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INTERIM EVALUATION
PROJECT ON
LEGAL AND REGULATORY REFORM IN HUNGARY

SPONSORED BY A GRANT TO THE
CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE
FROM THE
US AGENCY FOR INTERNATIONAL DEVELOPMENT

Prepared by
John D. Sullivan
Executive Director
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INTRODUCTION

With a grant of \$1 million from the US Agency for International Development, the Center for International Private Enterprise, an affiliate of the US Chamber of Commerce, is carrying out a program of legal and regulatory reform in Hungary aimed at improving the business system. The project is a coordinated effort of six Hungarian public policy institutions, an Hungarian advisory board, and a CIPE coordinating office in Hungary. The project began in October 1992 with an office established in Hungary in December.

The following report is the second interim evaluation of the project. The report covers the progress in implementing the results of the first project; the reaction to the National Conference on Policy Reform held in September 1994; overall progress to date; and, follow-up activities that are still to be done to carry out the essential advocacy efforts. The report is based on a trip to Budapest the week of September 11 and evaluation forms filled out during the conference. Additional evaluations are being sought from the members of CIPE's Hungarian Advisory Board.

Goals and Objectives

The project's overall goal is to identify the principal policies impeding the growth of the private sector and recommend reforms that will improve the prospects of private business and lead to economic growth. Specifically, the following objectives were identified for the project:

- * To frame the economic debate in Hungary by developing and advancing a consolidated reform program based on sound research on the principal economic policy requirements of the country.
- * To accelerate the pace and focus the direction of economic policy reform through a coordinated advocacy effort by Hungarian organizations.
- * To improve the skills and ability of Hungarian private independent business and public policy groups to advocate legal and regulatory reforms. And to foster greater cooperation among these groups.

The project was designed to bring together a group of public policy research institutes with a cross section of the private business community to generate specific policy recommendations and press for their adoption. At its inception the project was conceived in three phases:

- 1) Development of in-depth research and advocacy programs to be conducted by Hungarian public policy institutes and associations of the private sector.
- 2) Research on those policy areas and advocacy of specific reforms, both carried out under grants from CIPE.
- 3) Consolidation of the research findings and reform recommendations into a **final project report** and presentation at a National Conference prior to the Hungarian elections in 1994. (Note: this report was issued as *Crossed Paths: Straightening the Road to Private Sector Growth*.)

The overall design of the project and the development of a proposal to USAID was based on CIPE's involvement in Hungary since 1989 in working with both emerging business associations and the public policy institutes as well as the US Chamber's twenty some years of involvement in the Hungarian economy. In 1991, CIPE staff held brainstorming sessions in Budapest, Warsaw, and Prague with representatives of the private sector and with academic experts. Based on these discussions and on the preliminary work conducted in phase one above, a set of issue areas was identified for the Hungary legal and regulatory reform program that included the following:

- Private enterprise financing
- Privatization strategies
- The informal sector
- Tax policy
- Regulatory impediments in the real estate market
- Private sector development and local government

CIPE staff worked with a variety of public policy institutes and private sector groups to design potential research and advocacy projects to address these issues. Over the course of the first several months of the project, specific programs of work and research designs were developed and the resulting projects (selected on a competitive basis) were presented to the CIPE Board of Directors for approval. The result was a series of grants and contracts with the following Hungarian organizations:

- Financial Research Ltd.
- Foundation for a Market Economy
- Institute of World Economics/Blue Ribbon Commission Foundation
- Kopint Datorg
- Public Policy Institute
- Budapest University of Economic Sciences

It should be noted that the original list included the National Association of Craftsmen's Federations (IPOSZ) as part of the tax policy study. However, they were dropped from the program as a result of internal management controls at CIPE which found that they were not in compliance with the terms and conditions of the grant agreements. (This has been fully reported on in prior quarterly reports to USAID and especially to the Hungary mission.)

The second element of the design was a Hungarian Advisory Board that would provide overall guidance for the program and ensure that the results were accepted within Hungary as a genuinely Hungarian effort at economic reform. The members of the Advisory Board included:

- Attila Chikan, University of Economic Sciences (Budapest)
- Anna Halusyik, Baker & McKenzie
- Michael Haraszti, Hungarian Franchise Association
- Arpad Kezdi, The Center for Private Enterprise Development
- Ivan Lipovecz, HVG Magazine
- Ivan Major, Blue Ribbon Commission
- Gyorgy Suranyi, Central European International Bank
- Gabor Szeles, National Federation of Industrialists (GYOSZ)
- Gyorgy Szucs, National Federation of Craftsmen's Associations (IPOSZ)
- Gyorgy Varga, Figyelo Magazine
- Tibor Vidos, GJW Politconsult
- Peter Zwack, Zwack Unicum

The third element of the project was to create a Budapest office of CIPE with a mixture of US and Hungarian staff to provide overall project management and, specifically, to ensure that the various sub-grantees worked together. The office was established in 1992 under the direction of Eric Johnson, a US citizen resident in Budapest whose background included a legal degree, private business exposure, and governmental service. In addition, three Hungarian employees were brought on to provide logistic and research support for the project.

Originally, the project was designed to be brought to a head in early 1994, prior to the Hungarian elections. Hopefully, a conference held in early spring could help set the stage by encouraging frank and open discussion on economic and business issues. However, political development in Hungary evolved in such a way as to cause CIPE and its partners to rethink that approach.

As anticipated, the Hungarian Democratic Forum (HDF) called for elections in the spring of 1994. The political atmosphere was charged with the prospects of a major shift in the political winds -- public opinion cast the HDF as the cause of the country's economic woes and the Hunarian Socialist Party as saviors. The major factor that affected CIPE's decision making was the increasing note of nationalism that appeared in Hungary centering around a division with the ruling Hungarian Democratic Forum. Certain political figures began to openly advocate much more intense opposition to the influence of foreign and specifically American figures in the country. Ultimately, this led to the formation of a break-away faction called the Hungarian Way party. In early 1994, it was felt that the nationalist element made it doubly inadvisable to sponsor a conference with US backing.

In this atmosphere of forthcoming seachange and rising nationalism, CIPE staff held consultations with the Hungarian Advisory Board and with USAID's Mission to Hungary. The consensus was that it would be very inadvisable to hold the national conference prior to the elections as the target policy maker audience would soon be changing radically and that CIPE, and inferentially USAID, might be seen as meddling in internal political affairs. Primarily, however, the concern was that the message of Legal and Regulatory Reform in Hungary project would be drowned out by the attendant clamor surrounding the impending general elections.

Hence, the conference was rescheduled for September 1994 to coincide with the end of the summer holiday season and the beginning of the Parliamentary session. Fortunately, the nationalism of the Hungarian Way proved not to appeal to the vast majority of Hungarian voters as the party failed to gather the 4 percent required to be seated as an independent parliamentary faction.

BACKGROUND

To allow for a better sense of the project's progress, it's useful to pause briefly to consider the context within which the project was conducted, namely the status of the Hungarian transition to a democratic market economy. There are both pluses and minuses to the Hungarian experience.

On the plus side, a second freely contested democratic election was held earlier this year with a peaceful transition to a new government. Further, although Hungary has experienced a very significant degree of output contraction and economic decline, there are signs that a private sector based economy is emerging and that essential institutions of a market system are being put into place. For example, formal incorporated private firms have increased from around 10,000 to over 200,000 and the total number of firms, sole proprietorships, and individual entrepreneurs have increased from 200,000 to 700,000 since the late 1980s. In addition, contract, bankruptcy, and accounting laws and regulations have been passed (regulations and enforcement lag) and business registration has been liberalized.

On the minus side, it's clear that Hungary has lost its position as reform leader to Poland and the Czech Republic. Recent economic statistics confirm that export earnings have declined, inflation may be on a significant upsurge, and there is a basic fiscal imbalance. Privatization has not proceeded in the industrial sector although the majority of small firms are private, especially in the retail and service sectors. Finally, although Hungary has attracted a significant amount of foreign investment, the inflow of funds appears to be slowing down due to recovery in Western Europe and, more importantly, the emergence of other attractive emerging markets as investment opportunities. Seen against the background of an extraordinarily high level of foreign debt, it seems that the new government may be facing a very difficult position.

One of the major criticisms of the outgoing Hungarian Democratic Forum government was that they were very late in laying out a strategy for macroeconomic stabilization and, even when they did, the commitment to implementation seemed to be weak. Further, the outgoing government's privatization strategy was based on the concept of strengthening the state firms and putting them up for sale on a case-by-case basis as had been done in Western Europe. There was a voucher scheme put in place based on vouchers being issued to those who could claim restitution for past expropriations of property. The very complicated and unclear system led to a lack of progress on the voucher front. The relative lack of savings and capital inside the country when combined with the complicated voucher system and bureaucratic tangles meant that only a relatively small number of the best firms were actually sold and these were mainly sold to foreign investors as buy-outs or joint ventures. To the government's credit, they did liberalize the international trade regime, open up competition, ease foreign investment rules, and begin to create market institutions.

Within the context of the CIPE project, it was very important to gauge the public's sense of and commitment to economic reform and market development. A public opinion poll was commissioned by CIPE and released in 1993. Essentially, the survey confirmed that Hungarians are supportive of a democratic system but have mixed views of a market economy. For example, while 68 percent of the public favored the idea that wages should be determined by the market, only 36 percent agreed that this should be allowed to result in large differences in income levels. Similarly, only 49 percent agreed that unsuitable people should lose their jobs and only 50 percent felt that large corporations should be able to own private properties. On the plus side, however, some two thirds of the public thought that not enough support is given to establishing private enterprises and there is a widespread perception that the tax system is unfair and restricts growth.

From the perspective of the private sector, there has been progress over the last four years but a significant number of bureaucratic hurdles, legal, and other barriers exist which impede business formation and economic growth. These barriers have been documented in the project's publication, *Crossed Paths: Straightening the Road to Private Sector Growth*. As described in the report, CIPE's public opinion poll also included a parallel poll of entrepreneurs. The entrepreneurs' attitudes are very revealing. For example, the survey found that 37 percent fully agreed and an additional 35 percent slightly agreed with the statement that "the majority of entrepreneurs avoid tax laws." Another question pointed to the underlying reason: 49 percent fully agreed and 34 percent slightly agreed with the statement that "the tax system forces entrepreneurs to play about with the law." Even more significant was the fact that 64 percent fully agreed with the statement that "regulations change so frequently that they are almost impossible to follow." The net result of these factors is the expansion of the informal sector as documented in the report. In this connection, the extent and growth rate of informal enterprise should be seen as a strong indicator of the consequences of the lack of progress in structural adjustment and institutional reform.

The combination of the record on economic reform and the attitudes revealed in the survey present a very mixed picture. Hungary might be characterized as a country that would like to enjoy the fruits of reform, especially if it resulted in a German or Swedish style social market system. However, many voters and political representatives are ambivalent about or opposed to actually making some of the tougher choices and paying the price of transition. There are strong voices urging faster and deeper reforms while others are still looking for a gentler, gradual transition over a longer period of time.

The results of the May 29 election reflected the complexity of the Hungarian scene. The new government, headed by the Hungarian Socialist Party (HSP), has committed market-oriented reformers in responsible positions such as the new Finance Minister, Laszlo Bekesi. Conversely, some of the statements made by the new Prime Minister, Gyula Horn, and the Speaker of the Parliament, Zoltan Gal (Socialist party) would seem to be resiting reform or at least seeking to slow down the reform movement. The Alliance of Free Democrats who are formally part of the government coalition tend to be very committed to reform and somewhat critical of their coalition partners from the market-oriented side. However, the Hungarian Socialist Party's trade union allies (MSZOSZ) pull in the direction of more subsidies and a softening of reform. Since a number of MSZOSZ representatives were elected on the Socialist party label under the terms of an electoral pact, this poses a delicate balancing act for Horn and his team.

In addition to the above survey of the political and economic context, it's important to recognize that the very concept of advocacy is new to the Hungarian context. In this sense, both the public policy institutes that participated in the program as well as the business associations and others on the advisory board were breaking new ground. As will be described below, not all of the organizations were comfortable with this new role while others needed additional training and exposure to advocacy techniques. Indeed, it should also be recalled that many of these organizations are less than three or four years old while others are striving to change course from government run groups to organizations in the private sector.

Finally, it is also important to keep in mind that the communist regimes left a legacy of deep suspicion and mistrust. Although traditions of voluntary organization and cooperation with like minded groups didn't completely die out in Hungary and some of the other formerly communist nations, the legacy of bitterness and mistrust made it difficult for groups to work together across organizational and sectoral lines.

As will be noted below, one of the challenges of the CIPE program was to forge an alliance of like minded organizations and individuals able to effectively work toward the common goal of legal and regulatory reform. Although the CIPE project was by no means the only program with this goal, it was one of the earliest and most visible efforts to re-introduce basic approaches that are part of the day to day practice of democracy.

INTERIM EVALUATION: NOVEMBER, 1993

As is common practice at CIPE, an interim evaluation was conducted mid-way through the program. Given the scale of the project, this particular evaluation was conducted by the Deputy Director for Evaluation and Administration, Steve Rogers. The interim evaluation was very timely and pointed up a number of areas where significant improvements could be made. A summary follows:

1. **Business Associations:** Once IPOSZ was dropped this left a void in participation by business groups. It was recommended that more representation be built into the Advisory Board structure.

As noted above, this was followed.

2. **Policy Recommendations:** The preliminary review found that the grantees tended to lack a sense that their work should result in specific action oriented policy recommendations. It was recommended that steps be taken to focus their work.

John Williamson from the Institute for International Economics agreed to go to Budapest to meet with the grantees and give them an overview of policy relevant research. This was done and offered them a good solid role model that reinforced CIPE's message.

The Hungary office followed up with each group and held brainstorming sessions to focus the projects on policy relevancy.

The result was over 40 specific policy recommendations each of which can be put into effect.

3. **Advisory Board role:** A series of recommendations were made to more closely integrate the Advisory Board into the project including individual consultations, more orientation, and frequent communication. In addition, it was recommended that more foreign experts be brought into to work on advocacy and related topics.

The Hungary Office adopted a policy of individual and frequent consultations with the Advisory Board especially on major issues such as the timing of the National Conference, the speakers, and participants in the program. Advisory Board input was also instrumental in shaping the final report, the policy recommendations, and the media output.

At best estimate, it is felt that between half and two thirds of the Advisory Board members were fully integrated into the project on an ongoing basis with the remainder playing a more honorary role. In retrospect, it would have been better to involve them earlier in the choices of policy areas and in the selection of grantees as well as the program design. However, the timing of the grant as well as the urgency to begin the program made this impractical. In subsequent phases of the program, this relationship can be enhanced.

Overall, the strength and direct participation of the Hungarian Advisory Board was absolutely essential to the success of the project. The fact that CIPE was able to bring these diverse people together was, in itself, a major accomplishment of the project.

4. **Advocacy:** A number of recommendations were made to enhance the advocacy element of the program including having joint events organized by CIPE and requiring grantees to submit advocacy plans.

One organization, Foundation for a Market Economy, actually followed this recommendation. Another, the Public Policy Institute also published their results and held a conference on local government which, while unplanned, made a positive contribution to their work.

The majority of the grantees didn't actively follow up with advocacy programs, nor do they seem to be willing to at this point. This will be addressed further below.

5. **Media:** An integral part of advocacy is media relations and the interim evaluation recommended that CIPE strengthen its ability to relate to the Hungarian media as a communications and educational opportunity. This was done by bringing into the staff a very talented public affairs specialist, Zsuzsanna Lipovecz, and by working closely with the media representatives on the CIPE Board.

The results of action on this recommendation can be seen in the attached set of press excerpts, not one of which was critical of CIPE playing the role of catalyst in discussing Hungarian economic policy reforms. Not only was the advisory board portrayed in the best light as the guiding force for the project, but the grantees view and the speakers views were accurately conveyed through the media coverage.

6. **Final Report:** Another series of recommendations concerned the need for a high quality final report that clearly lays out the main findings of the individual research projects but also provides a consistent format geared to the needs of the various target audiences.

The Hungary office recruited an experienced Hungarian economic journalist, Gyorgyi Kocsis, to guide the final preparation of the materials and to write the overall summary document. This proved to be perhaps the best single decision made during the program. The resulting product has gained uniform respect and acceptance and is clearly and simply written with discrete policy recommendations contained throughout.

Another recommendation concerned seeking outlets for the report prior to the National Conference. In this respect, the Hungary Office was successful in having the report presented at a meeting held by the Hungarian Academy of Science prior to the elections at which the economic platforms of the various political parties was presented and discussed. CIPE's document was the only such report.

7. **Management:** The evaluation also recommended the development of a thorough program of work showing how the project would lead up to and accomplish the conference with special attention to logistics and speakers.

The Hungary Office director prepared and executed the program of work with the result that the conference was held on time, within budget, and resulted in a successful high level conference. (See the section below on evaluation of the conference.)

8. **Evaluation:** The interim evaluation also laid out a series of indicators for evaluating the overall project. These were:

1. Press and media coverage
2. Expressions of interest through requests for information.
3. Direct citing of the project in political or legislative debates.
4. The level and extent of participation in the conference and other project activities.
5. And, ultimately, the enacting of any recommendations of the project.

The remainder of this report addresses the items listed above with the partial exception of number 5 since it is rather premature to reach a final conclusion on legislative action.

CROSSED PATHS: STRAIGHTENING THE ROAD TO PRIVATE SECTOR GROWTH

Each of the grantees was responsible for producing final reports that would be compiled into a conference publication. The material received, however, varied considerably in terms of quality and timeliness. The decision, referenced above, to retain an experienced Hungarian economic journalist, Georgyi Kocsis, to compile a magazine length publication suitable for public policy decision makers, journalists, and business people proved to be a critical decision. The resulting study which was released in May 1994 was of uniformly high quality and received very sound reviews by the CIPE Advisory Body.

Over two thousand copies of the report were released in Hungarian and English throughout the summer and into the fall. Copies were also circulated during the conference.

The overall collection of papers from the conference will be published later this year in Hungarian. An attempt was made to simultaneously translate these papers into English. However, the result was not acceptable. At this time, it is intended to simply publish the Hungarian version only. A book launch and series of marketing efforts will be made at that time.

As noted, a collateral publication was issued by the Public Policy Institute and a companion conference was held at Eger earlier this year.

Interestingly, two of *Crossed Paths* most important recommendations have been reflected in the new economic plan put forth by the new Minister of Finance, Laszlo Bekesi. One concerned a significant reduction in the tax rate on corporate profits from the current rate of 36 percent to the 25 - 30 percent range. The other proposed eliminating the minimum turnover tax entirely.

Crossed Paths and the various studies and projects undertaken by the Hungarian organizations generated a significant amount of media coverage throughout the spring and summer. An annotated bibliography is contained in the attachments of the pre-conference media coverage for review.

NATIONAL CONFERENCE ON POLICY REFORM IN A TRANSITIONAL ECONOMY

By all accounts the national conference can be considered a major success. The first major success was that Dr. Marton Tardos, Chairman of the Economic Committee of the Hungarian Parliament, co-sponsored the conference and acted as Honorary Conference Chairman. This guaranteed that the program was received in the parliament and among academic circles as a significant event given his history as a reformer and his pivotal role in the legislative and political process. On the CIPE side, Mr. Charles T. Manatt represented the CIPE Board and the US. This was also well received given Mr. Manatt's status as a former chairman of the Democratic National Committee.

