it will nevertheless be practical to assume that, as far as industrial policy is concerned, the additional scope of movement will be primarily in the area of programmes (subsidy projects, economic organisation measures) which can be organised during the preparatory period. Thus in the following chapters we shall rather approach the problem of "EU maturity" from the aspects of subsidies which can be made available for the preparation.

## 2. The derogation – support alternative

*The establishment of the industrial policy tasks of preparation and the separation of negotiation proposals, the arrangement of optimum ratios, are in fact most complex economic policy matters, although in the attached materials of the working groups that has been more or less arranged. Disregarding, for the moment, slight differences in conclusions drawn in relation to specific proposals related to border areas and hence analysed by several working groups, one must face a question which is even more difficult to manage and pertains to selection from among alternative solution options to adaptation-related tasks, that is, whether a given problem should be solved by asking release, by transitory postponement or by treatment with appropriate economic development instruments, and whether in the last case adaptation is planned out of internal resources and/or with the use of external resources.*

Of the attached summaries and proposals of the 14 working groups, one can conclude that most of the large number of derogation and other proposals contained in the 66 sector studies prepared in the autumn of 1997 did not pass, for various reasons (general statements, absence of reference to legislation, not properly developed, unfounded, partial interests) the selection criteria of the experts of thematic working groups. *The horizontal working groups found comparatively few derogatory requirements worth representing: after considerable selection, they requested temporary release primarily from the adaptation of some environmental regulations; they composed some requirements for neutral customs treatment and requested special treatment in areas of market protection, industrial rights protection and infrastructure.*

However, the number of proposals specifically related to *derogation* were also affected by reasons not linked to the sector materials. Of these we point to three key considerations:

a.) Most of the commissioned working groups interpreted derogation requirements included in the EITB materials as *some kind of governmental determination*. The reason for that was partly that several of the experts invited by the project also worked as members of EITB working groups and the joint position worked out there limited their approach. (That also shows that we have very few experts properly versed in EU matters, to whom we can turn to.) It is even more important that in the absence of a developed national integration strategy, no other basis for comparison was available for the professional groups.

b.) The only exception was the product of the customs policy working group, the work of which was based on *original calculations*, comparing the EU customs tariffs and preference system and obligations undertaken within the framework of the Uruguay Round to the Hungarian customs tariffs and the obligations undertaken in relation to customs duty reduction. That

comprehensive analysis has made it possible for the working group to base its derogation proposals primarily on the comparative analysis of customs tariffs, and draw attention to expected tensions even in cases when they were not evident for those preparing the sector materials and the EITB report.

It is to be noted here that the appendix of the summary study prepared by the working group states, as a manual, the (fictive) duty charged on Hungarian imports in 1997 and calculated with the EU and Hungary's MFN customs tariffs for 2001 grouped as per the direction of customs difference, in HS2 and HS6 details, and attaches, in an exhibit, the list of series of products of import in 1997 and customs tariffs in 2001. Later on that exhibit will need to be continuously updated with the transfer of the changes of GSP after 1995 and with the preferential system changing after 1998. Since knowledge of the product line list ever will be imperative for the preparation activities of corporations, after the evaluation by the competent authorities of the possible publicity limits related to the use of the customs database, we plan to make it accessible to as wide a range of users as possible.

c.) The expert working groups – composed of researchers and/or company experts, occasionally even of civil servants employed as experts – are incapable of easing the contradictions arising from the rigid Hungarian structure of authorities and the inflexibility of co-operation between the affected ministries on the one hand and the requirement to evaluate in a complex way the problem areas of the accession chapters on the other. That has created difficulties for two reasons.

On the one hand, an inter-departmental reconciliation procedure went on related to derogation parallel with the work performed in the working groups, within the framework of which the earlier EITB proposals were significantly modified based on the effect of the materials prepared by and reconciliation exercises conducted by the working groups in the course of their work. Information available to the ministries on the issues considered in the course of the work, however, were mostly inaccessible for the external experts of the project despite efforts to continuously maintain contacts. Concurrency and accelerated work speed due to the date of negotiations getting closer have led to a situation in which study components prepared within the framework of the project were no longer valid by the time they got published, and in other cases, on disputed matters, the ministry's position differed from that of the working groups. In such cases the role of the project was to specify and bring to the surface the issues concerned, and with that it contributed to the understanding of the issue even if the ministry finally decided in ways different from what the project suggested.

The other problem is that industry – because of the horizontal negotiation chapters – can almost never be analysed in isolation, within the range of operation of the Ministry of Industry. The validity of this statement is comparatively easy to realise in industry-related areas such as environmental protection, infrastructure, employment policy or research and development, which operations (even in their negotiation and preparation phases) are controlled by other ministries, authorities. We only want to note that occasionally an industry policy chapter referred to above in itself affects several national authorities. For instance, because of regional, subsidy and work safety issues related to employment, in the development of the position to be taken in the procedure of EU accession, in addition to the Ministry of Labour, the Ministry of Environmental Protection and Regional Development and the Ministry of Finance have important roles to play, while migration-linked matters cannot be represented without political considerations related to Hungarian workers living outside the borders of Hungary.

We can also list here agro-industrial relations. Let us refer with two randomly selected examples to the importance of budgetary considerations linked to agrarian strategy and price issues. The agricultural strategy approach related to the EU common agricultural policy (CAP), for instance, basically determines Hungary's tasks related to the preparation of the Hungarian fertiliser, agricultural chemicals and agricultural machine industries, moreover, also the future of these industries. The other example relates to a proposal of the working group to analyse the contact points of agriculture with industry (pertaining to the introduction of the category of a natural gas price in chemical industry, which could be of determining significance from the aspects of the profitability and competitiveness of fertiliser production), which can, in fact, not be assessed in the absence of analyses of its budgetary and competition policy consequences and the relevant positions taken.

Interdependence relations are less striking in cases when we consider the preparation chances of small businesses, of vocational training, quality matters or consumer protection, despite the fact that these areas can be evaluated – as they belong more or less to the titles enjoying subsidies in the EU – only in close relationship with the assessment of the financing capacity of the Hungarian budget because of the necessary co-financing requirements. Moreover, in the absence of active contacts between the authorities themselves, the internal structure for the employment of accessible EU fund, the optimum "application mix", cannot be decided on either during the preparatory period. We shall return yet to the problems related to the development of the subsidy strategy. *Problems perceived in Phase II in these areas are not independent of the simultaneous but autonomous organisation of the 14 horizontal working groups, and that again can be explained with the time shortage.*

In the area of environmental protection, the real issue is the identification of sources available for funding subsidies amounting to hundreds of billions of forints which will arise as surplus burden once the new legislative provisions, of enormous effect, will be introduced (primarily in relation to underground waters, wastes and environmental fees). According to the working group dealing with budgetary relations -- with a great rate of uncertainty -- the upper limit of subsidies which can be obtained from the structural funds around 2000 will be a maximum of HUF500 billion, with some Hungarian co-financing requirement. Although the external source of the HUF500 billion is also uncertain, it is sure that environmental protection is not the only area to be supported, moreover, the industrial priorities also seem to be uncertain, not to speak about infrastructure and agriculture.

