Overview

With a strong record of structural reform even pre-dating the regime change, Hungary is now among the region's most successful transition countries and a premier candidate for European Union (EU) accession. The country has successfully attracted substantial inflows of foreign direct investment (FDI), built up a robust private export sector, and achieved solid economic growth with low unemployment. In its drive to join the EU, Hungary has concentrated on completing the transformation agenda while establishing a sustainable, prudently-managed macroeconomic environment. The country has narrowed the gap with the rest of the EU, with continued advances expected.

Hungary began the transition with some significant advantages relative to most Central European economies, both in terms of living standards and a more pragmatic economic policy stance initiated during the communist period. Following the change of regime, the country quickly undertook structural reforms and stabilization measures. By the mid-1990s, however, macroeconomic performance deteriorated, with the reemergence of unsustainable twin current account and fiscal deficits. The country responded with a second round of deep and far-reaching reforms that included the enterprise, banking, and public sectors. Structural reforms were complemented with a strong fiscal stabilization package (1995-98) and the maintenance of sound macro policies. Robust economic performance followed, with real GDP growth averaging 4.4 percent over the 1997-2001 period.

Since 2000, economic policy priorities have shifted from structural reforms to rebalancing living standards and upgrading public infrastructure. Wages, pensions and public sector investment have been increased. Yet some structural reforms are still pending notably in health financing, and sub national finance and capacity building. In addition, there is a need to increase fiscal transparency and bring overall budget deficit levels back down to sustainable levels.

Focus of World Bank Assistance

World Bank assistance to Hungary, which joined the Bank in 1982, focused on building foundations for economic liberalization, expanding productive capacity (particularly in industry and agriculture) and modernizing infrastructure (transport, energy, and telecommunications). During the 1990s, the focus of the Bank’s program shifted to support for macroeconomic and structural adjustment, human resource development, and institution building.

Bank Support for EU accession was underpinned by the completion of a Bank Study “Hungary on the Road to the European Union” (November 1999). Advisory work in collaboration with the EC supported pre-accession institutional development in the energy sector. Work on social cohesion linked together the Government and many partners in civil society. A poverty assessment update pointed to the likelihood that a core group of long term poor might emerge in Hungary in spite of robust economic performance and EU accession, and analyzed policy options to address this issue.

At US$4,800 in 2001, Hungary’s per capita income is still somewhat below the graduation threshold at which discussions to initiate formal graduation would normally commence. However, in light of the progress Hungary has made in completing the transition agenda, and its favorable access to capital market finance, the authorities have informed the World Bank of Hungary’s intention to enter into pre-graduation arrangements with the Bank. They have further indicated that they do not foresee borrowing from the Bank during the pre-accession period. Bank analytical and advisory assistance to Hungary during this period will continue to be demand-driven and the graduation process will be based on the Bank’s framework for support to EU Accession candidate countries.

The Bank’s assistance program for FY03-05 will focus on a program of analytical and advisory activities (AAA) selected from the following priority areas:

Sub-national development. Prior to accession to the EU, Hungary’s sub-national system requires further strengthening and reform, in order to receive and administer EU structural funds. The assistance program would help support the establishment of regions as effective intermediate layers of governance, with an appropriate alignment of functions and financing competencies between the central and sub-national government levels, as well as improve local financing and management capacity and expand public-private...
Energy. The Bank is hoping to continue support to help Hungary complete the energy policy requirements of the *acquis communautaire*, in the context of key reform provisions of the Electricity and the new Natural Gas Acts which are expected to adopted in 2002.

Social exclusion and poverty. The program will help strengthen the Roma Secretariat established in the Prime Minister’s Office; develop financing mechanisms to ensure the sustainability of successful projects and pilots; and provide policy advice on specific sectors such as education and housing.

Health care financing. In response to the Government’s request, the Bank will provide support for the reform of health care financing to help ensure quality health services.

Environment. The ongoing Municipal Wastewater project is part of a Euro 100 million investment aimed at reducing the pollution load in the Danube River Basin, strengthening compliance with Hungarian and EU environmental standards, and improving wastewater operations in the water and wastewater utilities.

Knowledge Economy. Developing the knowledge economy; e-Europe, e-government, e-commerce, enhanced research and development, innovation and education – will be a focus of future Bank activity in selected accession countries, including Hungary.

Center of Excellence. As part of the overall framework for Bank support to EU accession countries, Hungary would be one of the regional centers of excellence with enhanced interaction with other countries in the sub-region, in particular in Southeastern Europe, iner alia to learn from Hungary’s successful transition and convergence experience.