The speakers at the program were also significant decision makers in their respective fields. Among those speaking were the following:

- * Dr. Marton Tardos, Chairman, Parliamentary Economic Committee
- * Laszlo Akar, State Secretary, Ministry of Finance
- * Dr. Andras Gyarmati, Deputy State Secretary, Ministry of Industry and Trade
- * Miklos Pulai, President, Hungarian Bankers' Association
- * Ferenc Rolek, Vice President, GE-Tungsram, Member of Hungarian Chamber of Commerce

Each of the panels was similarly represented by recognized leaders in their fields.

The audience for the opening session entitled "Policy Makers on Policy Reform" was the most well attended with nearly 350 participants present. This opening session was seen as the key event of the conference since it was the part of the program where discussions were held on the overall economic reform program. During the opening session there were 12 members of parliament present representing several of the political parties in Hungary as well as representatives of the leading firms, academic groups, media, and labor. Several of the participants including Tibor Vidos (Advisory Board member) commented that the mix of participants and panels was very unusual in Hungary since these groups often don't meet with each other.

The media present both to cover the program and to participate in the media panel represented a cross section of all of the leading papers. The attachment on media coverage provides an in depth summary of the print and electronic media coverage. Several of the articles, especially the one in *Nepszabadsag* of September 16, present a very in depth look at the conference and the policy recommendations contained in *Crossed Paths*.

As with any program, there were some lessons to be learned and several aspects of the conference that could have been improved. For example, in retrospect it would probably have been better to focus more attention on a few of the most important policy recommendations through a formal presentation of the study during the opening session. Although many of the points did come out during the speeches and particularly in the presentations by Ferenc Rolek and Marton Tardos, the study itself probably should have been highlighted. Frankly, there was too much left to the Advisory Board members and moderators. In several instances they didn't fulfill the requests made to them to bring up the specific policy recommendations.

A second point was made by Marton Tardos directly to John Sullivan when he said that he would have preferred to have at least a few speakers present who were acknowledged international experts. The point was that by bringing in some international experience (not just US but with an emphasis on US experts), it would have added an additional dimension by placing Hungary in a comparative perspective. In this respect, CIPE may have erred by going too far to ensure that the program was seen as an Hungarian event. Although the emphasis on Hungarian voices and experts was welcome, in retrospect it didn't have to be at the exclusion of any international participation.

A minority view was expressed by several of the American firms present at the conference. At least two or three individuals expressed the opinion that the Hungarian business representatives were not natural leaders and lacked clout. They also felt that the political personalities were not of the first rank and only spoke in broad generalities. When pressed on who they felt would have made a better choice, they were largely silent except for the universal feeling that the Minister of Finance would have made a better choice than the Secretary of State in the Finance Ministry (actually Bekesi was invited but couldn't attend due to pressing state business). Others, however, felt that Laszlo Akar as Secretary of State was a good choice. He is an eminently qualified expert on economic and political affairs, representing that important liaison point in the policy process where research and statistics from below are translated and transmitted as policy statements for the government. Hence, although he was a second choice, the consensus is that he was not second best. Further, Minister Bekesi had already participated in several CIPE and other business events including a policy address to the Advisory Board and a major speech at the American Chamber of Commerce.

In reflecting on these comments and in asking others to comment on these opinions, it seems that the root of the issue lies in comparing the conference and the proceedings to similar

programs that might be organized in Western Europe or the US. However, seen in the context of a comparison to the Hungarian reality (see background section above) and the fact that this was really one of the first attempts at this type of program, it seems more natural to see it as a success from a Hungarian perspective.

It is for this reason that the evaluation forms completed by the Hungarian participants should be given considerable weight. The forty responses gathered by the CIPE staff represents a fair sampling of the participants.¹ As can be seen from the chart, the conference format and approach seems to have met its objective in the Hungarian context.

HUNGARIAN GRANTEE PERFORMANCE

Overall, the level of compliance by the Hungarian grantees with the terms and conditions of the CIPE program ranges from good to excellent. The one exception to this pattern is in the area of advocacy and formulating specific policy recommendations. As noted in several places above, none of the Hungarian participants, with the partial exception of the Foundation for a Market Economy, really had much advocacy experience. A number of the Advisory Board members, including Georgy Varga of Figyelo magazine, Tibor Vidos of GJW Politconsult, and Ivan Lipovecz of HVG magazine, are very well acquainted with the arena of public policy debates, media, and communications. However, the only research group with a similar background is the Foundation for a Market Economy and that was through a prior CIPE project.

Lessons Learned

In looking at the experience of the Legal and Regulatory Program over the last 18 months, four key factors can be identified. Each of these represents an area where training, management and technical assistance, and exposure to other countries could make a major difference in performance. In this regard, it should be added that on each of the dimensions, Hungary compares favorably with other Central and Eastern European countries but lags the growing experience of Latin America and parts of Asia. These observations are based on lessons learned through the 25 projects supported in Central and Eastern Europe since 1989, including the Hungary projects.

- 1) *Identity and Purpose* - Many of the research institutes lack a clear sense of direction, mission, and affiliation. Often the solution to the problem is as simple as the crafting of an effective, realistic mission statement for the institute that can be used to give the organization a sense of identity and purpose from which to base activities and plan for the future.
- 2) *Research, Analysis and Policy Formulation* - While most of the research institutes have well-developed research capabilities, few have the ability to effectively analyze the results of the research. Fewer still are accomplished in policy formulation. The ability to effectively analyze data and formulate policy are essential components of a marketing strategy.
- 3) *Education, Dissemination and Advocacy* - An additional component of a successful marketing strategy is the effective distribution and promotion of the end product of

¹. Completing evaluation forms is also not a custom in Hungary. However, we were fortunate in gathering 40 completed evaluations.

research, analysis and policy formulation. Through education, dissemination and advocacy, research institutes attain the ability to effect change on a governmental level, which contributes not only directly to accomplishing short-term regulatory and statutory change, but enhances the reputation of the institutes while helping to further define the mission statement and direction.

- 4) *Management and Organizational Structure* - There exists a need among many research institutes for a consistent management and organizational structure that will promote increased productivity, more effective focus on current policy issues, and improved marketing capabilities. In this respect, human resource development and an enhanced blend of communications and research skills would increase output. Also, a clearer sense of organizational structure would help staff become oriented to the concept of team work as opposed to each staff member being thought of as an independent academic specialist.

CIPE staff have begun to design programs that will address the organizational development issue including approaching several donors for funds to conduct training programs for public policy institutes.

At the same time, it has to be acknowledged that the business associations are even further behind in development than the majority of the public policy institutes. The Hungarian Chamber did enjoy some advantages in terms of identity and mission but that has been put into flux as a result of the new chamber law.

In order to address this issue, CIPE held a strategy session and follow-up meetings this summer in Warsaw and Budapest. Seventeen national chambers were gathered in Warsaw in late June to discuss the transition issues and their own missions. Given the nature of CIPE's overall work in Hungary under USAID sponsorship, follow-up meetings were held in Budapest as well. The result of these meetings and analysis is that a renewed effort must be made with the business association structures to foster the development of a viable constituency supportive of market oriented economic reform and private enterprise development through business advocacy. The first step in this process has been to work with the Foundation for a Market Economy to develop an in-depth study of the Hungarian business association structure with special emphasis on the development of the new Hungarian Chamber law. This project is set to begin as soon as it's approved by the CIPE Board which should be by mid-November. In addition, CIPE is planning to conduct a business association management program early next year following along the same line as programs held by the US Chamber and CIPE in the US, Latin America, and Russia.

FOLLOW-UP

The original intent of the Legal and Regulatory Reform program was that the Hungarian organizations would press for the adoption of the 40 plus economic reform proposals advanced in the *Crossed Paths* report. However, during the conference it became clear that the public policy institutes either lacked the sense of mission (identity) as advocacy groups or the experience to carry out effective programs. Hence, CIPE staff have designed a number of mini-projects in consultation with the Hungarian Advisory Board, USAID, and the grantee institutions. It should be noted that the range of participation in the follow-up projects will go from acting as an expert analyst/speaker to that of full partner in some of the activities. The most complete role will be that of the Foundation for a Market Economy which, as noted above, will be undertaking a program designed specifically to address the role of business associations.

The six-part activity plan for follow-up to the Legal and Regulatory Reform Project is being proposed as part of a Public Education Program (PEP) for Hungary, to be facilitated by the CIPE-Budapest office and the USAID Hungary mission, and drawing on many of the components that have proven successful in past year project activity. As part of the PEP, the following activities are proposed:

- 1) **Hungarian Economic Policy Roundtable** - CIPE proposes to continue in the same spirit of the Hungarian Advisory Board by bringing together top policy, research, business and media experts every two months to discuss the recommendations in *Crossed Paths* and its companion publication due to be released in the Fall of 1994. The roundtable will use the Hungarian legislative calendar as a guide to putting the six categories of policy recommendations forth for public discussion. A prominent Hungarian business publication such as *HVG* will co-sponsor the roundtables, which will add immediate press coverage of the discussion to the advocacy effort.
- 2) **Executive Branch Briefings** - As a companion effort to the roundtables, CIPE will organize issue briefings bringing CIPE sub-grantees and roundtable members together to meet with members of the executive branch responsible for policy, to discuss the recommendations in an informal setting.
- 3) **Book Launch** - The full research reports and data from the six CIPE sub-grantees, as well as a conference report, is currently being compiled and bound together in one comprehensive volume. This book will serve as a detailed primer for policy research and recommendation writing, and will be launched at a series of public events both in Budapest and in regional centers throughout Hungary.
- 4) **Worldnet Conference** - CIPE proposes to work jointly with its Board of Directors and the United States Information Agency (USIA) to discuss and disseminate the recommendations contained in *Crossed Paths* using the extensive network of teleconference downlink sites throughout the world that comprise USIA's Worldnet. The Worldnet conferences will also enable policy makers in other countries to derive value from CIPE and USAID activities in Hungary, as well as to assist in the promotion of the book publication launching.
- 5) **Communications Training** - For over ten years, CIPE has been at the forefront of legislative advocacy activity throughout the world, both through the work of skilled sub-grantees, and through adaptation of the US Chamber of Commerce's successful Institute for Organization Management Training Program. CIPE proposes to hold three one-day seminars in Hungary designed to help impart the institutional knowledge that it has gained to research institutes that need an institutionalized advocacy component in order to be effective policy makers. Experts will be drawn both from the US and from the Central and Eastern European region, and will focus on advocacy, communication skills, and strategic planning.
- 6) **Chamber Development/Advocacy Training** - CIPE additionally proposes to work closely with Hungarian business associations, both in the public and private sector, to help them to develop and strengthen grassroots advocacy campaigns that will assist them in influencing the policy debate in Hungary. These activities will benefit from CIPE experience in grassroots development projects throughout the world over the past ten years.

CONCLUSION

At this stage, CIPE and the Hungarian project participants can be pleased by the progress the project has made in identifying and coalescing a certain amount of support around the central policy reforms identified in *Crossed Paths*. This is no small accomplishment given (a) the lack of progress made to date in Hungary on many key fronts, (b) the legacy of the communist era, and (c) the need to develop new skills in policy formulation and advocacy. The widespread media acceptance combined with the participation of key Hungarian leaders on the Advisory Board and at the September conference are all key indicators of the level of success to date in identifying and gaining acceptance for specific policy reforms to strengthen the business system.

Conversely, it is also clear that CIPE cannot simply turn the project over to the Hungarian organizations or to the Parliament. While CIPE alone could not and should not become an advocate by itself within Hungary, CIPE will have to continue playing the role of catalyst while simultaneously seeking to build advocacy skills in the emerging public policy institutes and business associations. It is for this reason that the fourth phase of the project has been advanced above under the heading follow-up. During this phase a great deal more attention will have to be paid to skills training in the areas of advocacy, education, and communication.

The findings in this report along with the advocacy action plan laid out herein will be discussed in November with the Hungarian Advisory Board members. Additionally, the Budapest office will be asking the Advisory Board members to give us their evaluation of the overall progress of the project. These findings will be forwarded to USAID when available.

As David Cowles, the USAID Country Representative to Hungary, said in his address to the National Conference,

"It has often been said that there is no road map for countries trying to make the leap from a centrally planned economy to a market economy. But it is equally true that there is no road map for donors who would like to support the process. ..."

Both CIPE and its Hungarian partners have gained a great deal in learning about both parts of David Cowles remark through the progress of this project to date.

ATTACHMENTS

- I. **Economic Reform Today - *Number Two 1994***
- II **Mid Course Evaluation: Legal and Regulatory Reform in Hungary**
- III. **Media Coverage of *Crossed Paths* (pre-conference)**
- IV. **National Conference on Policy Reform in a Transitional Economy Program**
- V. **National Conference on Policy Reform in a Transitional Economy Participant List**
- VI. **Selected Presentations: National Conference on Policy Reform in a Transitional Economy**
 - **Dr. Marton Tardos, Chairman Economic Committee**
 - **Mr. Ferenc Rolek, GE-Tungsram & Hungarian Chamber of Commerce**
 - **Mr. David Cowles, USAID Representative to Hungary**
- VII. **Participant Evaluation of the National Conference on Policy Reform in a Transitional Economy**
- VIII. **Memorandum on Press Coverage of CIPE's National Conference on Policy Reform in a Transitional Economy**

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Democracy in Hungary: Maintaining the Pace of Reform

by the Center for International Private Enterprise

● Hungarians find themselves at an economic and political crossroads. While their new government faces many conflicting demands, policymakers realize that voters will ultimately judge them on one issue: improvements in the post-socialist economy. Economic developments will also influence the Hungarians' attitude toward democracy itself, for their new won freedom came long after economic reform began. The continuation of democracy in Hungary depends in no small part on the policies resulting from the debate between the government and opposition and on the new administration's policies. Moreover, the importance of the outcome extends beyond Hungary's borders, for reformers in other emerging market democracies look to it as a model.

To retain its status as a model reformer and consolidate its new democracy, Hungary must promptly allow entrepreneurs to contribute their ideas to plans for promoting economic growth. If their ideas are accepted, more jobs will probably be created, strengthening public support for the current democratic system over extremists' illusory alternatives. Hungarian consumers will also have more faith in democracy when more goods and services are available for purchase with their hard-earned money. This faith will become even stronger once Hungarian society grows accustomed to associating choices and competition with positive economic results.

However, much depends on dismantling barriers to private sector activity. The

This article is based on CIPE's report Crossed Paths: Straightening the Road to Private Sector Growth (Spring 1994; see page 23 for details.)



An entrepreneur is setting the course.

Photo Jacques Langevin/Sygnis

Legal and Regulatory Reform in Hungary Project, launched by the Center for International Private Enterprise (CIPE) with funding from the US Agency for International Development, was started last year to help Hungarian leaders and voters alike identify the kinds of needed economic and structural reform (see box on page 23). Through published research,

speaker tours and a conference last fall, the project's participants point out how lasting and balanced economic growth occurs only when capable people take the initiative and use their expertise in fair competition.

The project's recommendations are contained in its far-reaching report, *Crossed Paths: Straightening the Road to Private*

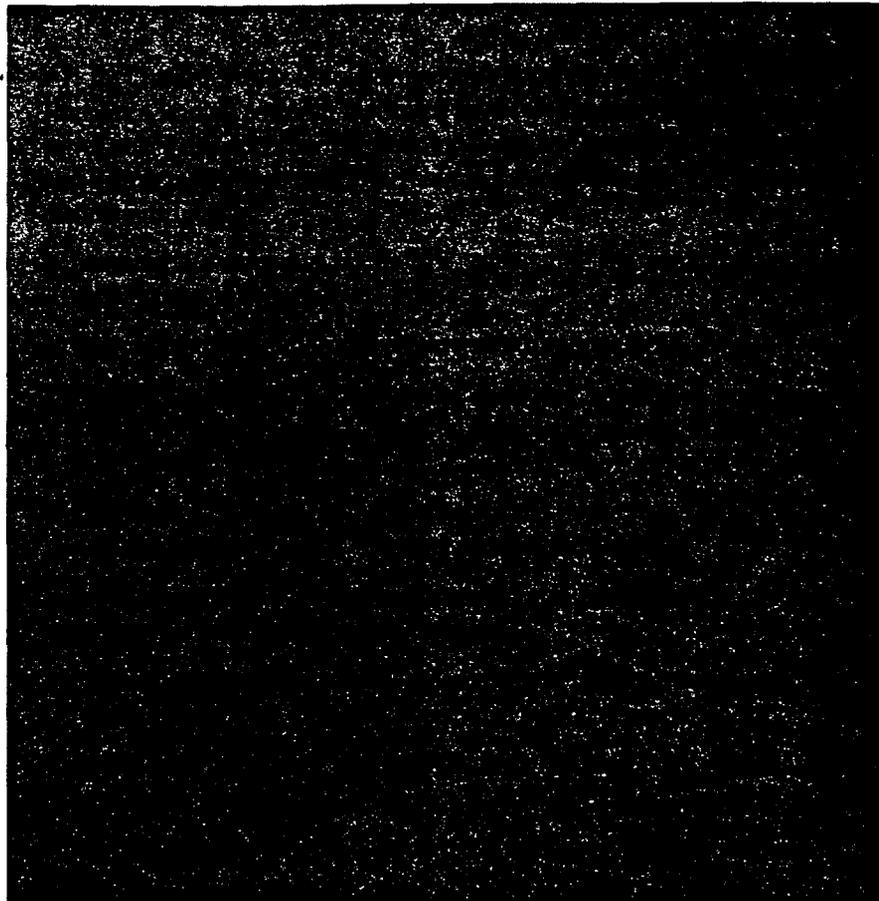
Sector Growth. Issued this year, the study can be a useful guide for reformers elsewhere. (See inside front cover for instructions on how to obtain free copies.)

Project participants analyze in the report how a competitive market can be created. Essential building-blocks are clear title to capital and land assets, coupled with sufficient financing to spark and sustain private initiative. Most important, project participants have made clear that individuals must have sufficient tangible incentives, such as lower taxes, before they try to realize their productive potential. The need to communicate these realities to Hungarian voters became evident from general public opinion polls conducted simultaneously with other project research. These polls reveal declining faith in a multi-party political system and an open economic market. In light of this decline, the project's published work analyzes key economic policy areas, substantiates those analyses with surveys of Hungarian entrepreneurs, and makes recommendations, which are outlined in this article.

Great Expectations

In contrast to the widespread confidence felt in 1990, most Hungarians' expectations have not been met. Two out of three respondents surveyed in tandem with the project expressed dissatisfaction with both the pace and nature of economic reforms implemented to date. Only 33% favor a completely free market economy, compared with 43% just three years ago. Almost every other person polled prefers a mixed socialist-market economy. Although most Hungarians welcome private-sector take-over of many government-owned and public services, they clearly oppose extensive private-sector ownership in the financial industry, including banks and insurance firms. Of all the social groups polled, only entrepreneurs want less regulation; but even they would limit how much property foreigners can buy—as do many other countries the world over.

Although their numbers have decreased slightly, over two-thirds (70%) still favor a multi-party democracy (as evident in the



recent hotly-contested election) as well as many market-oriented policies. Most Hungarians, like their counterparts in East Germany, Poland and Russia, to name but a few, still believe the private sector offers better career opportunities. Moreover, as in 1991, every sixth person polled has serious plans to launch a business despite the many constraints.

There's still a long way to go. Some two-thirds of the general public believe the government hasn't given sufficient support to new ventures. The widespread perception is that the tax and financial systems are inequitable and restrict growth. The government needs to change this perception in order for free enterprise to take hold in Hungary. To this end, the CIPE/AID project has analyzed key areas where policy-makers should now orient their reform, and the direction these might take.