It has to be noted that tensions arising due to accelerated law approximation, which seem to be the most significant in the area of environmental protection, can be experienced in other areas also (e.g. the system of institutions of quality-related issues). The interest in the reduction of derogation has often shifted focus towards subsidies for preparation (especially in environmental protection, but elsewhere too). That creates problems primarily because perspectives are uncertain almost in every aspect in the area of subsidy policy and possibilities.

### 3. The need to transform the subsidy policy

*As seen by project experts, the advantages arising from EU accession are determined by present force relations in the EU member countries, their interests and preferences, rather than the specific development status, structure and economic policy of the Hungarian economy.* Thus the possibilities/alternatives for which the Hungarian party can prepare itself will depend on the reform of the Structural Funds, or on how much sacrifice the EU member countries will be ready to accept in relation to the extension of the Union to the East. (The final ratios will be determined by the expected ratios of burdens and advantages considered acceptable, by the losses in subsidy positions.) Currently, there is clear uncertainty in relation to the expected changes of the EU subsidy system and the specific conditions of Hungary's accession, and so the analyses on the availability of EU resources need continuous updating.

The problems are caused mainly by the fact that Hungary has no traditions in regional development, moreover, the regions have not been established unambiguously either. The decentralisation approach is currently alien for Hungary's industrial policy. As there is great uncertainty in the volume and accessibility of external resources which could be employed as well as in their actual drawing method, the identification of the demand for the change of approach is also weak and is standing on uncertain feet.

It is, however, certain that the highly centralised Hungarian subsidy system needs to be significantly altered to become conform with the EU subsidy principles (concentration, partnership, programming, additionality, monitoring) and be suited to accept EU subsidies. That requires not only the transformation of the central subsidy system, but also to make the business capital as well as local regional -- local government -- resources suitable for co-financing programmes.

For this reason, within the framework of the reform of state finances, we need to arrange the equalisation mechanisms based on different basic principles and related to local governments with differing economic positions and resources. In some form we have to solve the co-ordination of regional development subsidies, and it is recommended to establish a Hungarian regional development fund, providing the possibility for decentralised use. The concept also presumes the co-ordination of the central and local tax systems, the adaptation of credits with favourable interest rates to regional policy objectives, the comprehensive subsidy to the establishment of industrial parks and incubator houses, the establishment of business zones in regions suffering from structural crisis, the launching of regional research and development programmes. *It is suggested to approximate, as fast as possible, the volume of the resources to be*

*allocated from the budget for integration purposes and their distribution among the ministries for integration purposes with the EU-conform subsidy policy.*

These tasks, of national economic significance, put into new light the tasks of the Ministry of Industry in relation to subsidies, which partly coincide with the discussed directions, but also contain features which are typical of the sectors. The work materials prepared within the framework of the project present a broad range of tasks for industrial policy. Almost every working group noted that the distribution of EU-related information was not adequate, the flow of information between the real sector and the authorities needed to be improved. There was a similar consensus on the need of education (including especially teaching EU related knowledge and foreign languages). The proposals dealing with the development of the system of motivation for enterprising and with the strengthening of trade associations -- with a large number of components and concrete tasks related to that latter area -- were of universal significance. During the *period of preparation*, a great deal depends on how well the trade and representative organisations of the individual sectors -- including the management of industrial sectors -- grow up to the standards the tasks demand, whether they become capable to articulate and realise their trade interests so the relevant EU funds become accessible to the affected companies, and they can fit into the systems of institutions and conditions of the possible programmes.

#### **4. Specific key findings of the survey**

##### *4.1. Trade policy*

After accession, deliveries to the EU, currently considered as exports, will qualify as domestic sales/distribution on the single European market. At the time of accession, we have to accept the international trade agreements of the EU and eliminate Hungary's international trade obligations differing from those of the EU.

From the aspects of trade policy, accession to the EU will be favourable in general: it cannot mean serious problems for Hungary to take over the EU system of foreign economic relations with third countries, to become party to that system. Because of the execution of the Associated Membership Agreement and the WTO agreement, accession to the Union will have only a limited direct effect in the area of industrial products. The conditions of trade in agricultural products and the management of our links to third countries will require some more serious preparation.

Although the GSP system of the EU and that of Hungary are not fully identical, the differences are not significant. We can expect in relation to the USA a deterioration in the conditions of entry of Hungarian products onto the market, and trade considerations to minimising possible settlement disadvantages may strengthen. Up to accession, in bilateral American-Hungarian trade relations, the biggest risk is withdrawal of current GSP benefits, which has become an issue of timing only. Among major trade partners, the granting of EU GSP benefits to Russia, Ukraine, Kazakhstan (and perhaps some additional CIS countries) and to China and South Korea can create problems. However, even in that latter case the potential risk is less, as for instance EU will also withdraw unilateral benefits from South Korea -- as the country has become an OECD country -- and for the other countries there are several exceptions, limitations granted for sensitive product groups either within the GSP system itself or within the framework of bilateral agreements.

Agreements concluded as part of the European region practically mean the extension of the single internal market, so when Hungary's accession takes place, the taking over of regulations will improve the possibilities for the entry of Hungarian products and services into the market. By the time of accession, the import duties of industrial products will be reduced to zero in relation to non-member CEFTA countries (Slovakia, Romania) as a consequence of the CEFTA agreement, so in this area accession will not cause significant changes. (It should, however, be noted in brackets that for agricultural products barriers to trade can increase in relation to CEFTA countries.)

During recent years, our earlier positions gained on the markets of former Soviet Union have been gradually weakened. Many of our companies have plans for expansion to the East, and they urge the conclusion of free market agreements with non-CEFTA-member Eastern European partners. From this aspect not only Russia and Ukraine, but -- because of the reconstruction following the war in the South Slavonic region -- Croatia and Yugoslavia have also moved into the focus. Hungarian companies expect the government to take measures and prevent Hungarian firms from landing in positions implying competitive disadvantages due to lack of international agreements (free trade agreement) on the given markets.

The “new generation” regional agreements of the EU, and Hungary’s free trade agreements are similar in structure: they target the gradual elimination for industrial imports of duties and non-duty type barriers; the conditions of trade in agricultural products are specified in separate protocols; and in addition to the classical elements of free trade agreements (protective measures, exceptions, the marking of the country of origin, etc.) they include new issues with trade effect in the broader sense of the term (e.g. standards, competition, subsidies, etc.).

An important element of our accession is that the EU, as a great trading power, can employ several instruments for the opening of foreign markets, which would not be available for Hungary outside the Union. The issue is not only that the EU can conclude free trade agreements more easily, but also that it can take more decisive steps against unfair competition, against illegal measures, limitations affecting European companies on the market of third countries.

Accession to the EU generally means trade liberalisation in relation to third countries. Hungarian WTO liberalisation undertakings, however, are greater in the most sensitive areas of trade policy ( e.g. agriculture, textiles) than the obligations undertaken by the Community, so in the course of further trade liberalisation we must not conclude a more liberal regime than the EU undertakings. It is also important to assess the areas and develop a strategy in relation to the expected compensation requirements of third countries. Volume-related limitations, especially textile quotas, will create a serious dilemma if accession takes place before 2005, because then Hungary will have to accept the still existing import limitations of the EU, which will trigger violent protest on the part of textile-exporting countries.