Impact on the Ground

Regional centers for retraining adults established, vocational schools reformed, and a national student loan program developed. Human Resources Development operations covered a wide range of activities including (i) establishment of seven regional re-training centers for adults to provide support for a labor market based training system; (ii) reform of more than 100 vocational secondary schools by developing new curriculum, providing equipments and training for the teachers; (iii) development of the national student loan program.

The energy sector is being strengthened and liberalized. In the Energy Sector, Bank-financed projects have helped establish a technical basis for interconnections with the West European electricity system (UCTE) and improving the environmental performance of power plants. In close cooperation with the European Commission, Bank technical assistance has helped liberalize the energy sector, establish a regulatory framework consistent with EU energy acquis communautaire, develop a strategy for the liberalization of the Hungarian natural gas sector, and develop balancing market rules and ancillary services framework for the electricity sector.

The bus and tram system in Budapest reformed and upgraded. In the Transport Sector the Bank has supported reforms and the upgrading of transport infrastructure, most recently the bus and tram system in Budapest.

Sewerage and wastewater treatment systems being upgraded in two Hungarian cities. In Environment the Bank is helping the cities of Budapest and Dunaujvaros upgrade their sewerage and wastewater treatment systems.

Bank support is helping to improve understanding of issues affecting the Roma minority. Working with partners, the Bank is helping to improve understanding of the issues affecting the Roma minority living in Hungary and elsewhere. A Grant supports the Hungary-based Pakiv Foundation, a cross-country fund set up to provide income generating and employment activities for the Roma in Hungary, Romania, Bulgaria and Slovakia.

Two Hungarian cities join a network of reform-minded cities under the “Cities of Change” program. In partnership with the Bertelsmann Foundation, two Hungarian cities were incorporated in a network of reform-minded secondary cities in the ECA region to share best practices in managing the transition to greater self-financing and program effectiveness at the municipal level.

Challenges Ahead

- Reform of health care financing
- Fiscal decentralization
- Public administration reform
- Social exclusion to address the needs of Hungary’s long-term poor, in particular the Roma
- Transparency of fiscal accounts

World Bank Partners in Hungary

The World Bank’s overall key partner in Hungary is the Ministry of Finance. The Bank’s support to Hungary complements the activities of the European Commission, European Investment Bank and the European Bank for Reconstruction and Development.

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<tr>
<th>PROGRAM</th>
<th>LEAD NATIONAL AGENCY</th>
<th>PARTNERS</th>
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<tr>
<td>Sub-National Development Program</td>
<td>Prime Minister’s Office</td>
<td>Bertelsmann Foundation</td>
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<tr>
<td>Energy</td>
<td>Ministry of Interior</td>
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<tr>
<td>Social exclusion and poverty</td>
<td>Ministry of Economy and Transport</td>
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<td>Environment</td>
<td>Office of National and Ethnic Minorities</td>
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<td>Ministry of Health, Social and Family Affairs</td>
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<td>Ministry of Education</td>
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<td>Ministry of Environmental Protection and</td>
<td>Water Management</td>
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World Bank Lending to Hungary

Total IBRD Commitments from FY91 to FY02: US$ 1,991 million
(by fiscal year, in nearest US$ millions)

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<tbody>
<tr>
<td>Commitments</td>
<td>1,330</td>
<td>-</td>
<td>293</td>
<td>336</td>
<td>-</td>
<td>32</td>
<td>-</td>
<td>-</td>
<td>1,991</td>
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<tr>
<td>Disbursements</td>
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<td>141</td>
<td>71</td>
<td>459</td>
<td>50</td>
<td>49</td>
<td>22</td>
<td>6</td>
<td>2,207</td>
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</table>

Total Commitments by Sector* since 1991
(in nearest US$ millions)

- Finance 117m
- Energy & Mining 234m
- Transportation 119m
- Information & Communication 257m
- Education 305m
- Industry & Trade 398m
- Law & Public Administration 441m
- Water, Sanitation, Flood Protection 31m
- Health & Social Services 91m

* A new Bank sector and thematic coding system was introduced in FY02. Under this new system, themes represent the development objectives of the operation, whereas sector codes for investment operations reflect the parts of the economy receiving direct support, and for adjustment operations, the sectors being impacted by the operation’s conditionalities. Thus, a given adjustment operation may span a number of sectors depending on the reform measures being implemented by the loan and may, for example, show up in education, health, trade and industry or other categories, even though there may not be a direct investment in that sector.

Fiscal year from July 1-June 30.

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