Privatization Alternatives

Although Hungary has moved quickly on

privatization, the results have been mixed to date. The self-privatization method, in which the existing managers were permitted to develop and carry out the process free of state intervention, has worked in most cases. Those enterprises are doing well and have become more efficient. However, Hungary's mass privatization schemes have not worked. Far and away the single largest obstacle has been the absence of a clearly-defined management cadre in these ventures. This is an important finding for other countries wishing to go the mass privatization route. In trying to make all citizens corporate shareholders, all too often privatized companies end up leaderless—and unprofitable.

The Hungarian experience provides other helpful pointers. First, *Crossed Paths* participants found that while the "for sale" sign is on, state firms frequently flounder because of the general atmosphere of uncertain ownership. In such situations, some firms might want to ensure they have

Recommendations to Increase Competitiveness and Capital Availability

Employ qualified on-site managers to develop and implement sound business strategic plans when they identify and take action on the following leading indicators:

1. Improve financial and operating performance of existing companies.

2. Attract foreign investment.

3. Increase productivity of existing companies.

4. Increase the number of new companies.

5. Increase the number of new investments.

6. Increase the number of new jobs.

all the personnel they might need. Second, the Hungarian government allowed many bankrupt companies to continue operating, thereby increasing its deficit. As *Crossed Paths* states, "fast and decisive liquidation is the most practical way to effect the withdrawal of non-competitive companies from the market." Debtors and creditors alike still don't have a stable set of bankruptcy rules on which to base decisions. As the Hungarians bluntly put it in *Crossed Paths*, "Debt consolidation schemes have a chance for success only if [the] banks and companies whose debts have been written off are privatized quickly."

Further, the Hungarian experience shows it's far from easy to make capitalists overnight. While many persons chose to take an equity stake in small state enterprises, these assets were probably overvalued. The government's slow privatization policies and vague approach to new enterprises do not measure up to the country's policymakers' fundamental goal: allowing the Hungarian economy to operate competitively.

Finally, the government continues to crowd out the already thin stock market.

The government has sought financing by flooding the market with bonds, drawing investors away from private company stocks. Tax breaks for government securities purchasers has exacerbated this problem. As a result, private corporate shares and other investments amount to only 10% of the Budapest Stock Exchange's daily turnover. The situation will persist as long as state finances remain in the red.

Inflationary Voucher Scheme

Inflation also has been produced by the vouchers the government gave out to spur privatization. Only one-sixth of voucher holders chose to purchase state-owned assets. Most bought land and homes, rather than corporate stocks, or sold them for cash, creating a serious inflationary effect.

A lack of developed institutions and infrastructure contributes to Hungary's stagnant market development in many ways. Business people are hampered by administrative barriers to property purchases, as well as illegal and semi-legal market activities. There are few accessible telephones (just one part of the poor communication system), inefficient banking

operations, and, perhaps most important, almost no information on markets, prices and other factors essential to successful decisionmaking.

Administrative and infrastructure barriers are only some of the obstacles to be overcome. Entrepreneurs appear unwilling to expand activities in the near future. Those with more resources feel wary of risk at present, while younger, aspiring business people need time to gain the necessary skills and knowledge. Solutions to these long-term problems will not come for some time either in Hungary or other emerging markets.

Heavy Tax Burdens

As *Crossed Paths* notes, notwithstanding many years of reform efforts, "slightly more than 60% of the total income was centralized and re-allocated through the budget." This disproportionate level of state economic involvement seems unlikely to diminish, as tax hikes have exceeded tax breaks. In addition, lower GDP growth, coupled with rising tax evasion, has caused a widening government deficit.

Although the government has reduced corporate taxes from 40 to 36%, this year it instituted a minimum tax. All enterprises must pay it regardless of their earnings. The enterprise startup allowance also was eliminated. Businesses are not alone in bearing higher taxes. While average personal income doubled between 1988 and 1992, personal income taxes almost trebled during the same time period. Hence, although the Hungarian government continues to privatize the economy, higher taxes on both investors and consumers are delaying the growth of the private sector.

The social security contribution has inhibited development the most, as it jumped from 25% to 44% over the past ten years. Entrepreneurs also must now provide sick pay for the first ten days of an employee's illness. As a result of steep social security costs, half of the entrepreneurs surveyed employ fewer people than they need. Others legally report lower wages or simply hire workers from the so-called informal sector. Social security con-



tributions are likely to be a prime cause of the fact that almost half of the 700,000 Hungarians registered as officially unemployed work in the informal sector.

The value added tax (VAT) is another new burden discouraging private sector activity. (It rose from 23.7% of all 1990 tax revenue to 29% in 1993.) Although it is relatively easy to collect, businesses must record the VAT at each phase of production and the administrative rules change often. Many entrepreneurs have had to hire special employees or outside experts to comply. In addition, those businesses that face high VATs, such as exporters and importers, suffer when their customers fail to reimburse them promptly for VAT payments. These costs have driven some entrepreneurs to sell without receipts, fueling the informal market and thus delaying the growth of free, legal enterprises.

To foster legitimization, the government has sought to cushion the short-term impact of its market reforms by maintaining high spending levels and raising taxes. But this is a no-win strategy. As the survey of business people indicates, as long as entrepreneurs remain pessimistic about the economy, private investment—and initiative—will remain on the down side.

Access to Financing

Business owners surveyed cite lack of

available capital and credit as a major stumbling block. Over 80% are not satisfied with the loans available for new enterprises. (Only 18% report launching their enterprises with an "official" loan.) Thus adequate financial resources rank high among the preconditions for a sustained economic recovery.

Hungarian banks don't attempt to fulfill small and medium-sized companies' credit needs. While part of the problem stems from banks' lack of viable risk management

strategies, bankers also see a major deterrent in current lending regulations. Mortgage foreclosure and registration take years, and a mortgage holder may have to initiate foreclosure before the registration procedure concludes.

As a result, banks have adopted stringent lending practices, such as charging exorbitant interest rates or requiring collateral of 150 to 200% of the requested loan amount. A lack of information contributes further to the loan market's stagnation. For example, the Banking Act's "banking secrets" provision prohibits lenders from sharing data on borrowers, while entrepreneurs can't obtain sufficient information about loan programs. Small and medium-sized businesses in particular have little chance of contributing to economic growth unless these and other related credit barriers are eliminated.

The lack of capital and credit has also hindered the agricultural sector's development. One problem is the absence of a uniform system of mortgage bonds or registration; another is the lack of modern land valuation standards. Moreover, the compensation approach to land privatization resulted in the breakup of large state and collective farms into small plots, many still fallow although now owned privately.



Hungarian private investment is picking up.

Photo: HVG Budapest

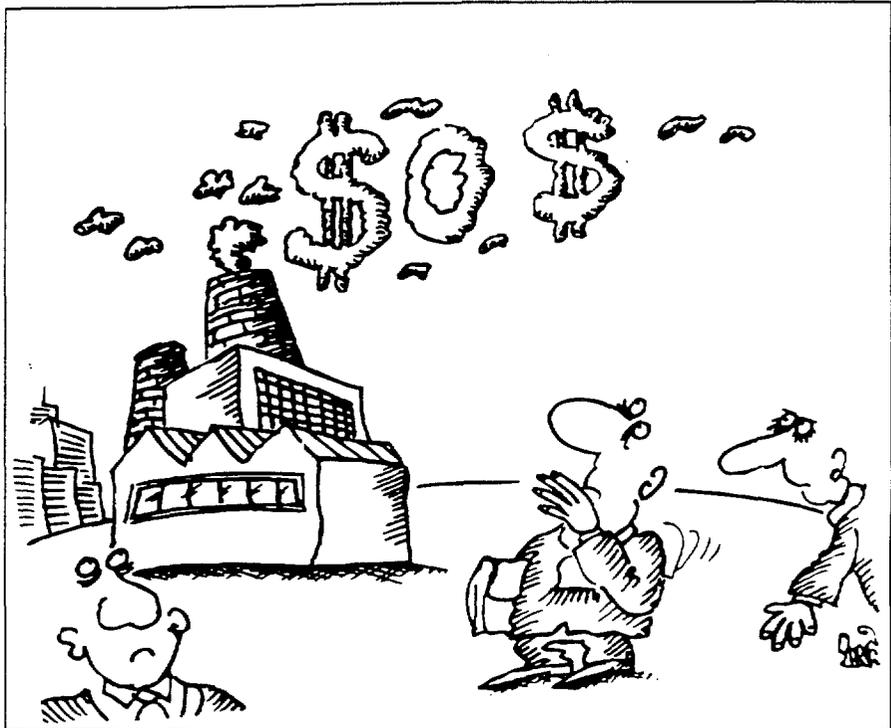
Unless they increase access to capital, Hungarian policymakers will have difficulty convincing many Hungarians that private business is a feasible option.

Unsuccessful Privatization Burns National Resources

What Drives the Informal Sector

Hungarians need more evidence that it is feasible to conduct business within the law, especially after decades of socialist rule forced business-minded individuals underground. Although socialist prohibitions no longer exist, corruption, inflation and cumbersome regulations support the misconception that the path to success lies outside the law. Consequently, informal-sector activity accounted for 25 to 30% of Hungary's GDP at the start of the 1990s, and has been rising since then, according to local experts. Much of this activity results from legally-established firms' unrecorded transactions, which in turn deprive the government of tax revenue needed to underwrite essential services if it is to avoid raising taxes further.

cont on page 32



From Hungarian Economy, Budapest

A Vehicle toward Better Reform Decisions: The Legal and Regulatory Reform in Hungary Project

The report *Crossed Paths: Straightening the Road to Private Sector Growth* represents the first phase of CIPE's project, Legal and Regulatory Reform in Hungary. CIPE wishes to thank the US Agency for International Development for its generous and timely financial support of this pacesetter program. The project is designed to restore momentum to Hungary's economic reform, and thereby help consolidate its democracy.

This effort began in March 1993, when CIPE arranged meetings of prominent Hungarian business, academic, legal and media professionals, many of whom now comprise the Project's Advisory Board. Speakers included Attila Chikán, economic advisor to the Alliance of Young Democrats; László Békési, MP, Hungarian Socialist Party; Mihály Kupa, independent MP; Márton Tardos, MP, Alliance of Free Democrats; and Iván Szabó, Finance Minister, Hungarian Democratic Forum. These meetings determined which economic policy issues merited research the most, and designated the following organi-

zations as the most qualified to conduct and analyze the research in specific areas:

- > financial sector - Financial Research, Ltd.;
- > informal sector - The Foundation for Market Economy;
- > privatization process - The Institute for World Economics/ Blue Ribbon Commission Foundation;
- > tax system - The Kopint-Datorg Foundation for Economic Research;
- > real estate market - The Budapest University of Economic Sciences;
- > private sector development and local government - The Public Policy Institute;
- > opinion polls of the general public and the business community - Medián Opinion & Market Research, Ltd.

Copies of the report can be ordered from either CIPE's headquarters (see inside front cover) or from its office in Budapest (Eötvös u. 44, 1/Foldszint, Budapest, Hungary, 1067; telephone (36-1) 269-5654, attention Zsuzsa Lipovecz).

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Cuba (cont from page 18)

racy. Members of the Yeltsin government, as well as Russian entrepreneurs, have retained fraternal sympathies for Cuba and hope to facilitate a peaceful transition to democracy and a market economy. In January 1994 Moscow and Havana concluded a new sugar-for-oil barter agreement (although much less favorable than previous ones).

This followed on the heels of a Russian-Cuban investment protection protocol, and the Yeltsin government's pledge of a US\$350 million credit to complete power generation and mining projects begun under the Gorbachev administration.

Despite the Castro government's vociferous condemnation of international financial institutions, last year it quietly invited a two-man team from the International Monetary Fund (IMF) to Havana to survey the economy and brief senior officials on the transition experiences of Eastern Europe. A summary of the IMF mission report warned the Cubans that "time is running out" and urged rapid and sweeping reforms. It stated that the Cuban government has decided that maintaining its inefficient, centrally-planned economy "would inevitably rupture the social fabric," with all the remaining accomplishments of Cuba's political and social model disappearing in the wreckage.

What the Future Holds

Fidel Castro and other aged revolutionaries are understandably reluctant to open the floodgates of change, which will either sweep them into retirement or subject them to a less benign fate. The Cuban people, meanwhile, are desperate for an improvement in their economic circumstances but are also apprehensive about some of the reforms the government has adopted. According to recent news accounts, the economy is showing some signs of stabilizing as the reform measures take hold. On the other hand, a growing gap has emerged between the small percentage of Cubans with access to dollars (obtained through tourism, joint ventures,

or foreign sources) and those without it. The rise of a new privileged class has caused popular resentment and could fan the flames of political discontent should this group continue to grow.

Members of the exile community have predicted that Cuba's economic crisis will result in an Armageddon for the Castro regime. However, a violent revolution is not a high probability, as the Cuban government recognizes that structural change is vital to its own survival.

While the government reportedly is divided on the pace and scope of economic changes, younger reformers like Roberto Robaina and Carlos Lage will probably prevail. Despite Fidel Castro's outdated communist rhetoric (which many believe to be largely the posturing of a shrewd politician), he quietly supports Robaina and his colleagues.

Castro's popularity among Cubans is now largely abstract, based on nostalgia rather than a belief he can fulfill all the long-awaited promises made 35 years ago. In what may be his tacit recognition of impending change, Castro has admitted he is "tired," the Cuban government is opening to new, younger leaders, and he would happily leave power "as soon as the people or the Communist Party asked him to." (*Paris Match*, November 16, 1993.)

CSAB (cont from page 13)

contributions to the Center. Moreover, the choice of research topics and researchers is made by the Center's senior management, without the participation of any donors. The only outside evaluation of Center manuscripts is the well known method of "peer review" by scholars at various research and academic institutions, including, of course, Washington University. CSAB also maintains a vigorous informal interchange with many other market-oriented research institutes. The exchange of publications and ideas, and also of scholars, helps achieve important savings just when private resources for policy analysis are limited.

Hungary (cont from page 23)

Even setting up a legally-constituted enterprise can be a daunting endeavor. A prospective business owner must visit five to seven different offices and institutions, and pay thousands of forints in administrative fees and related costs. Further attempts to use police powers against the black market are likely to fail. If policy-makers hope to convince the public that business success is not linked to law-breaking, they will have to alleviate costly startup requirements, and the regulatory and fiscal environment will have to become more hospitable to business.

Reinforcing Legitimacy

Reducing the informal sector's appeal, lowering taxes, and increasing capital availability can reinforce the popular legitimacy not only of the free-market model, but also of democracy. Both systems depend on free and fair competition. While the Hungarian people have demonstrated a strong commitment to market-oriented reform, project research indicates their faith has been shaken by many of the challenges inherent to market liberalization. Like others elsewhere, their leaders are struggling with daunting issues. Key ones include how to reconcile prudent monetary and fiscal management with needed social services; how to shrink the state's economic stake without increasing already bloated unemployment rolls.

Crossed Paths' contributors and sponsors have sought to promote such competition by suggesting needed fundamental economic reforms, which may in turn inspire Hungarians to make the most of their democracy. Economic and political successes there will serve as an example for other emerging market democracies.

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**MID COURSE EVALUATION
LEGAL AND REGULATORY REFORM IN
HUNGARY**

November 9, 1993

Prepared by
Steven B. Rogers
Deputy Director
Evaluation & Administration
CIPE

INTRODUCTION

With a grant of \$1 million from the U.S. Agency for International Development, The Center for International Private Enterprise has initiated a major program of legal and regulatory reform in Hungary. The project is a highly coordinated effort of six Hungarian public policy institutions, a high level advisory board and a CIPE program office in Hungary. The goal is to identify the principal policies impeding the growth of the private sector and recommend reforms that will improve the prospects of private business and lead to economic growth.

The project consists of three phases:

- 1) Identification of local organizations who would participate and the major economic policy areas in need of reform.
- 2) Research on those policy areas and advocacy of specific policy reforms, both carried out by local organizations under contract with CIPE. and
- 3) Consolidation of the research findings and reform recommendations into a final project report and presentation at a National Conference prior to Hungarian elections in 1994.

This mid course evaluation is conducted during the second part of phase 2. At this point the participating organizations should be nearing completion of the research and beginning to form advocacy strategies to promote their findings and recommendations. As a formative evaluation this is the ideal point at which to take stock of the project's accomplishments and consider all adjustments and planning necessary to ensure accomplishment of the project objectives.

The evaluation was carried out in Hungary during the week of September 27 - October 1, 1993. The findings are based on attendance at workshops on project research results to date and an advocacy strategy session that involved representatives of all participating organizations and the Advisory Board. Also, separate interviews were conducted with members of the Advisory Board, staff of the participating organizations, members of the media, and CIPE staff in Hungary.

The following report is divided into four sections. Each section includes specific recommendations to ensure successful completion. The sections are:

- I. Progress to Date - Research
- II. Future Activities - Advocacy & Consolidation
- III. Project Management
- IV. Conclusions

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I. PROGRESS TO DATE: Research

1. Project Objective

A review of the approved grant proposal and the subsequent project plans reveals that a single, concise, written objective was never included. There does appear to be general agreement on the purpose of the project between the staff in Washington and Budapest, USAID, the Advisory Board, and for the most part the participants. Nevertheless, a written objective statement is necessary to keep the project focussed and as a basis for evaluation, among other purposes.

Recommendations

- The following recommended objective statement is drawn from the original project documents, particularly the statement of anticipated results.

To frame the economic debate in Hungary by developing and advancing a consolidated reform program based on sound research on the principal economic policy requirements of the country.

To accelerate the pace and focus the direction of economic policy reform through a coordinated advocacy effort by Hungarian organizations.

To improve the skills and ability of Hungarian private independent business and public policy groups to advocate legal and regulatory reforms. Foster greater cooperation among these groups.

2. Identification of Issues

The first step of the project was to identify the legal and regulatory areas that are impeding private business development in Hungary and in need of reform. The issues selected for analysis and advocacy are as follows:

Regulatory Impediments in the Real Estate Market
 Private Sector Development and Local Government
 Private Enterprise Financing
 Privatization Strategies
 The Informal Sector
 Tax policy

These issues not only reflect the priority policy concerns of a group of private sector research groups, but are linked directly to the predominate campaign issue of the upcoming Hungarian elections.

Identification of these issues was predicated on CIPE's involvement in Hungarian projects since 1989 and continuous monitoring of conditions in the country. CIPE organized a roundtable discussion with private business leaders in Hungary in 1991 out of which came a preliminary list of legal and regulatory barriers to private

sector development. In the year immediately preceding the inception of this project two field studies added to CIPE's analysis of Hungary's economic status. Final selection of issues was made in conjunction with the selected grantees. Now, as the research phase begins to show results, all of the Hungarians interviewed in the course of this evaluation agreed that the topics are right on target. An additional paper is being written on the Hungarian Commercial Code by Anna Halustyik, a member of the Advisory Board.

Attention in Hungary is beginning to focus on next May's elections. The major election issue at this point is the economy. After leading the region in economic reforms in the late 1980s the reform process has stalled. The economy is performing poorly, unemployment is on the rise and, as a opinion poll conducted as part of this project shows, public support for a market based economy appears to be eroding. The extent to which the voters maintain faith in market economic solutions will have a marked effect on the outcome of the election. Many in the country believe that an Hungarian version of the recent Polish elections is a plausible outcome.

In the course of the evaluation interviews, there was unanimous agreement that the overriding concern for those seeking office is how to develop the preconditions for economic growth in Hungary. Additionally, there was consensus regarding the most important specific topics within that issue. Heading the list are privatization and banking, two subjects that are specifically subjects of this project. Other topics, agriculture, unemployment, and the national budget, are elements of several of the project studies.

Recommendations

- The May elections firmly places the project within a highly publicized debate and not simply an insulated academic or public policy exercise. As it addresses the critical campaign issue right down to the level of specific topics, the CIPE project is well positioned to attract the attention of the media and opinion leaders and play an important role in framing the economic debate.