As law appropriation tasks arose essentially only in the area of state export credit guarantee, and because sector studies often raise naive expectations, showing ignorance of reality, we believe that attention should be drawn to the importance of internal explanatory work in relation to export incentives. It is important that people should realise that in the EU export stimulation is not regarded as a Union-level task: export subsidies are of a normative type and, in addition to the state, the role of chambers and trade associations is decisive in their allocation.

Although there are special small business programmes to support small and medium-sized companies, these are also the types of companies which can expect to receive real export incentives.

#### *4.2. Customs duties*

Thanks to legislative changes introduced already, Hungarian regulations on import duties can be regarded as greatly approximated and the coming few years will be sufficient to take all the measures needed for full law approximation. Hungary will face difficulties in the area of adaptation in the field of duty administration, not that of the legal regulations themselves.

From the moment of accession, Hungary will have to employ the single external (integrated) customs tariffs of the European Union. Although the basis of product nomenclature is the EU's Combined Nomenclature, Hungarian customs administration does not have the integrated tariff of the type the EU has in the form of Taric (Integrated Tariff of the European Communities) which serves not only the purpose of actually imposing the tariff, but also the execution of the application of trade policy instruments and statistical registration. Thus comparison between Hungarian and Community customs tariff levels is not exact and is most complicated.

The Community concluded and is concluding a number of bilateral and multilateral agreements with third countries and groups of countries. From the time of accession, Hungary will have to adopt and employ the EU trade agreements as the agreements in force and will have to terminate its own (preferential ) agreements concluded with third countries. That means that the range of countries with which Hungary will trade with the most favoured nation clause or with preferential treatment will change. (In view of the fact that the European Union is one of the world's leading economic powers, it extends trade preferences to many countries with which Hungary has been trading on the basis of the most favoured nation treatment.)

For almost three quarters of the Hungarian imports, the application of the external customs tariffs of the EU will be of no significance, as import will change from external to internal import or, on the basis of free trade/ associated membership agreement, will enter the country duty free. Of the products imported by Hungary in 1997. 4.8% came from developing countries (GSP treatment, Tariffs Column I.), 0.4% from under-developed ones (LDC countries, duty -free) 22.7% from countries with the most favoured nation treatment (Tariffs Column II.).

The essential difference in the country categories set by the EU and Hungary, respectively, for trade (tariff) treatment can be summarised by stating that in the EU the group of countries with GSP treatment and duty-free treatment is much larger than in Hungary, while the most favoured nation treatment applies to only a few countries. The products of the most advanced

countries (USA, Canada, Japan, Australia) enter the Community with MFN treatment. (Although the EU has an agreement with the USA, too, which makes trade easier.) After the accession, Hungarian imports, the tariff level of Hungarian imports, could be most affected by the fact that the CIS countries as well as the countries of South East Asia belong to the GSP range, while the categories used in Hungary put both groups of countries into the group of MFN. However, the significant difference in the country-categories will not cause drastic change in the tariff level.

The tariff rates to be used after accession will differ not only from the rates employed by Hungary today, but also from the currently applied EU tariffs. The relatively stable elements of the EU tariff system are composed of the items with the most favoured treatment, which will be reduced by the EU (also) in the schedule specified by the GATT/WTO Uruguay Round. Uncertainty is much bigger in relation to the EU's non-mutual preference agreements and regulations than the uncertainty related to MFN tariff items.

By comparing the most favoured nation treatment tariffs of the EU and Hungary for the year 2001 -- as they will emerge as a consequence of tariff reduction undertaken at the Uruguay Round --, we wanted to answer the following question: How would the position of the various product groups and their users change if instead of Column II. of the Hungarian trade customs' tariff we would need to employ the EU MFN tariffs? By this method, assuming that everything else remained unaltered, we could determine how much the maximum duty increase or reduction would be that Hungarian importers of product groups and products would have to consider at the time of accession.

Considering exclusively comparable product lines, the industrial MFN duty level in 2001, weighted with the Hungarian MFN import in 1997 (a total of HUF861 billion), is 4.76% calculated with Hungarian fixed duty items, and it is 2.69% using the EU tariffs. The absolute difference between the two duty levels is 2.07 percentage points.

In 1997, 43.6% of the total import of HUF861 billion entered the country on a tariff number for which the EU tariffs for 2001 will be lower than the Hungarian tariffs. 37.2% entered the country on a tariff number for which the Hungarian and EU tariffs in 2001 will be identical.

19.3% of the MFN import was imported on tariff numbers in relation to which the EU 2001 MFN tariff items are higher than the Hungarian tariff rates. On that import worth HUF165.6 billion, HUF3.8 billion (2.3% tariff level) would be charged as duty based on Hungarian tariffs for the year 2001, and when calculated with EU tariffs (7.4% duty level), the duty would be HUF12.3 billion. The difference between the two duty items is HUF8.5 billion -- that is the sum the importing companies would have to pay, *ceteris paribus*. According to the calculations, in 2002 -- if accession takes place -- the Hungarian budget will have to waive some 1% of its total

duty revenue to the benefit of the Community. (That, naturally, does not mean as if that were the sum the EU budget would receive, as the EU tariffs will be lower than those of Hungary and a specified percentage of customs revenue will remain in Hungary to cover customs administration costs.)

According to the calculations performed, although the difference in the order of duty levels is not negligible, for most manufacturing companies that will primarily mean reduction of costs, so it will have a favourable effect. On the other hand, such a reduction in the protection level -- as part of the procedure of market opening -- by itself cannot lead to a significant increase in import competition. (For this reason the working group suggests to manage problems of this sort with market protection instruments). In the sectors, businesses, where the EU duty will be higher at accession than the Hungarian would be, although on the macroeconomic level the increase in the duty will not be large enough to make it worth fighting for derogation, in certain cases it is still in the interest of the national economy or of the sector to represent requests for release. Moreover, Hungarian companies and companies producing in Hungary will have the same chances for fighting for duty suspension and contingents as other EU producers.

#### *4.3 Market protection*

The negotiations to be conducted on the issue of market protection will involve the subject of taking over trade policy regulations in relation to actions against an increased volume of imports with (price) conditions which would have an ill effect on the operation of the market. The market protection instruments of Hungarian trade policy have become compatible with the system of regulations in the Community, although some tools of market protection, and especially its servicing infrastructure, are less refined and less efficient than those of the Union. In connection to the preparation for accession, there are no directly and imperatively needed significant approximation tasks. If any requirement arises in relation to the Hungarian regulations, it will be related not so much to approximation, but rather to a better use of market protection instruments.

Non-tariff related tools with market protection effects employed by other, non-trade-related policies, however, can occasionally create actual or potential difficulties in mutual trade, despite of the approximation and greater EU compatibility achieved by that time. The pace of approximation to EU norms is limited by the fact that the process involves a complex, costly and time-consuming legislative and juridical procedure.

Most of the proposals submitted by the companies did not include derogation requirements, that is, asking for release from the application of the EU market protection regulations, in relation to market protection in the narrow sense of the term. However, some implicit fear can be detected in relation to the import of some products from Eastern European countries, produced not entirely

under the conditions of market economy. The strengthening of control over the import of black/grey products, with quality defect, of polluting products, the establishment of systems and techniques preventing fraud are certainly EU conform, although some of their elements can create presentation difficulties as they may become of the procedural protectionism type.

#### *4.4 Environmental protection*

A survey of the accession-related tasks of industry suggests that most problems occur in the area of environmental protection. The identification and survey of special-branch-level legal material on industry proved to be a tremendous task and so far could be performed with significant simplifications only. In most cases, preparation has only reached the stage of specifying the tasks on some level (in some cases standard texts were produced, in other cases principles were developed). Often major disputes arose between industrial and environmental experts. The working group (most probably under-) estimated the costs of environmental approximation as being altogether HUF2-300 billion, emphasising that the estimation could not be based on proper methodological accuracy.

It can be stated in general, that

– the flow of information is inadequate: industry is not properly informed, the Government does not have the sufficient know-how on the technical and cost features of potential solutions. The determination of tasks and the technical and economic evaluation of solutions are conditional upon one another, so neither party can make optimum progress without the participation of the other one. As the tasks were not defined in a uniform way, with proper consideration of the available scope of motion and the subsidy system which can be used, ad hoc features and subjective approach may have been present when composing derogation requirements;

– industry did not disclose or develop properly the potential solutions of the tasks in the technical or in the economic sense. It follows that the technical and economic analyses performed within the framework of the project only reflect the level of knowledge we have now, in what can be regarded as a very early phase indeed;

– no institution has been established which could maintain the dialogue between the individual actors of industry and the government, and so, for the time being, the smooth and regular arrangement of the necessary feed-back has not been solved. There is no system available which would provide for institutionalised access to information imperative for the preparation.

The working group pointed to the following key problems on the major environmental areas:

**a.) Protection of air purity.** For the execution of air-related EU legislation -- where some EU regulation does not specify a specific limit for the given sector --, the scope of movement, the conditions for execution for the Hungarian party, including the industry (in the absence of derogation) are specified by Hungarian regulations.

For Hungary to meet the relevant EU requirements in this area, the task is to reduce the emission of industrial combustion facilities. There are several solutions: reconstruction of firing equipment, switching over to fluid-bed firing, employment of various other solutions for the furnace chamber, use of fuel with more favourable environmental effect or of alternative, regenerative sources of energy, energy efficiency measures and various end-of-pipe-type solutions can be employed to reduce pollution. In certain sectors, solutions closely linked to the technology can reduce emission. These solutions reduce the volume of various pollutants to different extents and if employed in proper ratios the EU requirement can be met. It is a preparatory/financing task to develop energy-efficiency projects for the citizens and the energy consuming industries to reduce emission by power stations to the necessary extent .

**b.)** In the area of **regulation of surface waters**, the EU is to introduce changes, wanting to introduce a system of target statuses in water quality. The starting point of the current regulation is similar, as for surface waters it specifies imission limits for 46 components, depending on the use of the water, for potable water, waters suited for swimming, waters suited as habitat for fish and waters suited for human consumption.

The member countries will have to develop programmes to achieve those water quality values, that is, by adhering to certain rules, they have the option to decide in what categories of water use they list their waters, and what emission limits they set on specific areas for given pollutants. However, some mandatory pieces of legislation on emission limit the programming possibilities of the members countries. It is only on these bases that specific environmental tasks will be established. Thus the determination of the environmental tasks of the industrial sector partly depends of the government's regulations and partly on the requirements the quality of sewage water has to meet when flown into a public canal.

Industry can perform these tasks by employing various solutions, or their proper combination: they can drain sewage water into the public sewage system and pay a higher expense or select the option to meet sewage water quality related regulations and pay the relevant cost. Industry can also establish the necessary sewage treatment phases and can rationalise the technology by reducing the volume of emission or that of the production of pollutants.

Compared to household sewage waters, the industry has smaller, but still significant problems. There are many reasons for that:

– The surplus investment costs related to the treatment of waste waters are high: for the chemical industry the cost is estimated to be HUF50 billion, HUF6-8 billion for the paper industry, HUF5-7 billion for the textile and leather industries, HUF8-15 million for machine industry. Still, one can assume that these costs are not higher than what the sub-sectors can cover: there are several branches of the chemical industry which are in favourable position and can earn in 1-2 years the resources needed for the purpose; the paper industry can do it in 5-6 years; in the branches of the machine industry which are more profitable (and where environmental “debt” is also less) the time needed to provide the fund is 3-4 years, in other machine industry branches 6-8 years. To make it easier for the companies to manage the problem, it is suggested to provide them subsidies in accordance with a detailed programme schedule developed in advance.

– In the branches of the chemical industry (the production of fertilisers, agricultural chemicals) and the leather industry where resources are scarce, or the fund required can be accumulated only during a longer period, the economic conditions for the modernisation of technology should be analysed together with the competitiveness and viability of the operation and then decision be taken on the possible subsidy or the gradual downscaling, in extreme cases on the termination, of the company’s operation.

c.) In the area of **the protection of underground waters and of soil**, the Council guidelines leave it to the member countries to specify requirements, so for the assessment of the exact effect of regulations we first have to determine Hungarian requirements.

In this area the sectors ask not for derogation, but for the moderation of the strict requirements included in draft Hungarian legislation, including especially in relation to the tasks of compensation. At the same time, special consideration is to be given to the fact that in Hungary 90 per cent of the supply of potable water is based on underground waters. This is the area where we can best see the need to turn into tasks the objectives set by EU regulations, the necessity of adopting them.

In this regulatory area, the scope of movement is set by the Hungarian determination of the requirements in relation to listed materials, including regional differentiation according to sensitivity, the differing limit values, the time horizon by which existing facilities have to meet the requirements, the different uses of areas.

d.) In the area of **protection against the harmful effects of wastes** there are some centrepieces in EU regulations:

– The tasks are biggest in the area of the proper treatment of waste, meeting the requirements in waste management. As there are many alternative concepts in relation to the deposition and utilisation of waste, for the time being it is not possible to exactly define the tasks.

– The proper treatment of hazardous waste actually involves conformity to regulations, in which case requirements in relation to specific types of wastes (PCB, PCT, batteries, oil) will also be met. We have our biggest problems in the machine and chemical industries, so it is in this area that we can consider most to request EU support.

– It would not be a problem to recycle a set percentage of packing wastes, such as paper, glass and iron, if the conditions for the selective collection of waste were available. The approximated sum of HUF16 billion is not excessively high: it is believed that with proper subsidies and programmes, the required proportions could be met after the revision of the current system.

– In relation to the transport of waste, the requirement of approximation is to be raised. In sectors where non-hazardous, re-usable waste is recycled (glass industry, paper industry, metallurgy, plastic processing), the reconsideration of import conditions has also been proposed.

Regulations on waste management specify guidelines, and leave it to the member countries to develop specific waste management plans. That leaves enough scope of movement for the member countries, as these plans can specify the waste management tasks of the individual sector, the period of grace, possible subsidy system or arrangement of economic incentives. The tasks in the area of regulating hazardous wastes emerge mainly in execution, and their scheduling is also part of the waste management plan.