Every effort should be made to make the most of that position. The project should be promoted and described in terms that clearly place it at the heart of the debate. This could be done even with something as simple as using a title such as "Preconditions for Economic Growth in Hungary" for the National Conference and final report. This or a similar title may communicate a stronger relevancy to Hungarians than "Legal and Regulatory Reform," which could be used in a subtitle.

3. Identification of Grantees

The organizations selected to carry out the project are:

Financial Research Ltd.
 Foundation for Market Economy
 Institute of World Economics/Blue Ribbon Commission Foundation
 Kopint Datorg
 Public Policy Institute
 Budapest University of Economic Sciences

These organizations represent the most significant private sector economic research group. This is the opinion of the members of the advisory committee members who were interviewed. In terms of economic public policy research all agreed that there was no other group in this league or higher that was omitted. However, the fact that no business associations representing private entrepreneurs are participating directly as grantees is a shortcoming.

Identification of the Grantees followed a course similar to the identification of issues -- through CIPE's three year involvement in Hungarian projects. At the outset CIPE laid out criteria for selecting grantees. Business entrepreneur groups must be independent and their members primarily private firms and public policy groups also must be privately supported.

Two business associations were identified as potential participants, but ultimately were not included. The first is the National Association of Entrepreneurs (VOSZ). VOSZ had been the first organization in Hungary supported by CIPE. It had long been the major representative of the private sector. However, VOSZ's management of their most recent grant had been unacceptable. They had incurred unauthorized costs and had failed to meet reporting requirements. Furthermore, the management of VOSZ recently changed and conditions at the organization are tenuous. Therefore VOSZ was not chosen as a participant. However, VOSZ is represented on the Advisory Board and is committed to the project and advocacy of the results.

CIPE has monitored the status of The National Association of Craftsmen's Federations (IPOSZ) for several years. They were initially identified as the group to undertake the project on tax policies. Their broad membership provided access to information on obstacles to small business posed by tax policies. However, CIPE was aware of the organization's limitations and worked with them to design a project in which the actual research was subcontracted. Furthermore, in awarding the contract CIPE built in strict control over the procurement process.

Those management controls worked to alert CIPE staff to the fact that IPOSZ was not fulfilling its commitment to the procurement process. Investigation into the matter by IPOSZ led to the revelation of internal management problems and IPOSZ's withdrawal from the contract. The President of IPOSZ remains on the Advisory Board and continues to be committed to the overall project, including the advocacy component.

Even without direct business association participation the list of grantees is very impressive. Furthermore, the project is strengthened by its collaborative nature. According to several Advisory Board Members and grantees there have been very few collaborative efforts like this and none involving so many organizations. They went on to observe how beneficial this collaboration had been already and the likelihood that some level of collaboration would continue beyond this project.

Recommendation

With its agenda of research and advocacy on behalf of the private sector this project has great potential for initiating a meeting of the minds of researchers and private business. Without the direct participation of a business association, however, special efforts must be made to ensure that this potential is achieved. Although the Advisory Board includes several representatives of private business and business

associations, other methods of drawing the private sector into the project need to be explored.

In the course of the evaluation several recommendations were made by staff and participants to further direct business involvement. They include

- Identify several businessmen in addition to the Advisory Board to review and comment on the research and final report while in draft.
- Develop a presentation of research results to take on site to business association meetings in Budapest and other cities throughout the country. This should be done between the release of the final report and the National conference. Time must be scheduled in the presentation for discussion and response from the business members.

4. Grantee Research

Most grantees' projects began in April, 1993. Kopint Datorg and the Institute for World Economies were delayed and did not begin until September. On September 30, 1993 a day long workshop followed by an Advisory Board Meeting provided the first opportunity for combined presentation and discussion of the preliminary results. The workshop also provided an opportunity to assess the progress to date.

Each grantee distributed written executive summaries and took approximately an hour to present their work and respond to questions. The following briefly summarizes the reports.

Financial Research Ltd. is examining private sector financing with a focus on financing small and medium sized businesses. Their research is not complete so they presented a thesis for discussion. They propose the following series of recommendations:

- Enact policies to increase capital accumulation of small and medium enterprises -- including tax incentives, anti-inflation measures, promotion of certain sectors, invest in infrastructure.
- Redesign financial institutions - including creation of local bank regulations to eliminate obstacles to obtaining credit, venture capital regulations.
- Improve state managed infrastructure - clarify role and function of the Hungarian Enterprise Development Foundation, depoliticize all parts.

Institute of World Economics/Blue Ribbon Commission is researching privatization strategies, specifically Small privatization schemes - examining the governments plan for distributing ownership to private citizens in a voucher type program as a way to create demand for the property. Plan to describe Small Investors Privatization Program (SIPP), the pros and cons, and outline other possible techniques. No specific plans for reform recommendations were mentioned.

Foundation for Market Economy has completed a very thorough study of the informal sector, its size and causes. The executive summary does not included very

concrete reform recommendations other than noting that informal activity is reduced when participation in the policy making process occurs.

Kopint Datorg, despite having just begun in September, has prepared a very thorough description of the Hungarian tax structure that assesses the fall in the tax base, tax avoidance, and concealed income. Although preliminary they are looking particularly at recommendations to reduce corporate tax rate, benefits and incentives for investment, paperwork simplification, social security reform, and removal of tax-type payments to state financial funds.

Public Policy Institute is critiquing the role of local government in promoting private enterprise. PPI is focussing on two regions and has collected data from municipal authorities and the business community. In early September they held a conference in Eger on the role of local government in privatization strategies.

Budapest University of Economics' original work plan calls for studies of five topics regarding regulatory impediments in real estate. They have now discussed the with staff and are expected to formally request a reduction in topics. Research so far is focussed on land mortgage credit system and agricultural investment. The summary is sketchy and does not conclude with specific recommendations.

Recommendations

- **More specific reform recommendations** - Although these are preliminary results, as a group they are long on description and short on recommendations. More recommendations may develop as the research is completed. However, to be certain that the grantees are working towards concrete policy reform recommendations, this requirement should be reinforced with them. This could be done in connection with communicating the requirements for the final project report -- as recommended below. This is particularly important in light of the tight timing of the balance of the project.
- **Timing** - Because of the crucial timing of the project any delays in the individual projects could turn into a major set back. It seems that several of the projects should be further along in the research at this point. To avoid future delays and ensure that the final research paper are adequate for timely incorporation into the final project report, a series of deadlines for draft submissions should be set at this point. The "Deliverables" section of the contracts does not address submission of draft research papers. This was an oversight that should be specifically corrected.

5. Advisory Board

The project design calls for an advisory board to include the leading figures in business and public policy. Attaining a high caliber board is essential in order to gain access to policy makers and the press, which is one of the major purposes of the Board. The other is to provide sound, informed review and recommendations on the research findings, the shape and direction of the final report and plans for the final conference.

CIPE has been successful in meeting the target of a high caliber board. Leaders of business, business associations, media, and research are all represented on the Board. The board consists of:

Attila Chikán - University of Economic Sciences
 Anna Halustyik - Baker and McKenzie
 Michael Haraszi - Hungarian Franchise Association
 Arpád Kézdi - The Center for Private Enterprise Development
 Iván Lipovecz - HVG Magazine
 Iván Major - Blue Ribbon Commission
 György Surányi - Central-European International Bank
 Gábor Széles - National Federation of Industrialists
 Péter Szirmai - National Association of Entrepreneurs
 György Szücs - National Federation of Craftsmen's Associations
 György Varga - FIGYEL Magazine
 Tibor Vidos - GJW Politconsult
 Péter Zwack - Zwack Unicum Plc

The Board's attendance at the monthly meetings reflects a reasonably good level of participation. Staff reports that roughly half the members regularly attend meetings. Although it would be desirable to have better attendance, as in any board there is a balance between a sufficiently high level of members with very busy schedules and attendance at the meetings.

Thus far the Board meetings have featured talks by the economic spokesmen for the major political parties and reports from grantees on the research. These have been productive in a several ways in addition to informing and involving the board.

- ▶ The participation of the political parties has informed and engaged them in the project at an early point, thus helping ensure access to the parties once the results of the project research is available.
- ▶ The meetings have been covered in the newsletter, thus informing a broader audience of the parties' economic agenda, the relevance of the project to the political agenda and CIPE's nonpartisan approach.
- ▶ For the project grantees this first hand message of the parties' economic agendas should help shape future advocacy efforts, although this may have to be specifically drawn out in the advocacy phase.

The Board meetings have not, however, involved foreign experts as originally planned. The project proposal called for, "talks by foreign experts in the areas of tax policy, labor law, credit reform, business formation and registration, property rights and other area."

The Board members interviewed in the course of this evaluation showed very strong commitment and support of the program. However, several also expressed some uncertainty as to CIPE's expectations regarding their full role. One Board member expressed his uncertainty in the context of regret at not having the opportunity to be involved in selecting the projects at the inception. Clarification of the role of the Board will be useful in dealing with the press. A reporter noted that when the project becomes fully publicized this will be a frequent question. There is also a desire for more opportunities to discuss the project individually with project staff, as opposed to always as a group.

Recommendations

- Begin bringing foreign experts to address the board as envisioned in the original project design. At this point perhaps the most important topic is advocacy. Now that the project is moving into the advocacy phase, and given the relative lack of experience by the grantees, a series of speakers on advocacy techniques, possibly followed by individual consultations, would be very advantageous.
- Step up the process of soliciting recommendations and feedback from the Board members, particularly on the best approach to the written final report. The CIPE Director in Hungary already has plans for a questionnaire.
- Initiate a series of individual meetings between project staff and Board meetings. This will help solidify their participation and result in more candid and thorough input.
- Although this may have been done at the outset, CIPE staff should discuss with the Board their expected role. There may have been some misconceptions at the beginning that can be clarified now that the project is at mid course. This is especially important given that the most intensive participation of the Board is expected in the second half. Preparation of a written statement on the role of the Board may be useful to simplify future responses to the press.



II. FUTURE ACTIVITIES: Advocacy & Consolidation

The project design implies essentially a two tiered advocacy structure. First, the grantees will carry out advocacy on the specific subject and findings of their projects. Second, consolidated advocacy for the full legal and regulatory reform agenda will be carried out in association with the final report and national conference. The anticipated results of the project's advocacy efforts are both improved regulations and a new ability and commitment of the grantees to carrying out future advocacy on their own.

1. Individual & Collaborative Advocacy

A meeting attended by representatives from all the grantees was held on October 1, 1993. The purpose was initiate the advocacy portion of the project by briefing the grantees on advocacy by sharing ideas and techniques. Some tough obstacles to effective advocacy are immediately evident from the grantees' comments and discussion at the meeting. The obstacles derive from ingrained attitudes toward advocacy and an almost total lack of experience with advocacy or the sense of democratic participation in decision making.

A couple of grantees began the meeting by staking a claim for pure scientific research and neutrality as the appropriate position for their organizations. This underscores how tenuous the idea of advocacy is in Hungary. The separation between economists and decision makers has been traditionally blurred. Economic research has a been carried out in connection with and in support of policy makers. Therefore the idea of independent research representing a private sector point of view vying for influence with a policy maker is relatively unknown.

The argument for neutrality was dismantled in discussion by other grantees citing the range of value choices inherent in simply selecting a topic and approach. For example researching obstacles to privatization assumes that privatization is a desirable pursuit.

The conclusion was reached in the discussion that it is appropriate and even a responsibility for a research organization in a democracy to actively promote their point of view and findings. However, there was not resounding, unanimous agreement. In the end a certain ambivalence toward advocacy remained in several of the grantees.

Part of the explanation of this ambivalence may stem from the fact that these are exclusively researchers. As researchers they may not feel the impact of economic policy with the immediacy of a business person trying to operate in Hungary. Stronger participation of business people would have injected a greater urgency into the discussions and plans for advocacy.

The question of who is ultimately responsible for advocacy of the overall consolidated results of the research has been alluded to but thus far not addressed directly. CIPE, as the connecting point of the project, is the obvious choice for this responsibility. However, for CIPE to actively take part in an advocacy program redefines CIPE's traditional role of supporter rather than actor. CIPE must define its role before advocacy functions begin falling on CIPE by default.

Finally, on a more technical project design issue all of the grants, save one, end on December 31, 1993. That will mean that all CIPE sponsored advocacy will end then. Since most final research findings will not be published until close to that date, advocacy based on the final research will be minimal.

Recommendations

- Develop a specific advocacy plan for the consolidated project results. This will entail defining CIPE's role in the effort. As a first consideration perhaps CIPE's appropriate role is to organize a series of activities for the grantees as a group. Such activities could include joint press conference, briefings for the political parties and government officials. CIPE's function would then be

coordinator rather than direct advocate. The plan should include a role for the advisory board.

- Seriously consider extending all grant periods through the dates of the National Conference. This will allow continued CIPE support of advocacy, coordination of efforts, monitoring and evaluation of results, and participation in the conference.
- Require any grantees who haven't already done so to submit outlines of advocacy plans in order to identify those with the weakest concept of advocacy.
- Utilize foreign experts to address advocacy at the Board meetings and follow-up with direct technical assistance to grantees most in need.
- Continue having advocacy meetings with all grantees to coordinate efforts and share techniques/experiences. Some of the grantees have good experience with advocacy but their contribution to the initial advocacy meeting was overshadowed by the conceptual discussion.

2. Media

As in most advocacy efforts, the media is a central focus. How seriously the final recommendations are taken depends in part upon media publicity -- the more widely known it is the harder for policy makers to ignore it. To its credit, there is already a growing interest on the part of the media in the project.

Just as there is individual grantee advocacy and coordinated project advocacy, there are emerging individual grantee media relations and overall project media relations handled by the CIPE staff in Hungary. Balancing the two will be necessary to avoid undermining the effectiveness of both. Whereas approaching the media from different angles through the various individual grantees has advantages, it would be a mistake if the project appeared predominantly in the press as simply a group of unrelated projects. There needs to be a degree of coordination and a way of instilling the collaborative identity of the whole project into the media activities of the individual grantees.

In the course of the evaluation interviews, most of the discussion of the media as an element of advocacy related to how CIPE and the overall project were presented rather than the individual research projects. Publicity of CIPE will become a part of the story and we need to be prepared for a range of questions, some simple some more complex. For example:

- What is CIPE?
- What is its interest in Hungary?
- Isn't CIPE interfering in Hungarian affairs?
- Where is the money coming from?
- Why these grantees?

This issue is one element of the advocacy of the overall project. The question here is how prominently CIPE should be featured in press announcements. Just as in the overall advocacy issue, CIPE needs to plan its appropriate role rather than taking on media activities by default.

Recommendations

- Develop a media strategy as an adjunct to the advocacy plan. Such a strategy will help keep control of how the project is portrayed including the political balance, the role of CIPE and other potentially sensitive areas.
- The media strategy should include at least the following materials/considerations:
 - A description of the project that forcefully communicates what is unique and timely about it. To get the media's attention you have to do or say something interesting.
 - A clear and concise written statement defining CIPE.
 - Press summary (concise statement) of the final report.
 - Identification of who on the CIPE staff is responsible for media relations.
 - Address language problems, strong professional Hungarian translations of any English materials.
 - TV and radio is most prominent, but most difficult to crack. The strategy should address this.
- In providing technical assistance for advocacy at least one advisor should have a strong media background. Such an advisor could help with this overall strategy. If Collingwood Harris for example were used, this work could possibly begin with Hungarian staff visits to Washington.

3. Final Report

The final report is perhaps the most critical product of the project. It is the culmination and unification of all the various research findings and recommendations. For most impact it should link the project directly to the issue of the day: how to generate economic growth in Hungary. The report will be printed in Hungarian and English.

The project scope of work specifies the following for inclusion in the report:

- a distillation of the findings of the grantees,
- a synthesis of the Advisory Boards findings,
- findings of the foreign experts,
- recommendations for eliminating or changing laws and regulations,
- an advocacy blueprint for Hungarian business and public policy organizations,
- a detailed analytic framework and matrix to legal and regulatory impediments and areas for reform,

This outline is very ambitious. Obviously, the Report cannot be just a compendium of each of the individual studies. On the other hand, some of the above

items may need to be modified or deleted for the sake of producing a report that is clear, timely and persuasive.

As part of this evaluation Board Members and participants were asked their opinion of the most important characteristics of the report. Their response makes a fairly short list:

- ▶ It should define the magnitude of the issue and recommend realistic and achievable legal and regulatory reforms. Several Board Members emphasized the word "achievable" noting that previous reform recommendations had failed because of overly ambitious, unachievable recommendations.
- ▶ It must be honest and open - such a report in Hungary cannot appease everyone and shouldn't try. It needs a strong point of view.
- ▶ It must be comprehensible - the target audiences is not going to patiently wade through dense, complex verbiage.

From this midterm vantage point a couple of potential obstacles are immediately identifiable.

Timing -- with the elections anticipated in May the current schedule allows no margin for delay. The political parties are now formulating economic platforms. The consensus is that January is the latest date of release for greatest impact. Earlier is better.

Unity -- the findings and recommendations of the individual projects must form a cohesive whole. It should address at least the three characteristics described above. Such unity may be a struggle to achieve since all grantees worked independently without even a guiding framework for format.

Recommendations

- Prepare an outline of contents of the report, determining whether all the items described in the scope of work should be included and in what form.
- Develop a production schedule with ironclad deadlines and defined format and length. Apprise the grantees immediately, possibly holding a special meeting for the purpose. It may be too late, but providing some guidance on length, format, and target characteristics (ie. achievable recommendations) may help expedite final drafting of the report.
- Define the role of the Board. Clearly having all Board Members review everything will be a drag on the schedule. One possible option is to assign specific board members as primary reviewers of individual sections of the report. These same individuals could possibly write introductions to those sections.
- The original project design called for staff to write the project report. Given time restraints and staff resources it will be more expedient to hire a writer.

The process of identifying a writer should begin immediately. The type of writer that best meets the criteria for speed and clarity is probably an economic

journalist. The writer must be chosen with great care. Because of the politically charged atmosphere in Hungary, the political affiliation of the writer will have a profound affect on how the report is received.

- Consider the needs of the various target audiences. It may be best to simultaneously prepare a book of 100 pages or so and a separate overview of 10 pages and a press summary of no more than 2 pages.

4. National Conference

The National Conference is the final activity of the project. It is intended to be a venue for discussing the final report both in terms of identification of the impediments to economic growth and to coalescing the various advocacy activities into a dialogue on reform. The Conference should be a major event with high level participation from government, political parties and the private sector. It is planned to video tape the conference for rebroadcast of segments on Hungarian television.

The conference is currently planned for March, 1994. That does seem to be the optimum time given the progress of the preparatory research and the necessity of maintaining sufficient time in advance of the elections.

Recommendations

- Develop a critical path of deadlines and activities necessary to prepare for the conference. This should include:
 - identification of the deadline for setting conference dates and venue,
 - when to finalize the agenda,
 - when to announce the conference and send out invitations,
 - when to ensure participation of the Board and other critical participants,
 - how to ensure that the video tape will be broadcast as planned.
- Particular consideration should be given to the appropriate project activities that should be conducted between release of the project report and the conference. These activities should further the advocacy objectives and generate interest and support for the project findings. Among possible activities are:
 - A series of presentations on the results of the research to be given throughout the country -- as mentioned in the section above on selection of grantees.
 - A session in which the economic staff of the political parties can respond to the project findings -- as mentioned in the section above on advocacy.



III. PROJECT MANAGEMENT

1. Hungarian Office

Establishing an on-site foreign office is a new endeavor for CIPE. Given the scope and complexity of the project, it was considered essential. The overall stated purpose of the Hungarian office is to 1) coordinate the Advisory Board activities, 2) serve as a central collection point for the grantee projects, and 3) produce the project report.