#### *4.5 Employment policy*

Although employment policy is not an independent issue to negotiate, certain aspects of the employment policy of Hungary can raise concern in some member countries. Within the European Union, growing attention is paid to the employment/ unemployment problem, which is further increasing due to the attitude of the unemployed people, which is becoming more radical. In the area of employment and welfare, the member countries enjoy great independence.

It is the main tendency of the times that capital flows to labour and not the other way round. For this reason, contrary to the relevant prognoses, there has been no major migration among the member countries of the EU. No significant volume of migration can be expected when Hungary joins the EU either. According to surveys, there is no significant, real, active demand in the Hungarian population for that and there will be no vacancy in the EU member countries. Moreover, Hungary's accession can take place under favourable growth perspectives, which will improve job opportunities in Hungary. Nevertheless, after this country becomes a EU member country, employers will have to expect certain opening up of the current, almost fully closed, national labour market. However, the extent of that will be very limited in the years

following accession. It will be possible for the employers to replace the labour they loose by low-cost, well-trained workers flowing into Hungary from neighbouring, non-EU-member, countries.

The employment level in Hungary is low in international comparison, so its increase is of both external and internal economic and social interest. During recent years, employment and unemployment have been dropping in parallel, leading to a dramatic increase in the number of inactive population of working age. The reduction of unemployment for financial reasons, by making entitlement to unemployment benefits more strict, has brought a “result” which brings Hungary into an unfavourable negotiation position when applying for subsidy from EU structural funds.

Vertical materials show that the EU is making it increasingly stricter to permit work on contract (outworking) to be arranged outside the member countries in order to protect its own labour market. It follows that we cannot expect a further increase in this operation category in Hungary and the affected sectors must base their medium-term strategy on a different foundation, or else their cut-back will become a realistic alternative. In the long run, only the perspectives of quality outworking are promising.

There is no significant incoherence -- with some exceptions -- between the Hungarian system of labour law and the European Union’s norm material in formal terms, that is, in law approximation. However, signals coming from law enforcement and from labour control suggest that in certain areas the attitude of employers is contrary to the requirements contained in the norms (especially provisions on the prohibition of discrimination). Hungarian regulations are stricter in a number of legal institutions than EU norms.

During the period of codification of Act XLIII of 1993 on Labour Protection, the European Community directives on labour protection were already in force and were taken into consideration by the competent Hungarian authorities, and now we have to adopt them in practice as well. In the area of five directives on labour protection coming under the competence of the Ministry of Trade, Industry and Tourism, changes are needed, and the working group has dealt with them.

According to the vertical studies, it is a problem to get to know and employ EU conform labour protection regulations. Some of the sectors studied did not even know what to adapt and what the cost consequences would be. Only the chemical industry asked for release or subsidy for taking over the labour protection regulations of the EU. Most probably that is primarily due to ignorance and not because the other industries have no problem or that conformity to EU regulation is not a costly affair, perhaps requiring a significant volume of investments.

Conformity to labour protection regulations requires today the force of law and control. With a few exceptions, employers try to avoid -- for cost reasons -- conformity to labour protection regulations. Employees are in general at the mercy of their employers, their representation is weak, they are afraid to lose their job, so they do not really demand labour protection facilities.

#### *4.6 Infrastructure (traffic/transport)*

The competitiveness and possibilities of the Hungarian industry will be affected -- in addition to the direct industrial infrastructure -- by the development level of the country's transport infrastructure. The development of Hungarian transportation -- accelerated by the endeavour for EU accession and the approximation requirements -- has a positive effect on industry in two ways:

- the development of the quality of transport (pan-European corridors, faster railways, modernising logistic centres, multi-modal transport) provide for industry, tourism and trade increasingly favourable conditions;
- motorization, increase in the volume of railway and highway projects and partly the development of water-borne transport and urban transport create market and references for the domestic industry.

The effect of a more advanced transport infrastructure and freight system on the increase of competition in industry and trade is also not to be belittled. For better, faster access possibilities, in the future foreign small and medium sized companies can enter the Hungarian market in bigger numbers to join multinational companies already settled here. Relationship between transport and economic development -- including industry and trade -- is illustrated by the fact that one unit of investment in a country of at least medium development level brings some three units of private capital investment.

The following linking points require co-ordinated, joint action between the ministries of industry and transport:

- on regulations on use of pipe-lines for transport,
- for thermally insulated glass, to decide which standard to adopt,
- for the production of other vehicles, the "selection" of development resources, and on that basis to decide what role the state should undertake,
- for the machine industry branches serving agricultural businesses, the identification of regional development resources for transport infrastructure.

There are only two points in relation to which the interests of industry and transport infrastructure are to be co-ordinated for the accession negotiations: transportation using pipe-lines and the production of other vehicles. For transportation using pipe-lines, one has to consider both advantages and drawbacks (additional income from transit transportation, but others can also have access to the use of the pipe-line). In the area of the production of other vehicles, it has to be clarified how the role undertaken by the state should be linked to the use of domestic products (vehicles running on rail and those travelling on water, port facilities).

Some one fourth of the transitory releases asked for by the Ministry of Transport and affecting transport infrastructure affect industry directly. For the industry, directives of determining importance once they come to be applied include those on the financial basis of the inland park of boats, on subsidies to be made available for railway, highway and inland water transport, on joint rules on combined freightage transport among member countries, on control instruments used on highway transport, on maximum permitted size and mass of certain vehicles in international transport, and on the distribution of railway infrastructure capacity and the charging of infrastructure fees.

#### *4.7 Research and development (R+D)*

The competitiveness-related problems of the Hungarian economy come from the low efficiency in technology and know-how distribution and innovation performance. A key factor in the preparation of industry to enter the very strong competitive market of the EU is to strengthen the innovation capacity of industry. The practical preparation for integration, the accession procedure itself, demands changes in the area of R+D.

According to the evaluation made by the vertical studies, on the basis of intellectual potentials, the most competitive R+D facility is that of the pharmaceuticals industry, and from among the new industries, software development. Of the 24 sectors of industry (in terms of R+D) 5 (paper and paper products, pharmaceuticals, cement and lime, office machinery and computers, telecommunications) claimed their R+D basis as a facility offering significant potentials for industry and regarded it as an important factor in competitiveness. On the other hand, 12 sectors stated that their R+D basis had collapsed and could not be instrumental to improving competitiveness. The sectors facing the absence of R+D capacities are as follows: coal mining, shoe industry, knitting industry, agricultural chemicals, rubber industry, metallurgy and some sub-sectors of the building industry and several sub-sectors of the machine industry. The drop was most dramatic in the research places of companies, that is, the R+D organisations serving industry most directly.

According to sector studies, the most general barrier to innovation was the absence of financing funds due, internally, to low profit-earning capacity, inflationary pressure on wages and tax- and levy burdens on live labour. At the same time, several vertical studies concluded that possibilities are unknown, or not correctly known. In relation to the financial resources needed for R+D and innovation, claims were raised for state (and EU) subsidies. Most probably the expectations for multinational companies to participate in R+D financing are excessive. The sectors which dealt with the supply of experts to R+D activities had a positive opinion on the quality of research staff, and claimed the problems were caused by limited replacement and by staff members leaving the facilities.