The AID grant further spells out several specific functions of the staff:

- prepare a set of questions for the first national poll,
- share the results of the poll throughout Hungary,
- develop a framework for categorizing and measuring policy changes,
- coordinating Board meetings and visits of foreign experts,
- compile data on small business programs supported by other donors, and
- prepare the project report.

The local office does not have a responsibility for managing or disbursing CIPE payments to the grantees.

Accomplishments

Logistics - The initial months of the project were spent registering CIPE in Hungary, recruiting staff and locating office space. The American Director was hired in December 1992. Locating appropriate office space and negotiating a lease took considerably longer than anticipated. A lease was signed in February 1993. The principal Hungarian staff was contracted in March and the office became functional.

At the same time that the office was being established the Advisory Board and the Grantee projects were being set up. This was accomplished by intensive work of the Washington staff including several extended visits to Hungary. It would have been advantageous to have the office functioning sooner to provide more assistance in establishing the projects, but the work of the Washington staff kept the project on schedule which is crucial for its success.

Financial Management - Although there is no responsibility for disbursing grantee funds, it is critical that the funds for the office activities (Board meetings, Newsletter, general office operations, etc.) be appropriately managed. After five months of operations CIPE commissioned an audit of the financial management of the office. The results showed the records and procedures in order and recommended only that financial records be put on a computer spreadsheet and a policies and procedures statement be prepared.

Concurrently with this evaluation Washington staff assisted the Hungarian staff in developing a financial spreadsheet, which is now in operation. The Hungarian staff is preparing written policies and procedures.

Advisory Board & Newsletter - Immediately upon its establishment, the Hungarian staff began organizing the Advisory Board meetings, publishing the project newsletter. These two activities have been crucial in terms of creating an identity for the project as a national collaborative effort on the highest level.

The newsletter is a monthly publication of about 6 pages in both Hungarian and English. The newsletter is meeting a twofold purpose. First, it is a primary vehicle for coordinating and communicating the progress of the grantees. Second, as it is

distributed to opinion leaders and interested groups, the newsletter is beginning to generate broad interest in the project. CIPE staff in Washington have worked with the Hungarian staff to improve the appearance of the newsletter, which is prepared on desktop publishing software.

In coordinating the meetings of the Advisory Board, the Staff Director in Hungary has initiated several important themes. In addition to presentations on grantee progress the Board meetings have featured briefings by the Economic Officers of the major political parties. The Director also initiated the workshops on research to date and advocacy in late September. These meetings proved to be crucial for taking stock of progress to date and what needs to be done.

On the other hand, the Washington staff has given very little guidance on utilizing the Advisory Board. As a result several items have been overlooked. For example, participation of foreign experts in Board meetings was budgeted and as yet not utilized. Also, the Board was intended to have an important role in framing the national polls conducted by Median. Ultimately, on the first poll that didn't happen. They only had an opportunity to respond to the results of the poll.

The reason these activities were overlooked is the lack of a detailed management plan. So far the Hungarian Office has functioned under a management plan consisting of only the broadest brush strokes. That approach is unquestionably a weakness. A minor weakness at this point during the first phase of the project, but one that has led to a failure to make the best use of the Hungarian Office. For example, one of the advantages of having a local office is their ability to identify the technical assistance needs of the participating grantees. This has only minimally been done. If the function of the office had been more thoroughly thought through and more specific objectives and deliverable identified, the office would have greater value. This relatively minor weakness now will become a major handicap if sustained through the second half of the project.

Future Requirements

The Hungarian staff is at a crossroads. Having established the office and its basic functions, they are now facing a much more intensive period of work through the National Conference. The coordination of the grantee's advocacy work, preparation of the project report, and organization of the National Conference were all anticipated objectives during this final phase. However, the advocacy of the overall project results and the accompanying media relations (as described above) were not fully anticipated. They will become major responsibilities for the Hungarian Staff.

At the same time they are facing this heightened period of activity, the Hungarian national staff seems to be somewhat uncertain of their role. Part of the reason for this is simply a need for a thorough briefing on CIPE, how it functions and the role of staff. CIPE may have taken for granted the delicate balance between technical and financial assistance, coordination and advocacy in the program that is baffling to these staff members without a more complete understanding of the organization.

More importantly, however, the uncertainty of the staff is symptomatic of the larger issue associated with a lack of a detailed management plan. Looking forward to carrying out activities as complex as publishing a report, advocacy, media relations and a National Conference without a detailed management plan and definition of responsibilities would lead anyone to question their role.

Recommendations

- The Washington and Hungarian Program Officers should jointly prepare a management plan to follow through to the end of the project. The plan should take into account the various requirements and recommendations detailed in this evaluation. Particular emphasis should be placed on identifying technical assistance requirements. The plan should spell out the specific duties of the staff members.
- Bring the two principal Hungarian staff to Washington for an intensive briefing on CIPE and improving the skills required in the rest of the project. Consideration could be given to providing basic training advocacy, media relations, conference organization, for example.

1. Evaluation

The project design calls for staff to develop a framework for categorizing and measuring policy reforms. CIPE has developed and used a number of indicators of success of this kind of project. These indicators should be systematically tracked by the Hungarian office. The indicators include:

- press and media coverage,
- expressions of interest through requests for information,
- direct citing of the project in political or legislative debates,
- the level and extent of participation in the conference and other project activities
- and, ultimately, the enacting of any recommendations of the project.

Some of these indicators have already begun to appear. Notably some press coverage and expressions of interest from other groups. In addition, the grantees should be monitoring these indicators on their individual projects.

The final polling conducted by Median is also intended to serve as an evaluation tool. The staff also needs to work with Median to ensure that the polls developed can be used to indicate at least to some extent the effect of the project and not just a change in attitudes.



III. CONCLUSION

The building blocks for a very successful project have been assembled. This evaluation has identified a number of accomplishments which make up the project's strengths. They include, first of all, the caliber of the Advisory Board and the Grantees. Clearly, this is a group of organizations and individuals who can drive a project of this magnitude. The collaborative nature of the project further strengthens

the project. Not only will it make the results more prominent and meaningful, but the grantees can learn a lot from each other, particularly in the area of advocacy. Finally, the timing of the project vis a vis the 1994 elections and the focus on the key election issues culminate further indicates the excellent potential of the project.

Even with those advantages, there remains a heavy work load through the end of the project. There are considerable challenges that need to be met in organizing the remaining project activities. Timing is one of them. As much as it is a strength it is equally a challenge. The May election leaves virtually no flexibility in the schedule. Ensuring that all work is completed on time may be a struggle. Overcoming some resistance to the idea of advocacy could become a drag on progress. Making up for the lack of direct business participation also needs to be addressed. Finally, defining and managing the appropriate CIPE advocacy function is crucial for the success of the project.

This project has many components. Overseeing the balance of participants, Board Members, policy issues, media, non partisan status, and the requirements of report publication and conference organization, to name a few, is a formidable task. Among the many recommendations of this evaluation the single overriding requirement is the development of a clear management plan to guide the project to completion. The plan must address the various project components and their timing and define the role of the participants, board and staff. Only with such a plan can the project fully capitalize on its strengths and overcome the challenges to successfully achieve the project objectives.

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MEDIA COVERAGE OF CIPE LEGAL AND REGULATORY REFORM IN HUNGARY PROJECT ACTIVITIES

<u>Newspaper</u>	<u>Date</u>	<u>Title</u>
MAGYAR NEMZET	31/06/93	<i>INDIVIDUAL COMPANIES MAY DISAPPEAR THE COUNTRY OF LTD'S</i> Re: The debate of CIPE's grantee, Financial Research Ltd.
NÉPSZABADSÁG	23/07/93	<i>PRIVATE WEALTH - SOCIAL RISKS</i> Re: The debate of CIPE's grantee, Financial Research Ltd.
FIGYELŐ	9/09/93	<i>PRIVATIZATION FROM CREDIT WITHOUT THIS IT IS MORE DIFFICULT, BUT FOR WHOM?</i> <i>DID THE E-LOAN INCREASE THE RATE OF EXPANSION OF PRIVATE ENTERPRISE AND PRIVATIZATION?</i> Re: "The article was written as part of the research initiated by The Center for International Private Enterprise (CIPE)."
NÉPSZABADSÁG	10/09/93	<i>THE CHILDREN OF SOCIALISM</i> Re: "In Hungary the great increase of enterprises came when there was the biggest economic recession in the country's history. The causes and consequences of this is analyzed by Mihály Laki, economist, in a CIPE (American Center for International Private Enterprise) sponsored study which is being in preparation."
FIGYELŐ	21/09/93	<i>DISAPPOINTMENT AND CONFUSION CAPITALISM IS A GOOD THING, BUT...</i> Re: "MKPI ('Medián' Public Opinion and Market Researching Institute) has made a survey, commissioned by the Center for International Private Enterprise (CIPE), on public opinion regarding economic transformation and privatization "

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FIGYELŐ	23/09/93	SMALL ENTERPRISES A SUCCESS STORY OR AN EXAMPLE TO AVOID Re: "Researchers have spoken about the results achieved so far from two of the six Hungarian projects, on the conference held in Eger by CIPE and The Institute of Political Studies."
FIGYELŐ	7/10/93	HIGH TAX LEVEL Re: "We will cover only one subject among many and that is the main features of the Hungarian tax system, from the debate organised by the Center for International Private Enterprise (CIPE) (Washington residence) last week."
HVG	9/10/93	RESEARCH ON MARKET ECONOMY NAVIGATING THE MINE FIELD OF REFORM Re: "Research companies consisting of famous experts have started to reveal the obstacles of the development of private enterprises a few months ago, sponsored by the Center for International Private Enterprise (CIPE), an affiliate of the American Chamber of Commerce."
FIGYELŐ	28/10/93	COMPANY ESTABLISHMENT AND THE SHADOWLAND Re: "The studies of the Foundation for a Market Economy have been prepared for surveying today's situation, sponsored by the Center for International Private Enterprise (CIPE)."
FIGYELŐ	18/11/93	WHAT CAN WE EXPECT FROM THE NEXT YEAR? AS THE MANAGERS SEE IT...
SZEMLE	11/93	THE MARKET POSITION OF PRIVATIZED COMMERCIAL BUSINESSES IN 1993. Re: "This study was sponsored by Kopint-Datorg KKA and CIPE Regulatory Impediments in Real Estate project."

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BANK & TŐZSDE	26/11/93	ENTERPRISE-SUBSIDIZE IN HUNGARY Re: A study by Financial Research Ltd.
NÉPSZABADSÁG	3/12/93	MDF (HUNG. DEM. FORUM): THE CABINET DID WHAT THEY COULD Re: "Iván Sándor, invited by CIPE Foundation, recalled the economic programme of MDF of 1990 before the audience, which had covered almost half of the whole programme of the party."
MAGYAR NEMZET	13/12/93	CONFERENCE ON PRIVATIZATION A GENERAL PROJECT FOR ECONOMY POLICY IS BEING PREPARED Re: "The supply of Hungarian state wealth is decreasing, but the demand is increasing... many people turned out at the conference organised by MTA (Hung. Scientific Academy) World Economy Research Institute and the American Center for International Private Enterprise (CIPE) last week."
MAGYAR HÍRLAP	13/12/93	CONFERENCE ON THE CENTRAL- EUROPEAN TRANSFORMATION PROPERTY CHANGE IN THE VISEGRAD NATIONS Re: "On Saturday CIPE (Center for International Private Enterprise) concluded its 2-day-conference in Budapest on the position of privatization of the Visegrad nations.
NÉPSZABADSÁG	22/03/94	ECONOMIC GROWTH ONLY AFTER 1997. Re: Debate organised by the Institute for World Economics of the Hungarian Academy of Sciences.
FIGYELŐ	24/03/94	INFORMAL SECTOR ONE QUARTER OF GDP IS ATTRIBUTED TO THE BLACK MARKET Re: The offers of some researchers - dr. Mária Major, dr. Péter Futó, László Kállay and dr. Zsanna Láng, FME - for decreasing the informal economic activity.

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HAZAI KÖRKÉP 28/03/94

THE CONDITIONS OF GROWTH CAN BE CREATED
ACCORDING TO MOST OF THE PARTIES IT MUST NOT BE DONE ARTIFICIALLY
Re: 2-day-conference - "Breaking points '94" - in Budapest organised by Hungarian Academy of Sciences on improving the economy. Hungarian parties tell their opinion.

MAGYAR HÍRLAP 28/03/94

WHEN CAN AN ECONOMIC UPTURN BE EXPECTED?
ACCORDING TO THE MAJORITY OF PARTIES, STARTING IN 1996.
Re: 2-day-conference - "Breaking points '94" - in Budapest organised by HAC on improving the economy.

MAGYAR HÍRLAP 29/03/94

RESEARCHERS DO NOT EXPECT GROWTH
Re: Researchers - László Csaba, Zsuzsa Mopolygó, József Veress and László Harsányi - analyze the parties' economy policy.

NÉPSZABADSÁG 29/03/94

BREAKPOINT: SOCIAL PACT
Re: 2-day-conference - "Breaking points '94" - in Budapest organised by HAC on improving the economy.

BUSINESS 06/94
CENTRAL EUROPE

WHAT SHOULD HUNGARY'S NEW GOVERNMENT DO?
Re: Here's what a recently published report (Crossed Paths), prepared by leading Hungarian think-tanks and the Washington-based Center for International Private Enterprise, suggests:..."

VILÁGGAZDASÁG 11/06/94

CIPE INSTITUTES RECOMMEND:
COMPANY TAX 30%, SOCIAL INSURANCE 15-25%
ENTERPRISES - MESSAGE TO THE NEW GOVERNMENT
Re: " Research, having been started in the beginning of 1993 , was initiated and organised by the Washington-based CIPE (Center for International Private Enterprise) with the support

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MAGYAR HÍRLAP 20/06/94

**THE OFFERS OF 6 RESEARCH INSTITUTES
THE MAIN OBJECTIVE IS TO ENCOURAGE
ENTERPRISES**

Re: " The final conclusions of almost one-year's work are summarised in the study 'Crossed Paths', the objectives of which is to make offers for the new Hungarian government and Parliament about the necessary economic tasks. The research was initiated and sponsored by Center for International Private Enterprise (CIPE), an affiliate of the US Chamber of Commerce, with the support of USAID - said Eric L. Johnson, director of the Hungarian office of CIPE. In the last year one million dollars were given for Hungarian research and the frame is the same for this year."

PROGRAM

NATIONAL CONFERENCE ON POLICY REFORM IN A TRANSITIONAL ECONOMY

Organizer: The Center for International Private Enterprise (CIPE) in conjunction with the Economic Committee of the Hungarian Parliament.

Dates: September 15 & 16, 1994.

Location: Hungarian Academy of Sciences (MTA), Díszterem & Tanácssterem
Budapest, V., Roosevelt tér 9.

Thursday, September 15: (Díszterem, 1st Floor, MTA - Academy of Sciences)

08:00 Registration.

09:00 Conference opening - Charles T. Manatt, Member of the CIPE Board of Directors.

09:15 Address by Dr. Márton Tardos, Honorary Conference Chairman.

09:30 Panel I - *Policy Makers on Policy Reform.*

Moderator - Tibor Vidos, Managing Director, GJW Politconsult

Panelists: László Akar, State Secretary, Ministry of Finance
Ferenc Bartha, Director of Privatization in Hungary
Dr. András Gyarmati, Ministry of Industry and Trade, Deputy State Secretary
Miklós Pulai, President of the Hungarian Bankers Association
Ferenc Rolek, Vice President GE-Tungsram, Member of HCC
Tamás Sárközy, Budapest University of Economic Sciences, Department of Business Law
Márton Tardos, MP, Chairman of Economic Committee

Rapporteur - Éva Várhegyi, Financial Research

11:00 Coffee Break - Foyer, 2nd floor.

11:15 Question & Answer Period - Panel I.

Thursday, September 15 (cont.): (MTA, Diszterem)

12:00 Conclusion of Panel I.

12.10 - 13.30 Lunch at MTA - Foyer, 2nd floor

13:30 Conference re-convenes after lunch.

13:35 Opening remarks

13:50 Panel II - *The Role of Research in Policy Formulation and Reform.*

Moderator - Attila Chikán, Director of Rajk College

Panelists: László Antal, Hungarian Foreign Trade Bank
Miklós Dobák, BUES
András Inotai, Institute for World Economics
Mihály Laki, Public Policy Institute
Pál Tamás, MTA Social Conflict Research Center
András Vértés, Economic Research Co.

Rapporteur - László Kállay, Foundation for Market Economy

15:10 Coffee Break. - Foyer, 2nd Floor.

15:30 Question & Answer Period - Panel II.

15:45 Contributions by the Project Managers of CIPE's *Legal & Regulatory Reform in Hungary* Project

16:20 Conclusion of Panel II.

16:30 *Economic Reform Today* (ERT) Roundtable - Tanácsterem, MTA.

Moderator: John Zemko, Editor of *ERT*

- Small group roundtable
- Discussion with CIPE CEE grantees on Economic Reform

Remarks by Charles T. Manatt, Member of the CIPE Board of Directors.

18:30 Conclusion of Day 1.

Friday, September 16: (Diszterem, MTA)

08.30 Registration

09:00 Conference re-convenes - Charles T. Manatt, CIPE Board of Directors

09:10 Remarks by David Cowles, USAID Representative to Hungary.

09:20 Panel III - *The Role of Business in Policy Reform and Advocacy.*

Moderator - Gábor Rényi, Novotrade

Panelists: György Lajtai, MHB
Dr. Iván Szász, Strook & Stroock & Lavan
Gabriella Szemere, Hungarian Franchise Association
György Szűcs, IPOSZ
György Gonda, Ernst & Young
Péter Keszthelyi, Hungarian Chamber of Economy
Péter Vadász, GYOSZ

Rapporteur - László Szakadát, BUES

10:50 Coffee Break - Foyer, 2nd Floor.

11:00 Question & Answer period - Panel III.

— CONCURRENT EVENT —

09:20 Roundtable Discussion (Tanácsterem) - *The Role of the Media in the Policy Process.*

Moderator - Györgyi Kocsis, HVG

Panelists: Katalin Bossányi, Népszabadság
Dr. András Domány, Magyar Rádió
Endre Hann, Median Opinion & Market Research
Ilona Kocsi, Magyar Hírlap
Iván Lipovecz, HVG
Gizella Sóvári, Figyelő

Rapporteur - Richard Hirschler, World Bank

11:20 Conclusion of Media Roundtable.

11:30 Conclusion of Panel III.

11:30 Conference Close (Diszterem) - Charles T. Manatt, CIPE Board of Directors.

SUGGESTED PANELIST DISCUSSION POINTS:

Panel I - Policymakers on Policy Reform:

1. Which 2 - 3 institutional mechanisms for communication between government, business, and other policy formulation organizations should be used in Hungary?
2. In what way(s) can the internal decision-making apparatus and the external policy-formulation function be improved?
3. What two new innovations can your organization introduce to catalyze policy formulation and implementation?

Panel II - The Academic Community and Successful Policy Research

1. In what way(s) can the role of research improve the policy formulation processes within "bureaucracies", political arenas, and special interest groups in Hungary?
2. What are the characteristics of useful and, therefore, successful economic policy research, i.e., a reasonable data base, testing alternative policy options, institutional independence, process openness, etc?
3. What two new innovations can your organization introduce to catalyze policy formulation and implementation?

Panel III - The Role of Business in Policy Formulation and Advocacy

1. Which 2 - 3 mechanisms should be used to enhance communication between government and business in Hungary?
2. In what way(s) can the business community be mobilized as a "voice" for the concerns of the Private Sector?
3. What two new innovations can your organization introduce to catalyze policy formulation and implementation?