In Hungary, within R+D expenditures, the ratio of funds allocated to the experimental development phase was low. This comes from the inherited structure, from the drop which is even faster in this area, and partly from the low ratio of business financing.

For the R+D aspects of industry, the advantages of accession are unambiguous, as in this case

- the conditions of participation in R+D consortia, industrial associations are more favourable
- most probably the necessary resources can be obtained for successful research, promising economic results.

As the studies analysing co-operation under the EU Framework Programmes pointed out, it is rather difficult to join R+D consortia because of the confidential character of R+D activities. Even parties who do not co-operate in full harmony think twice before changing partners. For this reason, the state must support entry into consortia by using all instruments available, whether economic or R+D diplomacy and perhaps proper financing method.

Legislation on R+D is a more flexible part of the EU legal system. The practice and legal backup of the Hungarian R+D regulations are not in conflict with any part of the relevant EU regulations. The White Paper drafting the accession tasks of the associated member countries does not contain legislative amendments in relation to R+D, so there are no law approximation problems in this field. Currently, the key issue of law approximation is to exercise the rights in practice. Practically, the only "sensitive point" of the national R+D regulations from the aspects of the EU is the issue of state subsidy.

It is a must to gradually increase R+D expenditures as the ratio of gross national product to 1.5-2 per cent, which is the average ratio in EU member countries. For that we need to

significantly increase the volume of public funds to be spent on that purpose as well as that of business funds.

The R+D policy as related to EU accession differs from the other areas in that Hungary has joined as full member the EU 5 R+D Framework Programme partly before the general accession negotiations have started and partly in parallel with them. Hungary's participation in Framework Programme 5 -- according to the calculation of the EU Commission and OMFB<sup>2</sup> which came to the same result -- will cost some 66 million ECU. For this reason the working group considers it as an imperative that Hungarian payment should not come from the current R+D funds, but from the resources of the budget allocated for integration or from resources advanced to the ministries for accession purposes.

Experts have different views on whether with EU accession Hungary would gain more from -- than the payment it will make to -- the EU community funds, and whether it can benefit from the funds serving the purpose of levelling up differences in development statuses. The funds and their distribution systems are expected to radically change on the effect of extension and under the pressure of the current member countries, so it is in our primary interest to continuously monitor that procedure.

The R+D state administration system differs from member country to member country within the EU. The biggest problem of the current, decentralised, Hungarian system is that the distribution of tasks and competence is not clear and co-operation within state administration is very low. The role of Parliament (Parliamentary Committees) in this area is negligible compared to the EU member countries.

#### *4.8 Vocational training*

The "country opinion" of the European Union is very favourable on the system and standard of Hungarian education and vocational training and does not mark any factor that would hinder or slow down the accession procedure. From the aspects of appropriation to market economy requirements, the opinion praises the system of vocational training, the progress made in recent years in updating the curriculum. At the same time, it points out that the resources allocated to vocational training are limited, the salary paid to teachers is low. According to the summary evaluation on this area, there will be no "essential problems" in relation to accession.

There is no direct law approximation compulsion in the area of vocational training. The existing systems and the regulatory environment are suited for accession. The spirit, basic principles of the acts -- passed since the transformation of the political/ economic system -- on

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<sup>2</sup> National Technical Development Committee

sectoral and public education, vocational training and on higher education are in conformity with the general European principles. It follows from the above that no derogation requests exist or are to be expected in this area.

The reform processes, parallel with the main European trends, which started in the second half of the 80s have accelerated significantly. The most important ones include the introduction of the National Core Curriculum, the reform of the general education and GCSE exams, the new system of teacher training, etc. These reform steps in fact assist the completion of the accession requirements and preparations for accession.

There are no major differences between the European and the current Hungarian vocational system. The differences originate from traditions and exist in the area of the structure of schools, subjects, qualification criteria and examinations. However, the formal, substantial and legal approximation of special qualifications will require a lot of work. In this field the age group problems, training locations, including primarily the practical training sites and the differences in various economic sectors cause most of the problems.

Accession has a motivating effect on the continuous modernisation of vocational training in context, organisation, methodology, and will make the education system more flexible for adaptation. The participation of trade representations and NGOs is expected to increase in the formation of vocational training, in consultation reconciliation procedures preceding comprehensive decision taking and in the various community programmes. Through partnership, it will become possible to involve Hungarian institutions and persons from outside Hungary's borders in co-operation in vocational training and that will have a beneficiary effect on neighbourhood relations. From the professional aspects, participation in community programmes will significantly help the professional development of teachers, will help them improve their knowledge in foreign languages. Accession will make it possible to draw external resources into vocational training from the central budget of the European Union from the subsidies allocated for the development of human resources.

In relation to accession, negative effects can also emerge, but they do not seem to be dangerous. There is also a chance for a drop in training standards. We must also take into account the effects of the increased mobility of skilled labour.

It is difficult to assess the costs of preparation for accession, as a significant portion of the tasks of preparation is organically linked to the modernisation of the affected industries. The cost of the comprehensive development of language training is high.

The working groups propose EU and Hungarian budgetary co-financing to support the purchase of equipment and language training.

EU member states pay much greater attention and provide more support to the SME sector than Hungary; Hungarian practice will have to follow suit. The requirements of subsidiarity, transparency, dialogue, and participation in decision making will have to be asserted to a much greater extent.

For the small enterprises, accession -- in general and in the longer run -- will be advantageous, but at the same time it will present a great challenge and emergency situation for many of them. Small organisations will have to meet much higher demands than they do now in technical, economic, market entry, management and entrepreneurial aspects. They have to acquire a great deal of know-how, the absence of which they do not even feel yet. The outcome of accession in this respect essentially depends on the performance and results we can produce in their preparation.

The EU has mostly recommendations only for SMEs as a specific group of companies: from this aspect, law approximation does not affect this circle significantly. However, law approximation poses hard demands on them as producing companies, a circumstance that was noted at several places by the vertical studies, but was not further processed. According to the surveys, the small enterprises and their organisations do not know these requirements; apart from voicing general concern; they cannot state a definite opinion on whether they would be able to meet these requirements, and if so, to what extent and under what conditions.

According to our survey, the small and medium sized enterprises and their organisations realise the competitive disadvantages primarily in the area of capital supply. Their next concern is market work, then quality-standard requirements. In conformity to that, in the area of preparation for EU accession they request support mostly in access to capital, then comes requirement in information in relation to the EU and the markets. Their organisations, chambers, trade associations feel they are not sufficiently prepared to provide proper information to their companies.

According to the working group, a comprehensive SME programme is to be urgently prepared then further developed to link the development of this sector and its various segments to the preparation for EU accession. Special parts of this preparation include forwarding masses of information on EU requirements, support of language training, the strengthening of the institutional network, the further training of staff members. With the other programme points -- including supply, export development, management consulting programmes --, general and EU accession preparatory promotion support areas are inter-linked. Another important issue requiring thorough, careful consideration and reconciliation is the promotion of a more rational

establishment of institutional networks, the strengthening of their co-operation. In advanced market economies, all that system has developed in decades or even centuries, while in Hungary the process had been broken. Especially trade organisations, associations, industrial boards, employers' organisation with voluntary membership are in difficult position, because they are incapable of performing the tasks they will have to perform also in the EU.