Panel IV - The Role of the Media in the Policy Process

1. What 2 - 3 mechanisms should be used by the media to improve the policy formulation processes within "bureaucracies", political arenas, and special interest groups?
2. In what two ways can the role of the media in the presenting of policy positions and options for public debate be maximized?
3. What two new innovations should your organization introduce to catalyze policy formulation and implementation?

Panel IV - The Role of the Media in the Policy Process

1. What 2 - 3 mechanisms should be used by the media to improve the policy formulation processes within "bureaucracies", political arenas, and special interest groups?
2. In what two ways can the role of the media in the presenting of policy positions and options for public debate be maximized?
3. What two new innovations should your organization introduce to catalyze policy formulation and implementation?

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Szalai	Györgyné	IKM
Szanyi	Miklós	Világgazdaságkutató Intézet
Dr. Szász	Iván	Stroock & Srtoock & Lavan Ügyvédi Iroda
Szász	Sándor	Balatoni Gazdasági Kamara
Szécsi	Éva	Magyar Rádió
Dr. Szemere	Gabriella	Magyar Franchise Szövetség
Szemlér	Tamás	MTA Világgazdaságkutató Intézet
Szenes	Gábor	Napi Gazdaság
Szigethy	Miklós	Kereskedelmi Bank Rt.
Dr. Szilágyiné Császár	Terézia	Parlamenti képviselő
Szili	Márta	Magyar Gazdasági Kamara
Dr. Szöllösi	Endre	Földművelésügyi Minisztérium
Dr. Szombathelyi	Ferenc	UNI-ECO Közgazdász Egyetemi Tanácsadó Kft.
Dr. Sztankó	Éva	IKM
Szűcs	György	IPOSZ
Tagai	Róbert	MTA Világgazdaságkutató Intézet
Dr. Tamás	István	Dunaholding Rt.
Tamás	Pál	MTA Társadalmi Konfliktusok Központja
Tardos	Márton	Parlament Gazdasági Bizottsága
Dr. Tarján	Balázs	FM Agrárrendtartási Hivatal
Taupin	Didier	Deloitte & Touche
Tenner	György	Postabank
Terták	Ádám	Ernst & Young
Tibor	Ágnes	Budapesti Közgazdaságtudományi Egyetem
Dr. Tímár	Erzsébet	Magyar-Amerikai Vállalkozási Alap
Dr. Toldy-Ôsz	Iván	Joint Venture Szövetség
Tolisz	György	Peace Corps.
Dr. Tolnay	Lajos	Magyar Gazdasági Kamara
Tolnay	Tibor	Magyar Építő Rt.
Torma	József	Energocoop Kft.
Török	Péter	APEH
Dr. Törökné Pálkás	Andrea	Budapest Bank Rt.

Tóth	István	MOSZ
Dr. Tóth	Judit	Nemzetközi Bankárképző Központ
Tóth	Péter	Abic Rt.
Tóthné dr. Pásztor	Zsuzsa	HUNGEXPO
Uhercsák	András	MOSZ
Dr. Urbán	László	Parlament i képviselő
Vadász	Péter	GYOSZ
Vági	Márton	BKE
Dr. Vajda	László	Földművelésügyi Minisztérium
Van Heesch	Winnie	
Vanicsek	Mária	ÁVÜ
Várhegyi	Attila	Szolnok Megyei Önkormányzat
Várhegyi	Éva	Pénzügykutató Rt.
Várkonyi	Zoltán	USAID Budapest
Dr. Vass	Ilona	IKM
Verdin	Georgette	Peace Corps.
Veress	József	Budapesti Közgazdaságtudományi Egyetem
Vértes	András	Gazdaságkutató Rt.
Vida	Pál	KNOW-HOW Gazdsági Tanácsadó Rt.
Vidos	Tibor	GJW Politconsult
Dr. Vígvári	András	Budapest Bank Rt.
Vincze	Péter	Kopint-Datorg
Volker	Karen	Amerikai Egyesült Államok Nagykövetsége
Voszka	Éva	Pénzügykutató Rt.
Weber	Donald	Baranya Megyei Vállalkozói Központ
Young	David	Price Waterhouse
Dr. Zatykó	Lajosné	Budapest XXII. Önkormányzati Hivatal
Zemko	John	Editor of Economic Reform Today

ENGLISH TRANSCRIPT OF HUNGARIAN AND RECORDING

Address by Dr. Márton Tardos

Dear Mr. Chairman, my dear friends, ladies and gentlemen,

Please allow me to welcome the participants of the conference in the name of the Economic Committee of the Parliament and to say a few words about the importance of this initiative which is called upon by an institution called TSEEPE in Hungarian and CIPE in English, and as a consequence of this initiative, we are sitting in the Assembly Room of the Academy and getting ready for a debate/discussion.

I think that all of us deeply understand that after the fall of Socialism and Communism there is a crisis in the entire region where we live. There is a crisis in Hungary too and so far we did not succeed in finding the way out of this crisis.

The moment that created this session with the initiative of CIPE with the participation of the politicians, research scientists, the specialists with the practical knowledge and the media people with the purpose of discussing this question is a special one, because there has never been a national conference that would have discussed these questions after the elections and after announcing the program of the new government.

The question that is indirectly the topic or should be the topic of this conference is whether the government that was created as the result of the elections will succeed, or may be successful in finding the way out and what does it need to carry out this program and to establish this order of action and how the social conditions for this can be guaranteed.

In my opening statement I would like to concentrate on one question, namely the one that I consider to represent the most serious problem and this is the fact that four years ago, or even more than that, when we witnessed the collapse of the Soviet power and along with that the power of the Hungarian

Communists. we were living in euphoria and we thought that everything will go into motion which is needed to increase the efficiency and to exercise our civil rights to the fullest extent, to improve the living conditions in our country. The people who did not deal with these question, but as citizens were living in the era of difficulties during the past decades and also the specialist, scientists and experts with practical knowledge, who had been involved for a long time in projects of transforming the economy, thought the same thing. They thought, they were sure that the obstacle to the development of a market economy in Hungary was the political system and the falling out of the members of this political system would create a situation which would make this road smooth leading us to a healthy growth of the economy.

And four years later after the onset of this euphoric condition, everybody is disappointed, although in varying degrees, and can hardly understand what we have to face now.

I will elaborate on four aspects of this unforeseen situation. It did not happen that an established "soft" central government control gradually developed into a free market economy in the direction of a free market economy dominated by the private enterprise, but a sudden collapse that resulted in the sudden stop of operation or a serious drop of efficiency of institutions that were established at that time and operating before '89. The conditions have changed overnight and this and this shocked every manager and every citizen. The shock effect was not apparent simply from the sudden drop of demand (for goods and services) by those who were able to pay for these, or from the changed level thereof, but from the fact that - if the system of economic relations and business agreements between companies is really based on financial factors - it is a qualitatively different situation with different requirements other than the ones we had before. In this new situation, the financial relations had such a definite impact on the economy that the cash flow which was not of much practical importance before 1989, suddenly became the overall determining factor in the economy.

We are already accustomed to saying that the Bankruptcy Law and the Accountability Law caused these problems. The problems are caused by the failure of the banking system, however, the truth is that these legal changes introduced by the legislation represent only the framework of the fact that

the intercompany relation and the economy are not coordinated by the central government and that this institution is no longer present. Furthermore the institution of Central Government was not abolished step by step, but as the result of an instantaneous decision, to the extent that we Hungarians were hardly the participants in this decision, because the Russian boots that maintained the difficult situation in Hungary for 45 years, stopped kicking into action and the central (unintelligible word) driving force of Hungary stopped working suddenly.

In the new system, and this is where I want to switch to the second aspect, new institutions, new laws and a new network of economic institutions became necessary, but the operation of this new network of institutions could not go into full force overnight, because it had very weak traditions and the working knowledge of the operators was minimal, even despite the fact that Hungary was the "happiest shack" and during the past 45 years made significant steps toward a market economy and was in a far better situation in this regard than any of the neighboring countries. The lack of private enterprise will disable any market economy. Private ownership, however, was very scantily present in Hungarian economy in 1989-90 and only private ownership that was used to the black market and the grey market was to be found. This created both the need for regulatory work and the presence of factors that could not be regulated.

The third serious aspect that we have to face now is what I have mentioned before. This is that there is no market economy if there is no private enterprise, which means that a structure represented by state or cooperative ownership had to be transformed that is privatization must take place, and fast, because the interests that can be regulated with market economy rules will form only in the presence of private ownership, which then would make the former state enterprises manageable after the collapse of the Central government, but successful mass privatization is almost impossible even in a society where practically every citizen and the society itself accepts that to privatize and to make privatization the dominating force is the basic political task, because in a country in crisis with failing economy, where the value of invested capital drops, where the standard of living also drops, where the capital market is undeveloped and unestablished, a fair privatization is not possible. The term "fair" is used to reflect general public acceptance of fairness. This is impossible even if nobody

commits fraud, nobody enters through the door of corruption, but in real life, it is also impossible to think that in a situation like this, there is no fraud and that nobody steps on the path of corruption. Therefore there are plenty of just and unjust accusations regarding privatization, and it is not a coincidence that the average citizens look at privatization not as at the prerequisite to the success of the modernization or the method of modernization, but as the hot bed of fraud and corruption.

The last but not the least important aspect out of the four, is a situation which is generally described as the "social net". During the Kádár regime or rather from 1945 through 1989, the national social net received a lot of justified criticism. It was considered to be a "money waster" in many respects, and undeveloped and incomplete in other respects. One thing is certain, though, that this system which worked so far, became a burden for the reallocation of the budget both in terms of money and needs. The Hungarian economy was unable to carry on and it could not be developed further in its original form and at the same time, the citizens' legitimate needs that was shaped by providing these services free are still there and valid. It provided job security, even at the price of a "beyond-the-door-unemployment" and low work efficiency, which as a matter of fact, can be considered as an extraordinary achievement, and provided free or at very low costs social services for every citizen. And that this system was not functioning perfectly and did not satisfy all needs and could not take the challenge of quality, could be considered by the average citizen as simple organizational problem rather than the result of internal contradictions within the system, which actually could have been corrected.

The change of post which came as a surprise and which as a matter of fact came to Hungary from outside, as a result of the changes taking place in the Soviet Union, which triggered the change of political system in Hungary, had a consequence, namely that the social net that was more or less working, although considered poorly working, still providing a multitude of services, suddenly became weak. It became weak in the sense that it could no longer provide the services it could before, and it became weak in the sense too that the question of possible perfecting the system was taken off the agenda, because today only a qualitatively different system, which will provide only much more modest services may be included in a current program.

Thus I think that the prevailing skepticism which follows and replaces the euphoria in the current situation, is not a coincidence, and we need to discuss the important question now, when the economic results are lower and lower, whether there is a program and a strategy to break out of this circle. One thing is certain - there is no unambiguous theory which would tell us what to do now. There is only one secure guide - namely that a break-out strategy can only be carried out successfully if it is very widely supported by the Hungarian citizens, and if there is an agreement on what to do and where do we have to make and where we shouldn't make a sacrifice, and where are the joint efforts necessary. Therefore I consider the CIPE initiative to organize the general discussion about these questions right now with the participation of experts, politicians, media reporters, very respectable and very important, and I hope that as a result of this conference in a few days we will be closer to form a uniform stand in these questions that presently keep us apart, and this uniform stand may motivate the entire population of Hungary to accept this strategy based on a consensus. Thank you for your attention!

Ferenc Rolek:

Thank you very much for the introduction. Ladies and gentlemen.

I will try to contribute to the topics we heard from the side of the entrepreneurs, and a little bit more closely to express the views of the Hungarian Chamber of Commerce and Economic Association of Employers whom I represent at this table. Before we discuss the various organizational frameworks and the options the employers and businesses can take advantage of in order to get involved in the work of the Government, the use of which organizational frameworks is practical in this process, we must find a true answer to the question: What type of economic policy would the business community like to assist, into which what type of economic policy can it integrate, what type of economic policy can it really support. First we have to mention that when Mr. László Akar stated that the Hungarian economy which requires a very serious stabilization process forged in blood and sweat, the employers will consistently confirm that they can accept the stabilization only if it is accompanied by growth, which means that the representatives of businesses could hardly agree to a digressive type of

stabilization ... (probably missing part on tape when turning to record on other side)

We must add at the same time that knowing the described problems of the national economy, the budget deficit, the high internal and external debt ratios, I think I can state it very realistically that only an export-oriented economic growth can be considered as an acceptable economic growth and only this is close to reality. And I think that I can say that even if the score of interests of the employers covers a relatively large area, depending on the type of businesses and type of business relationships and interests, I think that the various organizations of the employers will basically agree with such a long-term business strategy. Within this, I think, there are some fundamental questions, and we have already heard most of them today. One of them is the simplification and the stability of the legal system and as Prof. Sárközi has already indicated, the entrepreneurs frequently feel that they are somewhat tied and gagged and this is how they have to try to dance and they are tied in such a way that even the Government will not benefit from it.

We would be very much interested in simplification of these legal regulations, but beyond that also their approach should be changed slightly, because we feel their affect every day on our skin. The economic regulatory activity should have a positive approach, unlike now, when already during the writing of these regulations the regulators try to presume abuses and plug up all small loopholes in them. Only part of these will be successful, and the shrewd businessmen will find the unplugged ones anyway. As the result of this the enterprises following a standard operating procedure will suffer from this. The other thing that we have to talk about besides the legal conditions, is the framework of economic conditions. I think that the current situation regarding business taxing and personal ties cannot survive either on a medium-long or on a long-term basis, which affects the businesses. Here I am talking about the very high labor costs which exist even internationally. In this, I think the Government could step back even at the expense of reforming the national expenditure (Translator's note: ambiguous statement - may mean either the national budget or government spending). This could be done in conjunction with the subjects mentioned or as it was also said, there is a need in changing the concepts in the area of providing social services. In this respect, I want to mention that we would support the reform of national expenditure, because we feel that the Hungarian economy

can no longer carry the heavy burden of paying for Government expenses of today's range.

We would support the acceleration and the real quick completion of the privatization. We would consider the support of private enterprises by financial institutions very important, which of course should be a business-like support and not in a form that the banks would provide the support to further the goals of the Government, but rather a financing policy to be used by the banks applying better interest rates and better loan conditions for private enterprises - this is the economic structure that we would support. This, of course, includes the total privatization and consolidation (whatever we call it) of the banking industry.

And last but not least I would like to state that the business community would support an economy, which works under and among solid social conditions. I think that every business and every capital investment needs stability and a stable society and this would, I think, jeopardize (sic!) the fundamental existence of businesses. Thus we have already reached the question of organizational structure because the social stability itself appears to carry the inherent thought that the social discourses and the acceptance by the various requests of the society are important in this economic policy.

I think it is very important, but I think I have to pose a fundamental question. This fundamental question is "How much shifting is present in the social discourses, which, of course, inherently carry the seed of compromises, since the generatrix of the various interests is shaped by solutions involving compromises, towards the compromises or to what extent is the Government capable of carrying out a very well defined economic program?" As the representative of employers, I think I have to be very clear about our firm position, namely that there is a burning need for such discourses and compromises, but they may not adversely affect the basic directions of the economic policy.

To compare this to a card game from the ancient Hungarian game of "ulti" you can play it by turning two cards face down - one for those calling "ulti" and the other one for those calling "betli" making thus a compromise but the remaining hand of ten cards have to be good enough to have the "red

ulti". There is no chance to call a "half-ulti-half-betli". We would expect our Government to show consistency in this and then this discourse has to use the non-existing and partially existing forms of realization.

I also think that the use of the Arbitration Council is one of the fundamental organizational forms, which seems to be working and sometimes not working. It would be nice of course if it had any legal basis, but the real legalization will come out of real life applications. As we heard it before, the different parties in the Arbitration Council show different strength depending, how much support they really have. The Government has a lot, and the unions have a lot, and probably the employers are the weak link in this chain. So I think that it is true, and we have to admit that because of the transition the employers are in a difficult situation. Things cannot be made legitimate simply by the elections. Businesses are active, but I think that this segment has certain legality (sic!) and it is legitimate enough to sit at the negotiating table as a participant even if we say that the state enterprise is not exactly the same as a private enterprise. It will develop - I have to say. I am sure that there will be some reshuffling in the interest group of the employers too, but despite the fact that it is not perfect we have to trust it and we have to do it. The other thing I want to say is that this Arbitration Council is not the only forum. This is a very good consultation forum, an excellent decision shaping forum. To step back to the extent of one sentence: "I think that fundamentally this forum must concentrate not only on labor questions that is the organization makes strong efforts to be part of the economic policy shaping process, but I think that besides this there are many economical measures, bills, and anything, for which one must find the specific partner beyond the Arbitration Council, with whom he can establish cooperation either geographically, either in a branch or in connection with a branch." I would like to add here one more thought, namely that it would be very good if in certain issues the association of the employers could be involved much more aggressively, and not only in the discussion of a completed draft or a concept or rendering opinion thereof, but even in the planning phase.

It is true that finding such a partner is not easy and I have to admit that most employers' associations struggle with the problem of diversity. Their membership is very diverse representing many different

interests. It is not the same when one is interested in importing or in exporting goods. It is not the same when one came from the processing industry or from among the manufacturers, or from the agricultural field. The profile of the company or the owner himself may make a difference. Sometimes even the employers' associations voice these problems, because they cannot take a unanimous position due to the heterogenous structure of their membership, but the Government is at an advantage, because in a specific situation it can locate the target-specific employers' association for inclusion in accomplishing this task, and , I don't have the courage to say, that it will prepare the draft or the bill as thoroughly as the government representatives, but maybe on the same level, because he feels it on his skin and he knows precisely what's needed to achieve a set economic goal. Therefore I would like to urge the Government to try to establish direct contacts of this type. And a very last one, that besides the government-employers' contacts also the Parliament-employers' contacts could be normalized, not for specific cases, not through personal connections, not because by coincidence one of the numbers of the employers' association happens to be also a member of the Parliament, but because there are official channels for this and one may be present in a certain committee and in the various groups of the Parliament, or hopefully no such lobby effort will be developed or Lobby Act passed in which the employers (sic!) would have a definite role. Thank you for your attention.

Márton Tardos

Ladies and Gentlemen,

I would like to mention two things that we did not discuss earlier in detail, but what I am going to say is relevant to Mr. Rolek's statements.

A considerable debate is going on currently in our society about the question if we will be able to get out of this crisis taking restrictive measures and I am convinced that restrictions have a place, they are necessary, but restrictions themselves will not get us out of this crisis. The answer is to provide the basis for the growth.

If we study the history of the countries where there was a significant economic success during the past ten years, we will see several things. One of them is that, be it Germany or Japan, South-Korea or Taiwan or Singapore, the situation in the beginning that is at the starting point that the potential (capacity) of the country and the wage level therein, were disproportionate, but this disproportion was unlike in Hungary - just the opposite, namely that the capacity of the country was higher for decades than the one realized in the wage level there (?) The other thing is the price level policy in these countries, which was good enough to serve as a big incentive for the export and for import-substitute activities. This means that the national currency was not overvalued, but rather the undervaluation of the national currency was typical.