#### *4.10 Quality issues*

The European Union treats standardisation and the European system of certification of conformity as axioms, and so it does not want to negotiate on them. The legal material on the regulation of the internal market has the objective of ensuring the free movement of goods. From the aspects of the free movement of goods, we have to start out from the fact that, as a result of the execution of the European Agreement in the area of industrial products as from the 1<sup>st</sup> of January 2001, free trade will emerge between the European Union and Hungary.

The general effect of standardisation and quality certification (quality issue) is realised in exactly the same way in every industrial sector. Measures taken in this area will affect the investigated sectors in the same way, so it would not be effective to treat the tasks in these two large areas in isolated, sectoral ways. The European strategy, methodology and structure of the institutional system of standardisation and conformity certification is above the sectors. Difference in this system can only come from the specific technical requirements of some sectors (products).

In the areas covered by legal regulations, the earlier fragmented, concurrently operating certification system can be significantly simplified, and, at the same time, with only minimum state support, it is possible to extend, make market-conform and more dynamic the old range of testing organisations run by the state, fossilised, in monopolistic position, and thus occasionally softened.

It is not derogation what the companies hope for; they want to operate as early as possible in accordance with the European standards and the quality certification system, as it is in their elementary interest to enter the European market. However, the sector studies show that the actors of the economy at times still expect and count on state support measures and activity even in areas (voluntary standardisation, voluntary quality certification, the establishment of quality assurance systems and environmental management systems) where market interests dictate the need for their participation in the standardisation and quality certification of their products and services.

The working group estimated the costs needed for industrial standardisation and in the area of quality certification to come to around HUF8.4 billion in the period between 1998 and 2001.

#### *4.11 Consumer protection*

In the area of consumer protection, the decisive principle is divided codification competence. It is a characteristic of the Community's legislation on consumer protection that it does not form uniform legislation; attention is focused on some components, which are rather complex, and in relation to national legal systems belong to different legal sectors. Some 80 guidelines have been approved in the European Union in the area of consumer protection law approximation. On the basis of the European Agreement, Hungary will have ten years to approximate the Hungarian legislation related to consumer protection to Community norms, and to reach the EU standard in consumer protection. The law approximation work progresses as scheduled, and is expected to be completed before the established deadline.

The law approximation of the EU guideline on general product safety has been completed. Of the key guidelines, law approximation has been completed in the area of organised tours, goods which in their presentation look different and thus risk consumers' health or safety, misleading advertisements, unfair conditions for consumer credit, contracts concluded with consumers and consumer protection tasks related to the marking of the price of food and non-food products. The guiding principles on the law approximation of member countries on the safety of toys and on the name of textiles have been adopted. The adaptation of the EEC guideline on cosmetics has been only partly completed, in this area some additional regulation will be issued. Several Community pieces of legislation (guidelines, recommendations, etc.) contain provisions which specify general consumer requirements valid for every product. Of these the ones worth special mention include the rules on information (labelling) to buyers and on packing including instructions to manufacturers, importers and distributors alike. Act CLV of 1997 on Consumer Protection provides for approximation with the various Community regulations.

The working group proposes that in the course of preparation for accession negotiations, the government should make use of the assistance of the consumer protection lobbying organisation of the European Union member countries within the Community, the Bureau Européen des Union de Consommateurs (BEUC) with seat in Brussels among others. The study puts forward several proposals in relation to the professional, financial and institutional conditions needed for preparation. The working group estimates that the necessary costs will be above HUF1 billion during the coming three years.

#### *4.12 Possibilities for using EU funds*

According to current information -- and Hungarian endeavours --, after accessions Hungary will be listed among the most backward regions, that is Target Regions 1. The most significant financing possibility seems to be coming from the Structural Funds, so it is suggested to fit the greatest possible part of projects to be subsidised into this category. Within that, we can rely most on the resources of the European Regional Development Fund (ERDF), so the working group proposes that the industry should try to link various industrial development objectives and regional development programmes. As during the pre-accession period -- at around the turn of the millennium -- 70% of the structural funds to be made available will be concentrated, most likely by the Commission, on the development of environmental protection and transport, the working group believes it likely that the role of other Community programmes and of the resources attached to them (the financial resources allocated for Community initiatives, small enterprise programme, R+D framework programme, other Community policies) will be only supplementary.

The reasoning is based on the argument that current EU industrial policy and the linked system of subsidies are meant to act as incentives not for programmes to develop sectors, but to the establishment of competitive systems of companies, the efficient co-ordination of the objectives of horizontal policies reaching across sectors. The basic areas include the co-ordination of the priorities of regional policy and industrial development, environmental policy fit to regional development concepts, the fastest possible diffusion of research results into the economy and, closely linked to that, the promotion of the emergence of a competitive small business sector, the development of infrastructure fit to regional and economic development priorities and efficient management of human resources.

The availability of EU resources is always linked to co-financing, which means that the programme proposals to be submitted to the Commission are determined in proportion to budgetary (public money +private capital) resources. The availability of resources presumes that by the time of accession

- the reform of the Hungarian system of state finances is implemented,
- the Hungarian system of subsidies is EU conform,
- the necessary institutional background is established,
- the Comprehensive Development Programme is prepared with the suitable target priorities determined,
- sectoral and company programmes required for the industry, or more exactly the individual companies, to react to the tasks ahead are developed and executed.

When evaluating the preparation requirements determined on the basis of the survey of the sectors, it can be concluded that in many areas there is the possibility to develop suitable EU-conform subsidy programmes.

The proposal to accept the transport sector as a sensitive industry matches the current concepts of the Union, just as the special treatment of environmental protection. According to the competition rules of the EU, the following sectors are treated as sensitive: coal mining, the steel industry, the textile and the motor vehicle industries and ship building -- an industry less important for Hungary. The relevant programmes and the application of the special status remain in force generally up to 2002, after which date the Commission intends to further reduce the possibilities to permit state subsidy under softer-than-general conditions. It follows that in this area by the year of likely accession Hungarian possibilities will be rather limited.

The Association Agreement makes it possible for Hungary to provide, for a transitory period, state subsidy for ESZAK products "in exceptional cases, for restructuring purposes, to make the beneficiary firms viable and to reduce the total Hungarian capacity". The special status of the steel industry needs to be extended in view of the fact that re-organisation has not been completed, but for the time being it is not accepted by the EU, and even in the case of extension, the special status would end by 2001. In the case of the European steel industry, the special resources available through ESZAK will no longer be there even for current EU member countries as the organisation is planned to be liquidated by 2002. ESZAK will have the task to support research programmes. Thus the Hungarian steel industry cannot hope for special benefits after accession, and the necessary development projects are suggested to be financed as parts of future regional programmes. As supplementary instrument, it may be possible to make use of the RESIDER II programme -- financed from Structural Funds -- aimed at the acceleration of economic restructuring in regions where earlier iron and steel industries dominated.