The third thing is that these countries received their significant share of foreign capital investment, thus their balance of payments showed a very favorable proportion between the expenses, disbursements and collected income, regardless if this income came from imported capital or from loans; the payments received were significantly more than the expenditures. Now, if we think about the past 4 years or even about the past 25 years whether the conditions of growth were present or the conditions that I just mentioned, the answer must be "No". They are not present. Just the opposite is happening - the capacity of the domestic wage level is overvalued, the foreign currency is given a higher value than it should be and in the sixties or the early seventies after the misused foreign capital or increased debt ratio the amount of debt service actually exceeded the (unintelligible word). There were some exceptional years, but the former is generally typical. How can we turn this around? How can we create the conditions for growth? Only if we recognize this tendency of overspending and help forming a national consensus to change it. This means that the reserves will be increased by at least one magnitude and we accept that increasing the reserves and creating job opportunities for efficient operations deserve all preferences and restrain those parts of the consumption and use of goods in every area, which will not lead to creating efficient workplaces.

There is another factor too, and another area where there is plenty of room for efficiency improvement in the region of increasing foreign capital attraction. Everybody knows that Hungary represents the favorite country in the Eastern European region where there is a relatively large

foreign capital injection. It still doesn't mean, that we played out all of our cards, and made every effort in the interest of this. We must take significant measures for this. We must look good to attract this foreign capital and to keep it here, increasing the foreign capital investments of 1,5 to 3 billion at least by a magnitude, generally speaking double it. This policy is hard to carry out, but the conditions described by my colleagues, namely that there is a boom in Europe and in America, are not unfavorable in this respect and as the result of positive indices in the past years, the relatively positive indices, Hungary had the largest share of foreign capital. This is also one of the favorable and not unfavorable conditions that show that it is time to act. The action has to be carried out in form of a concentrated political task and then we have the third remaining question. "What should happen with our national debt?" I agree with the suggestion that the debt structure has to be changed and the very bad debts have to be eliminated. I am, however, not convinced, on the contrary I am more convinced that despite the fact that Hungary reached the point where the national debt and the GDP are approximately on the same level - no use to argue if it is 98 or 96% which seems to be the accurate figure - and with this debt ratio our country prominently advanced on the list of indebted nations, but we should acknowledge that there are other very successful countries that are in deeper debt than we are, still we have room to move around. We should know one thing, which is relevant to the previously made statements, namely that we generally must not get into debt to finance our every-day food, our bread and other daily expenses, but it is alright and wise to get into debt for something that will bring us a significant profit next year. This kind of debt has its rationale. The consequence is that we must realize that a country like us, which is deeply in debt, cannot afford to allow a budget deficit equal to 7% of the GDP and this deficit is primarily used to pay for the government expenditures. It may be alright to have either 7 or a few percent deficit in the national budget, but this must be used up to the last fillér for efficient investments or for investment incentives. Now, this means that in the privatization arena, with the state property, within the state-owned banks a very well defined growth-targeted policy must be initiated and implemented with the use of government resources and to create the necessary framework of conditions for this, but at the same time much better sanctioning, control and accountability has to be applied on those, who are responsible for handling and manage state properties, which was quite unsatisfactory during this and the past years. It means that situations when state owned businesses survive by financing their

operations by using up their assets, cannot be completely eliminated, because there are situations where it's beneficial to maintain temporary conditions of this type, but instances where we do not know the cost of creating an additional position at such institutions, is not permissible. Consequently, not only the pace of privatization, but also the management of these still state-owned enterprises - temporary ownership though - is very important so that these question not be forgotten and wrong decisions be penalized. The penalty should be that officers of state-owned company management and bank management could be terminated for approving bad loans or making poor investment decisions. We must recognize that these instances exist and the accumulated debt that we have to live with and which does not bring profit and is unsecured and this is not just the direct consequence of past mistakes, but frequently it is the result of mismanagement by specialists in the field.

But to create this attractive growth, a budgetary reform would be truly essential in order to reduce taxes and at the same token reduce government spending, but we must know that in our current situation we cannot take radical steps, therefore we must make every effort to make progress step by step. If we take these steps, we can hope that the conditions needed for a true, effective, budget reform will be met, not with restrictive means, but rather by providing good foundations for the growth, because all the problems that I spoke about can be remedied only if the national income will pass the level of our 1989 national income.

Today we are way below it and our legitimate need for better standard of living etc. have not been reduced at all. This, however, is unbearable and unmanageable. That is we have to do everything possible within our power to ascertain this growth.

My second subject is these prerequisites. After this, I will close my presentation. The fundamental question is how to present these problems to the public, and how the social-economic pact will be established in the country. There are two phenomena that I would like to mention here. One is in fact a criticism of the events that took place during the past few weeks. If the Government declares that the situation is catastrophic if we are unable to save a few tens of billions of forints, or precisely 50 billion in 1994 in the budget, it is to be known that this is a very tough requirement and it is not

easy to carry it out, but from which it is very difficult to get out with the hazy insight how the entire program will bring 50 billion, even if 10 to 15 billion forints in the program might need technical justification and then to doubt that 20 more billions cannot be earned, it indicates that a serious mistake was made. It is a serious mistake because it awakes doubt in the Government's ability to make proper judgement, because either there is a need or there is no need for 50 billion and from this 15 billion can be kept in uncertainty and 20 billion can be sold, the opening statement was untrue.

But I think that the opening statement was correct even if noncompliance with it in 1994 creates no catastrophic conditions, but it does not stop a process which in 1995 can cause lots of problems. And second, one ought to know that the meaning of the term "agreements with a compromise" does not mean that we set certain conditions in important matters and then we give in, but rather that we give something and we get something, and we can picture a scenario when in one area we were too tough, but then in other areas we have to make up what we have lost there. And if we don't do it, we end up in a situation which does not have that real cling to it. And here, I'd like to elaborate on my last thought, namely that the sole institution or almost sole institution of this social pact - since Mr. Rolek has stated that the ÉT (AC) cannot be its sole institution, and I want to support him that he is absolutely right - my opinion is that in wage related issues - and a social pact is generally based on wage and income issues, - no true agreement is possible nationally on a political basis, because it is not clear what the essence of the story is. In certain taxation and other inflation-related issues, the AC agreement must include an override agreement on general wage increase questions, accepting at the same time the fact that the place where it is to be realized is the workplace. The workplace, because at the company providing the workplace both the workers, the employees and the owner are aware of their common interests and the common goal, the willingness and the need to make compromises are not in esoteric regions.

Here both parties know that if there is a work stoppage, because the workers are not willing to work under these circumstances, it will have tragic consequences for the owner, and the owner knows that if the workers stop working, he will stop making any profit and he knows that he has to gain over the workers in order to assure a profitable production. It means that both parties are interested in

implementing the conditions of tomorrow. The Hungarian social thinking and the Hungarian unions and employers, however, in practice, are not familiar with the concept of the wage dispute at the workplace. The wage issues in Hungary are centrally regulated and this is typical primarily for completely state-owned companies and majority state ownerships, therefore the institutions managing state property will have a huge task in the future, and we have to state it very clearly - as I had said it before - that there will be a wage freeze at the companies operating on state subsidy or they should know that if financing the wages creates a loss in the company budget, how much of the loss they can accept when they want to create an additional job. In this we have to provide clear guidance to every company manager, because this is still missing, and if a positive program is created in this and similar areas, in my opinion achieving stability relatively shortly will not remain an illusion. If in these issues we are unable to do anything different than the all former governments were doing, namely pushing the problem from one place to the other, both the stability and the growth remain an illusion.

Debate

Dr. Márton Tardos responding to a question:

I think the question should have been directed to someone who works in the Registration Department, because they would be able to give a more accurate answer. My opinion is that whoever want to make improvements should get started and proceed with the work, but for four years he did not do any improvements. It is true that a company with improved efficiency can be better sold in the privatization process and we should not hinder anyone in this matter. But, please, get started now and make those improvements. Unfortunately this had certain budgetary limitations and those will be present in the future too. And second, in the new privatization bill, which is being reviewed by the various Departments of the Government, there is a method, - which I like very much - which would require the announcement of the intent of privatization of all small and medium-size companies one more time because whatever underwent privatization, has left companies, which have a very good chance to be sold in the privatization process - we already talked about MATÁV, ANTENNA, HUNGARIA (unintelligible) MM, MOL - and there are about 2000 companies that don't have a very

good chance for privatization, regarding these the bill proposes - we'll see how the colleagues will like it - to make new public announcements the second time. Anybody would be entitled to go for them paying at least the limit and if he goes there and accepts it, he owns it. Following this, however, the management of the company would be authorized to try to do its own privatization at this limit price adhering partially to negative, partially to positive sanctions, namely that he (?) would get 10% free. In my opinion the majority of companies will be able to do this. And if the Government decides to make the improvements on certain properties, those should be separated, improved - but this should not be carried out by the Office of Privatization, because it's not part of its job - and then decide if it wants to go through with the privatization or not. The Government has the power to do this. But I think, if we all follow this process, and I think that my colleagues in the economic field will agree with me - that in the past the foreign capital was invested in the so called "green field" projects and not for privatization. If I look at the foreign investments, namely that the majority of them do not include privatized companies and the capital share of foreign investments is below 5%, while it was above 30% before the war, I can say that the "selling out the country" absolutely did not take place, and because there is a recession in the Western World, we cannot sell it. Even if we might want to sell out, but there are no buyers. That's it.

Mr. Ferenc Rollek's comments

I just want to add two sentences to the issue of making company improvements. Basically I don't trust the idea that if these improvements have to be made, the Government should be responsible for it. If there is a good chance for a company after the improvements, and such improvements are realistic, this can be done more efficiently and far better by a private business, and finally if the Government carries out the improvements, it will cost more than the excess amount gained in the sale through privatization. Those companies that have a real potential will be spotted by the private entrepreneur, who doesn't mind to make these improvements himself.

Dr. Márton Tardos's supplementary comment to Mr. Akar's response:

I would like to add two things to what Mr. László Akar said. One of them is that I would definitely like to stress that the new system which is valid according to the current laws has discontinued the subsidies in form of a nominative framework and replaced it with individual agreements. This definitely has to be eliminated. I don't know how we will neutralize the effect of the promises of the Boross Government made during its last days in power to multinational companies offering unbearable tax allowances, but we have to count serious troubles, like tax relief till the year 2000 that was offered by the former government without any countermeasure / counteroffer, but what happened is done, and whatever has a legal basis, it must be acknowledged, regardless how unpleasant it might be. What we can do in cases, when we want to attract a multinational company, and the requirement described also by Mr. László Akar, namely that the tax relief is normative - is strictly applicable, and if it is not enough for them, generally there is a lighter side, which can be discussed, or negotiated, namely that new developments, primarily the "green field" ones, but not only them require investments for their infrastructure too, and that what kind of infrastructure related activity is carried out in the areas where Suzuki already has invested, by the autonomous local governments or the state government to assure that another company investment be placed in the same area in the future, it is an issue where normative agreements are not even possible, and in which the Government would get a negotiating position to attract transnational companies to Hungary.

CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE

REMARKS BY
DAVID COWLES
USAID REPRESENTATIVE TO HUNGARY
The Role of Business in
Policy Reform and Advocacy
Friday, September 16, 1994

USAID has been here since about 1990. To date we have obligated about \$170 million in grant funded assistance to support the transition in Hungary.

It has often been said that there is no road map for countries trying to make the leap from a centrally planned economy to a market economy. But it is equally true there is no road map for donors who would like to support the process. So I would like briefly to describe our strategy in providing a program of technical assistance and cooperation to Hungary to support the transformation.

Hungary today, as is well known by most people in this room, is a real "good news, bad news" story. The bad news is it is difficult. This is the fourth year of recession in Hungary. Industrial production is maybe 70% of what it was in 1985. This is a collapse put on an order of magnitude of the Great Depression in the United States. The corresponding unemployment figures emphasize just how serious it is.

But Hungary also has a tremendous amount of good news: over \$7 billion in direct foreign investment, and a very vigorous and rapidly growing private sector. This then frames the challenge, both for Hungary and for the countries that would like to assist Hungary. How can the private sector be helped to grow fast enough to create the jobs, exports and tax base to support the country through this period of transformation and beyond?

We have devoted a large part of our efforts toward expanding the private sector. Initially we concentrated on privatization, and this is still a very important focus for the US assistance program. It is one of the first and most important steps for shifting GDP from the

public sector to the private sector. As is well known now, over 50% of Hungarian GDP now comes out of the private sector.

Another important element is investment—direct foreign investment. Hungary has been very successful. Investors have come in to participate in the privatization process and also in Greenfield investments. USAID has been very interested in trying to promote the flow of investment capital into Hungary. Investors bring technical expertise along with their capital and access to new markets.

Small business development is also exceedingly important in Hungary. In my view, small business development will ultimately be the most important element of Hungary[’s economic development]. Sooner or later all of the really significant assets held by the state will be privatized.

Foreign investment has an important supporting role to play, but as more and more countries begin their transformation, the competition for investment dollars becomes more intense. In the long run, the indigenous Hungarian private sector has to be the engine of growth for Hungary. This means that new businesses must be created. Informal businesses must grow and enter the formal sector. Small businesses must grow and become and prospering medium and large size enterprises.

Greater employment is needed; now perhaps only 30% of employment comes out of the private sector. Even though we’re getting GDP contributions in excess of 50%, vigorous private sector growth and job creation are essential.

Once the private sector gets bigger, there needs to be an enabling infrastructure supporting the business sector. The first and most obvious part is the macroeconomic climate. Inflation, the budget deficit and foreign exchange convertibility are all very important issues. There must be a host of government institutions and non-governmental institutions in place to support the process. Probably one of the most significant institutions lacking in Hungary today is

an effective banking system to channel credit into the private sector. By some estimates, as little as 5% of all bank lending actually reaches the private sector. Of course, a whole host of legal and regulatory structures are needed to support business. Currently Hungary has a combination of old rules left over from the days of central planning, and a vast number of new regulations and rules enacted in the past four years. When all these factors are taken together, they make up an environment not entirely conducive to rapid private sector growth.

The policies affect a range of actors. There are policy implications for the large foreign investors, who are interested in their tax treatment and foreign exchange issues, as well as repatriation of profits. There are issues that affect small businesses—labor laws, taxation and some of the local zoning issues. How does one acquire property? How do you get something zoned appropriately to conduct business there? Finally, there is Hungary's very large, dynamic informal sector, which is affected by a whole range of government laws and policies.

So how does the government come up with a coherent policy to deal with all these actors in a rapidly evolving situation? Clearly, a dialogue is needed which engages academia, business, and policymakers. People need to come together and talk about the issues. But the challenge to policymakers is incredible. There are many competing demands. Steps that could be taken to improve the macroeconomic climate, curb inflation and deal with the budget deficit can also create immense hardships not only for the population at large, but also for people trying to do business in Hungary. Therefore, as policymakers seek a balance between the demands of competing actors, they need to have the very best information available. They need to hear from the academic community, the business community and the research institutes, and then formulate policies accordingly.

In that regard, a conference such as this is clearly invaluable. Hungary has been a leader in the transformation process as early as 1968, the time of the New Economic Mechanism. Hungary is still a leader in charting the course for the transition.

From the donor's perspective, one lesson learned by USAID in Hungary and elsewhere is that good government policy yields benefits. Donors can help, but there is nothing a donor can do absent good policy. In sum, this effort is extremely important and very timely.

Evaluation of the National Conference on Policy Reform in a Transitional Economy
 September 15 & 16, 1994 - Budapest, Hungary
 Total responses - 40

1. Are you familiar with the work of the following organizations in contributing to the policy reform debate in Hungary?

CIPE	28	70%	IWE	29	72.5%
FR	30	75%	KD	26	65%
FME	9	22.5%	PPI	11	27.5%
BUES	27	67.5%	AID	12	30%

2. Do you represent: (3 answered more than once, therefore total equals more than 100)

Business	13	32.5%	Government	17	42.5%
Media	3	7.5%	Academia	7	17.5%
other	3	7.5%			

3. Please rate the following sessions from least useful (1) to most useful (5)

	1	2	3	4	5
Panel I	1 (3.13%)	4 (12.5%)	9 (28.13%)	16 (50%)	2 (6.25%)
Panel II	3 (9.38%)	2 (6.25%)	13 (40.63%)	11 (34.38%)	3 (9.38%)
Panel III	0	4 (26.67%)	5 (33.33%)	4 (26.67%)	2 (13.33)
Media	0	1 (7.69%)	2 (15.38%)	7 (53.85%)	3 (23.08%)
ERT	0	1 (9.09%)	3 (27.27%)	3 (27.27%)	4 (36.36%)
Manatt	1 (6.67%)	0	2 (13.33%)	8 (53.33%)	4 (26.67%)
Cowles	0	2 (20%)	3 (30%)	1 (10%)	4 (40%)

4. Has this conference provided an adequate forum for high-level discussion of the most effective and open ways to resolve the issues facing Hungary today?

Yes	28	80%	No	7	20%
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5. How important are the contributions of each of the following groups to the reform process (rate on a scale of 1-5 with 1 low and 5 high)

	1	2	3	4	5
Parliament	1 (2.78%)	3 (8.33%)	17 (47.2%)	9 (25%)	6 (16.67%)
Government	2 (5.56%)	5 (13.89%)	11 (30.56%)	10 (27.78%)	8 (22.22%)
Media	1 (2.86%)	2 (5.71%)	9 (25.71%)	20 (57.14%)	3 (8.57%)
Business Leaders	0	5 (14.29%)	5 (14.29%)	20 (57.14%)	5 (14.29%)
Academia	0	2 (5.71%)	10 (28.57%)	18 (51.43%)	5 (14.29%)
Public	3 (9.09%)	8 (24.24%)	13 (39.39%)	7 (21.21%)	2 (6.06%)
Int'l Org	1 (2.78%)	9 (25%)	15 (41.67%)	6 (16.67%)	5 (13.89%)

6. How important do you believe it is to discuss the policy making process

Very important	29	74%
Important	10	26%
Not important	0	

7. Has your perception of the role of the private sector, especially business & research organizations, in the policy-making process changed during the last two years?

No	10	26.32%
Yes	12	31.59%
Somewhat	16	42.12%

Center for
International
Private
Enterprise



1615 H Street, N.W.
Washington, D.C.
20062-2000
(202) 463-5901
Telex 277559 - CIPE UR
TELEFAX 202-887-3447

MAGYAR GAZDASÁGI-JOGI REFORM PROGRAM
EÖTVÖS U. 44. 1. FOLDSZINT BUDAPEST 1067 HUNGARY
TELEPHONE (36-1) 269-5654 (32-1) 353
TELEFAX (36-1) 112-1470

MEMORANDUM

October 4, 1994

Richard L. Leshner
President

Willard A. Workman
Vice President

John D. Sullivan
Executive Director

*Hungarian
Advisory
Board*

Attila Chikán

Anna Halustyik

Michael Haraszti

Árpád Kézdi

Iván Lipovecz

Iván Major

György Surányi

Gábor Széles

Péter Szirmai

György Szücs

Tibor Vidos

György Varga

Peter Zwack

*CIPE-Budapest
Director*

Eric L. Johnson

To: John D. Sullivan
From: Zsuzsanna Lipovecz
RE: Press coverage on CIPE's *National Conference on Policy Reform in a Transitional Economy*
Ref: Attachements

**National Conference on Policy Reform in a Transitional
Economy
September 15-16, 1994**

**A. Print media coverage
Summary**

HVG 24 September

As the culmination of the LRRH Project a conference was organized by the Center for International Private Enterprise. At the conference Márton Tardos, Chairman of the Economic Committee of the Parliament criticized heavily the amendments to the budget submitted by László Békesi, Minister of Finance according to which plan the budgetary deficit should originally have been reduced by 50 billion HUF, an amount of 20 billion HUF was cancelled forced by the social partners and an additional 15 billion HUF do not seem to be properly founded. All this makes the Government's credit impair. Economist László Antal said that the academia has not been able to answer properly to policy and Mihály Laki warned that old cadres who got accustomed to 'advices whispered in ear' have the power again.