In the case of the energy industry, adaptation required by accession demands significant energy saving and environmental projects. Subsidised credit programmes and the availability of Phare resources are already typical in this area and for the above purposes it could be possible to obtain EU resources even in the pre-accession period. The costs of the establishment of new energy efficient -- co-generating -- block heating works (with the entrepreneurs of other sectors) as project to be subsidised can be built-in into the future national development plan, while the costs of reducing emission (of NO<sub>x</sub> but especially of SO<sub>2</sub>) is suggested to be covered by internal or co-financing of generating companies.

The current EU action programme in force up to 2000 for the textile industry makes the so called "multi-sectoral regional subsidies" possible for the sector; the key areas of programme

include subsidy to R+D<sup>3</sup>, training programmes and support to small enterprises. The action programme pays special attention, in the area of public procurement, to the improvement of the competitive position of small companies operating in the textile and clothing industries and to providing better access to market information channels. A programme of this type could be composed for the Hungarian textile industry also, especially when relying on the EU programmes supporting small businesses. The RETEX<sup>4</sup> programme and the SME initiative<sup>5</sup> financed from the Structural Funds specifically target the textile industry. If these programmes remain in force after accession, they will provide possibilities for financing targeted sector projects.

In relation to the modernisation of the vehicle industry (including the manufacture of vehicle parts), we have to make use of the possibilities offered by current EU regulations. Although the current guidelines remain in force only up to 2000, the Commission will take a new decision in three years' time on the possible extension of the term on the basis of the findings of the analysis of the current position of the sector, in harmony with the priorities of the new financing period. For the sector some subsidies can be made available (with proper reporting obligation) of which in some cases EU resources can also be obtained (investment subsidy linked to regional concept, subsidy to vocational training, to R+D, investment subsidy linked to environmental projects, etc.).

Relying on information on the sector, the working group has drafted also some sector-specific programme proposals which can fit into the industry development chapter of a future national development programme taking into consideration the development approaches of Target 1. region.

#### *4.13 Budgetary relations*

When analysing the budgetary links of industry -- that is, its taxation and subsidy systems --, we can conclude that we are close to the system established and approved in the EU, so we do not have to expect significant discrepancy and consequent drawbacks in general as a consequence of the accession.

The approximation of taxation systems is among the politically most sensitive issues. Currently, the taxation systems of the member countries differ significantly from each other in terms of types of taxes, tax basis and tax rates. The taxation discipline and the instruments of tax collection are also significantly different. In view of the fact that -- despite repeated initiatives -- the European Union could so far not fully approximate taxes (tax bases, rates and tax collection

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<sup>3</sup> R+D Framework Programme 4, individual sub-programmes such as "Total Quality Textiles", CRAFT, ESPRIT contain elements which specifically target the improvement of the competitiveness of the textile industry.

<sup>4</sup> to regions specifically depending on the textile and clothing industry to launch the economic restructuring procedure, reduce the unbalanced features of the economic structure

<sup>5</sup> Within the frameworks of this initiative, for Target 1. regions altogether 1 billion ECU can be available as subsidy for a six-year period for small businesses for innovation, inter-company co-operation, for improving quality control, etc., and 0.2 billion ECU is allocated to other regions.

systems), the issue does not yet form part of the “*acquis communautaire*”. In the area of direct taxes, the complete unification of the system is not on the agenda of the day, although full economic and financial integration will sooner or later make that happen too.

In its basic principles and construction, the Hungarian taxation system is in conformity with the system applied in the EU, but the rates are significantly different in some areas. That may need to be altered primarily because otherwise we would face a big competitive disadvantage (for instance due to the high VAT rates levied on Hungarian products). In relation to industry, a 5 percentage point reduction in the VAT rate (calculating with 1996 data) could mean some HUF15 billion drop in state revenue. The approximation of VAT rates would not create a significant burden for the system of public finances in the area of calculating and financing the price of medicine, as a result of inverse effects. Requirement for approximation is raised also in the areas of consumer and excise taxes and dividend tax. This latter item will considerably reduce budgetary revenues.

The current state subsidies can basically fit into the EU system; some 70% of them can be co-financed also from the aspects of EU funds (or can be transformed as such). In relation to the subsidies, we can expect benefits from accession to the extent we can join the established EU subsidy system and structural and cohesion objectives with proper, mature proposals, programmes. Success presumes that the presentation of subsidy requests is acceptable for the EU.

Following the accession, state finances will also be burdened by the contribution to be made to the EU budget. The ceiling of contribution currently cannot surpass 1.27% of the GNP (the limit is expected to be reduced to 1.1 per cent.) That can mean some HUF150 billion (calculated with foreseen domestic data around 2000). The ceiling of the subsidies we can obtain -- according to the concept -- is 4 per cent of the country's GDP. The expected volume will be around HUF500 billion at around the likely date of accession.

EU subsidies can be made available with domestic co-financing. We can calculate with 40% domestic participation on the average. Thus altogether we can expect net subsidy of maximum HUF350 billion (500-150), also depending on the acceptance of our request on refunds to reduce the moderation of our budgetary revenues. For that, however, we have to have appropriate programmes and the funds needed for co-financing.

In relation to industry, no major net change will occur for the Hungarian budget due to the modification of tax rates, but we can rather expect some revenue increase.

#### *4.14 The links of agriculture to industry*

The economic position of the country and its favourable natural resources would justify specialisation in agriculture, but this is unlikely to be in conformity with the long-term agricultural concept of the EU. The most important element of the Hungarian negotiation strategy is that it calculates with agricultural development, but it is aware of the fact that the development concepts will have to be executed in strong competition. The Ministry of Agriculture believes that the advantages of full membership are bigger than the relevant drawbacks.

As requested by the Ministry of Industry, Trade and Tourism, of the complex system of inter-relation between agriculture and industry, the working group has dealt with the production of agricultural chemicals, fertilisers and the production of agricultural machines.

In the EU countries, there are deliberate efforts to reduce the use of plant pesticides and insecticides. Therefore, they restrict agricultural production and support self-restrictions, introduce stricter environmental regulations and reform the biological basis of plant production (genetic modifications). Accession will affect the Hungarian pesticide and insecticide industry through changes in the external market opportunities and modification of the agricultural production options. The working group considered that, in the long run, in addition to other advantages in security and environmental protection, the EU accession will result in the reduction of agricultural production and the market of pesticides and insecticides.

No advantages should be expected from the EU accession for the Hungarian artificial fertiliser industry. Restriction of agriculture at the level of the Community may lead to reduction of use, environmental regulations are expected to become stricter and artificial fertiliser manufacturers are threatened with extra taxes. For environmental considerations, the chemical industry will not face an impossible task through accession if it is given adequate time to prepare and a period of grace to enforce the provisions contained in the EU directives.

The position and market relations of the significantly changed (decentralisation, reorganisation, privatisation) and streamlined agricultural, food and machine industry sectors have stabilised during recent years. Accession involved an increase in co-operation, supply and market relations for the machine industrial branches. Law approximation related to accession primarily relates to the labour safety, transport safety, ergonomic, hygienic and environmental requirements, assessment and certification of agricultural, forestry and food industrial machines. The majority of those are known by now and approximation has begun with the involvement of IKIM, KHVM and FM. The working group suggests that the two relevant machine industry branches should be considered as “sensitive sectors” pursuant to EU criteria and they should be subsidised in order to improve their competitiveness.

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