Népszabadság 16 September

Professor of law, Tamás Sárközy pointed out at CIPE's conference held at the Hungarian Academy of Sciences that for the coordination and harmonization of interests an institutional form should be created since this institution is not far from the principles of parliamentary democracy.

According to Ferenc Rolek the legal environment of business activities should be simplified and stabilized; tax rates levied on enterprises and the social security contribution reduced in order to achieve a stable economic growth. Whatever measure is introduced discussions and compromises are needed.

Márton Tardos expressed his critique on the Government for declaring a cost reduction program and not to carry it out.

Magyar Hírlap 16 September

The Center for International Private Enterprise (CIPE) organized a conference at the Hungarian Academy of Sciences with the objective to consider the role of the policy makers, academia/researchers, business and the media in the policy reform.

László Akar, State Secretary of the Ministry of Finance believes that strict stabilization measures, a crisis management program need to be introduced and no real income to be raised the coming year.

Tamás Sárközy, law professor warns that Hungary cannot be the state of executives therefore an urgent dismissal is required which measure is unlikely to be carried out by the current Government either. An other issue that he brought up was that the privatization has to be finished very soon no matter at what price. Besides creating an amendment to the constitution and the act on media Parliament should also have an eye for drafting bills on businesses. Following these guidelines Hungary could become a balanced economic legal system by 1998.

Napi Gazdaság 16 September

At the conference of the Center for International Private Enterprise Ferenc Bartha, director of the privatization in Hungary emphasized that the privatization process should be speeded up and finished within reasonable time because delays cause even bigger loss. Hungary already suffered a loss of 700-800 billion HUF because the companies to be privatized had used up a significant part of their assets. At privatizational purchases compensation coupons may be accepted up to 20% as a mean of payment, the remaining bigger part should be paid in cash. According to Bartha future objectives are the creation of the financial stability, the reduction of indebtedness, milder the deficit of the current balance of payment and the launch of a healthy economic growth.

Világgazdaság 16 September

John D. Sullivan, Executive Director of CIPE Washington considered not only the two-day-conference very successful but the transition into a market economy in Hungary as well, although "there is still a lot to be done". The conference was organized by the Center of International Private Enterprise, the affiliate of the U.S. Chamber of Commerce as the culmination of the Legal Regulatory Reform in Hungary Project.

Világgazdaság 17 September

More than 300 people from ministries, the media, business, administration ect. participated in the conference organised by CIPE. László Akar, panellist indicated that although the new Government has been accepted by the society fairly well, it will have to undertake some unpopular and urgent measures to save the economy.

Ferenc Rolek expects the Government to simplify the legal environment, decrease tax rates levied on private enterprises, speed up the privatization process and to guarantee social stability.

Tamás Sárközy, law professor emphasized that the existence of paralelly operating interest organizations slow down the work of the Administration. Speeding up the privatization process would be of vital importance.

Márton Tardos believes that the Hungarian economy can only recover from the crisis if conditions of economic growth are created just like in Germany, Japan and South Korea which he brought up as examples: the accumulated effect of three factors resulted the economic growth in these three countries: the performance of the country exceeded the level of wages, the undervalued currency encouraged export and a significant amount of capital flew into the countries. None of these conditions were realized in Hungary over the past 25 years.

B. Broadcast media coverage
Summary

"Üzlet magazin" - business program September 15 & 16, 1994

Interview with **Ferenc Bartha**, director of privatization in Hungary:

Bartha considers the flow of the privatization process all in all as too slow and not efficient enough. He recommends to spend the state budget more efficient in order to solve problems arising from the privatization and to sell properties involved in the privatization mainly against cash. He plans on changing the flow of the privatization totally to support policy problems. As a new concept Bartha introduced 3 proposals:

- to speed up the privatization process
- to involve experts in the decision & process
- to use the privatization revenue for deficit balance

The major problems of the privatization until the present situation were that many substitutes for money have been used; the privatization itself was very cost effective and the revenue has been put into many decentralized funds (it drained away); not much could be returned into the state budget.

According to Bartha the privatization process can be made more effective in selling high value companies for a good revenue and against cash payment, companies that represent low value with preference.

Interview with **Gábor Rényi**, managing director of Novotrade

Rényi, as moderator of the business panel pointed out that most of the panellists in his panel emphasized that the business sphere and the policy makers should and could cooperate on a formal and informal basis although the informal way has been criticized many times. According to Rényi policy makers should not learn about the interests of the business sphere in an informal way but with the help of interest groups, associations, democratically elected representatives and this on a legal basis. The cooperation between these two spheres seems to work since according to his point of view policy makers want to know the opinion of the business world.

Interview with **Györgyi Kocsis**, economic editor, HVG

Györgyi Kocsis talked about the role of media in the policy process which according to her is basically the interpretation & broadcasting between the different representatives of the society. The readers and politicians are fed up anyway with the complaints of the media when they bore them with own business.

An other remark of her was that the Hungarian media should recover financially very soon because if once it is at somebody else's mercy it could easily get in danger morally.

Népszabadság 15 September

Future of Hungarian Private Enterprises

CIPE's National Conference on Policy Reform in a Transitional Economy held at the Hungarian Academy of Sciences

The Budapest office of the Center for International Private Enterprise (CIPE) organizes a conference entitled "Policy Reform in a Transitional Economy" on Thursday and Friday. The conference held at the Hungarian Academy of Sciences will be the culmination of the "Legal and Regulatory Reform in Hungary" project. The Project with the most outstanding Hungarian experts as participants establishes theses for the leading Hungarian politicians, economists and the entrepreneurs. The most important statements of the conference published in a study entitled "Crossed Paths: Straightening the Road to Private Sector Growth" are as follows.

In September 1992 the United States Agency for International Development (USAID), Regional Mission for Europe granted USD 1 million to the Budapest Information Office of the Center for International Private Enterprise (CIPE) to conduct the Legal and Regulatory Reform in Hungary project.

Between the dates of 30 September 1992 and 1 March 1993, when CIPE opened its first and currently only overseas office in Budapest, CIPE's staff studied the criteria of critical importance to SME development in Hungary. This study involved prominent Hungarians (from academia, Government, media and business) who later agreed to become members of the Project's Advisory Board. They advised the issues to study and the research groups to involve in the Project. The Budapest University of Economic Sciences is conducting a research on the impediments of

the real estate market, and the Financial Research, Ltd. is studying the problems of financing private enterprises. The subject of the study of the Foundation for Market Economy is the informal sector. The Institute for World Economics and the Blue Ribbon Commission Foundation are examining the privatization process. The Kopint-Datorg Foundation for Economic Research is studying the taxation system. The Institute of Political Studies is dealing with the role of local governments in the development of the private sector. Additionally, the Median Opinion and Market Research Company was commissioned to analyze the opinion of the general public and business people on the private sector development. This joint work resulted in the study entitled "Crossed Paths: Straightening the Road to Private Sector Growth" which was sent, before the elections, to the experts of the most important political parties as well.

The poll results analyzed by the Median Company in September 1993 indicate that the Hungarian people have contradictory feelings towards market economy. The majority welcome the political efforts to establish market economy with multi-party democracy. At the same time, many insist that certain activities should remain under state control. However, the majority still consider career opportunities to be better in the private sector. Every sixth person says that he has serious plans to launch a business of his own. It is to be considered that, regarding the Government, banks and taxation, approximately two-thirds of the general public (more than 90 % of the entrepreneurs with experience) state that not enough support is given to new enterprises.

The study also publishes the poll results on privatization and new enterprises. As the most important conclusion, it states that the operating costs of enterprises should be reduced. The privatization techniques should be encouraged which actively

involve the management and employees. Private asset holding and managing companies should be contracted in order to efficiently operate the as yet unprivatized state assets. State funds to be used for the KRP should be rather spent on the extension of the availability of loans to small enterprises. The dumping of government securities should be restricted, and the present bankruptcy rules should not be eased. It is an important statement that the banks and companies whose debts have been written off should be privatized quickly.

The relation of enterprises and taxation was separately studied. The study states that in order to reduce tax rates, which are high by international comparison, basic budgetary reform is inevitable, the expenditure side of the budget should be restructured. It is advised that the corporate tax should be decreased to 30%, the minimum tax should be eliminated, and capital investments should be promoted with tax allowances and accelerated depreciation. The corporate tax code should not be changed annually in order to create a stable economic environment for entrepreneurs.

The average personal income tax should be between 28 and 32%, and the personal income tax table should be decreased to 3-4 tax bands, with a maximum rate of 36-40%. Tax on interest and share income should be eliminated as well. It is also recommended that the allowance after the purchase of long-term state securities should be eliminated, and at the same time the allowance tied to investments into new and existing enterprises should be restored. The authors recommend that the two VAT rates should be drawn closer together in order to reduce the distorting effect of the current price system. (Two rates are recommended: 6-10% and 15-20% respectively.) The experts indicate that the basic social security reform is inevitable, which would result that the obligatory social security contribution will decrease to 15-20%.

Regarding the financing of enterprises, the experts think that action should be initiated by the Government. They suggest that the Government should introduce a taxation system which does not prevent entrepreneurs from accumulating capital. In order to achieve this objective, the Government should pursue an anti-inflation policy and provide tax allowances. It is also recommended that the Government and the chambers of commerce should jointly form a mutual assistance system for the prevention of bankruptcies, which would provide loans under special conditions and free consultations to entrepreneurs facing difficulties due to outstanding debts. Venture capital companies, following the examples of some Asian countries, and investment companies investing into small enterprises are recommended to be established. The decision makers are addressed that only the best performing banks should be involved in the preferential lending projects, and a clearly defined risk sharing agreement should be concluded between the banks and Government in case of preferential loans.

Credit associations for entrepreneurs should be established as well. Non-profit guarantee funds and mutual insurance funds should take over the role of Government guarantee funds. The authors of the study also give their suggestions on a uniform system for defining mortgage rights, the modernization of land market, land valuation and registration systems, and the securities act as well.

The study also analyzes the relation of entrepreneurs and the informal sector. It is recommended that, in order to fight illegal economy, the regulations related to the foundation of companies should be simplified, and "all-in-one place" type offices should be created where representatives of the tax agency, the social security organization and the banks, etc. help the entrepreneur candidate under one roof so that a company can be established immediately.

Vilggazdasg 17 September

No help without social consensus

More than 300 Hungarian and foreign representatives of administration, media and business participated in the conference entitled "Policy Reform in a Transitional Economy" organized by the Center for International Private Enterprise (CIPE) in conjunction with the Economic Committee of the Parliament.

Lszl Akar, State Secretary of the Ministry of Finance stated : "the new government is about to make troublesome decisions which can no longer be postponed, because economy may reach a much more critical situation than the present one". Real wages should decrease in the way that the growth of this year be counterbalanced. The Ministry intends to improve its decision preparation work which will involve research groups of independent experts and social partners as well. The Secretary thinks that after the elections the Government has strong public support, the Council for Interest Co-ordination (T) and the legitimacy of the trade unions are powerful, while the legitimacy of the employers is insufficient.

Ferenc Rolek, Vice-President of General Electric-Tungstam, Member of Presidium of the Hungarian Chamber of Commerce thinks that it is difficult to create the legitimacy of the employers, because the entrepreneurs' sector is in constant motion, and currently the State is the biggest employer. Privatization may change the situation. Mr. Rolek expects the Government to simplify the legal environment, reduce the tax burden of the entrepreneurs, speed up the privatization process and create social stability.

Tam Srkzy, Professor of the Department of Law at the Budapest University of Economic Sciences emphasises that, although the

Council for Interest Co-ordination has no legitimacy, it is an important organization because if the Council did not exist the lobbies would take over its role. At the same time, the existence of paralelly operating interest representing organizations and chambers slow down the work of the Administration several times. Reducing the overdeveloped institutional system is impeded by the conflicting interests of the Administration. For instance, the State Agency for Restitution and Compensation should liquidate itself at the end of the compensation process, and the State Property Agency should do the same at the end of the privatization process.

Speeding up the privatization process is of vital importance. The professor quoted Istvan Tímpe who said that if we did not finish it as soon as possible, it would finish itself, referring to the rapid process of losing the value of companies. Eliminating corruption is important, but focusing on revenue cannot be important. Carrying out the privatization of companies with several value assessments frequently exceeds the revenue itself.

Múrton Tardos, Chairman of the Economic Committee of the Parliament thinks that restriction itself is insufficient to help the Hungarian economy recover from the crisis, it has to be accompanied by creating the conditions of economic growth as well. The expert mentioned the examples of Germany, Japan and South Korea where the accumulated effect of three factors resulted in the solid growth: the performance of the country exceeded the level of wages, the undervalued currency encouraged the export and there was significant import of capital. None of these three conditions were realized in Hungary in the past 25 years. The actions of attracting more working capital and establishing jobs should be improved, and social consensus should be created in the future.

Napi Gazdaság 16 September

Price of slow privatization: 700-800 billion HUF

On Thursday, at the conference of the Center for Private Enterprise (CIPE), Ferenc Bartha, director of privatization in Hungary stated that the privatization process should be speeded up because delays would cause loss of value. He added that the State had already suffered a loss of 700-800 billion HUF, because the companies to be privatized had used up a significant part of their assets in the meantime. Bartha considers supporting the creation of financial stability, reducing indebtedness, easing the deficit of the current balance of payment and launching economic growth as the future objectives of the privatization process. He announced that the purpose of the amendments, to the acts of privatization and ownership, currently being discussed by the different State organizations would be to turn domestic savings to effective investments. According to the plans, small investors and individuals with compensation coupons would be given preference in the process when shares of state owned companies are quoted on the stock exchange. Additionally, the shares of 3-4 investment funds to be established will be offered in exchange for the coupons. In the process of privatization, compensation coupons can be accepted up to a level of 20%, while the remaining bigger part should be paid in cash. There are exemptions from it, such as the agricultural co-operatives and local governments which involuntarily get large amounts of compensation coupons.

Vilggazdasg 16 September

Establishing market economy

The two-day conference entitled "Policy Reform in a Transitional Economy" has been finished. It was organized by the Center for International Private Enterprise (CIPE) in conjunction with the Economic Committee of the the Parliament.

Responding the question of Vilggazdasg, John D. Sullivan, Executive Director of CIPE Washington said that Hungary was following the right way towards establishing the basic institutions of market economy, "but there is still a lot to do".

In 1983 the CIPE was established as an affiliate of the U.S. Chamber of Commerce supported by the National Endowment for Democracy (NED) and the United States Agency for International Development (USAID). Its objective is to strengthen emerging democracies through the promotion of private enterprise, market-oriented economic reform and legal, regulatory institutions.

In March 1993, ten years after its establishment the first and only overseas office was opened by CIPE in Budapest, and the Legal and Regulatory Reform in Hungary Project was launched supported by USAID which involved Hungarian research institutions. As completing the first phase of the Project, a study entitled "Crossed Paths: Straightening the Road to Private Sector Growth" was released in spring 1994. We published an article on the study in the issue of 11 June and also details of it in the issues commencing on 17 June.

The two-day conference finished yesterday was the completing event of the Project attended by representatives of research institutions, business and media. John D. Sullivan considered the conference very successful.

HVG 24 September

CIPE's Conference

Last week, at the conference organized in Budapest by the Center for International Private Enterprise (CIPE), an affiliate to the American Chamber of Commerce, Múrtton Tardos, Chairman of the Economic Committee of the Parliament, member of the Alliance of Free Democrats (SZDSZ, ie. a party in power) criticized the amendments to the budget submitted by Lúszlú Búkesi, Minister of Finance saying that "in comparison to the originally planned reduction of the budgetary deficit by HUF 50 billion, an amount of HUF 20 billion was cancelled forced by the social partners, and an additional amount of HUF 15 billion does not seem to be properly founded, which impair the reputation of the Government". The event is the culmination of the research project supported by CIPE with an amount of USD 1 million during a period of 1,5 years, which provided a framework for 7 Hungarian research institutions to analyze the domestic obstacles towards establishing market economy and to give recommendations how to tackle them. At the conference, economist Laszlo Antal said that research results were not able to give actual answers to the burning questions of economics, and he found necessary a "healthy rotation" among experts of research and economics. Economist Mihúly Laki stated that experts of economics put the questions in a wrong way to the researchers, and he gave a warning saying that "now people are in power who, in the Kúddúr regime, got accustomed to advices whispered in ear".

Népszabadság 16 September

No longer postponing

Tardos: Restrictions are needed

In the opening speech of the conference entitled "Policy Reform in a Transitional Economy", economist Márton Tardos, Chairman of the Economic Committee of the Parliament said that it could be understood if the euphoric atmosphere towards transition got replaced with scepticism. The conference was organized by the Center for International Private Enterprise (CIPE) at the Hungarian Academy of Sciences on Thursday and Friday.

After the opening speech, experts discussed the most urgent duties of economics. Professor of law Tamas Sarkozy argued for creating an institution for interest co-ordination, because after an initial period of mistrust, it is now certain that this institution is not far from the principles of parliamentary democracy. Ferenc Rolek, Vice-President of Tungram Ltd., representing the Hungarian Chamber of Commerce stated that the employers only considered the stability meaningful if it was combined with creating the environment for economic growth. To achieve it, they argue for simplifying and stabilizing the legal environment of business activities, and additionally, for improving the economic environment as well. The present level of financial burden (the social security contribution, in first place, making the cost of labour high - he stressed) on enterprises can no longer be maintained. Mr. Rolek added that this is why he is supporting the thorough reform of the state budget and allocation systems. He emphasized the importance of discussions and compromises, adding that the employers expect the Government not to give up its basic economic objectives.

In the discussion, Marton Tardos criticized the Government for declaring a cost reduction program of HUF 50 billion, saying that

it was necessary in order to create the budgetary balance. Due to the allowances, it would be an achievement to save even the one-third of this amount, which may impair the reputation of the Government. Mr. Tardos says that either the analysis of the situation was wrong or the Government was not determined enough. He thinks that the principle was correct: to introduce restrictions because of the imbalance, even if that they themselves can not be sufficient. Not denying the importance of the socio-economic agreement, Mr. Tardos stressed that resolving the problems can no longer be postponed, because stabilization just remains a mere illusion.

Magyar Hírlap

September 16, 1994

"Hungary cannot be the state of executives"

Economic researchers propose drastic reduction on tax rates

The entire East-European region, including Hungary is in a deep crisis and the 'way out' has not been found yet - this statement was made by Márton Tardos, Chairman of the Economic Committee of the Hungarian Parliament, at the National Conference on Policy Reform in a Transitional Economy that began yesterday. Tamás Sárközy, professor at the Budapest University of Economic Sciences pointed out that Hungary cannot support 1 million executives, therefore an urgent dismissal is required.

The conference held at the Hungarian Academy of Sciences was organised by the Center of International Private Enterprise in conjunction with the Economic Committee of the Parliament and financed by the United States Agency for International Development (USAID). The aim of the conference is to consider the role of academia, business and the media in the policy reform. On the first conference day policy makers discussed questions concerning policy reform.

László Akar, State Secretary, Finance Ministry, believes that in the current situation Hungary is in, strict stabilization measures are required. He emphasized that real income must not be raised next year and that there is no chance to raise the budget spent on social expenditures. According to Akar the policy is full of conflicts - and at a particular time when the financial apparatus is weak - that should be managed by the Ministry. He hopes that the social-economical agreement with social partners will soon be made although tough confrontations are expected.

Tamás Sárközy, professor at the Budapest University of Economic Sciences pointed out that Hungary cannot be the state of executives. The current number of 1 million executives is too high, therefore a considerable dismissal is needed. In his opinion the current government will not carry out this measure either, but he expects a more determined action in this matter this time. The privatization must very soon come to an end it does not matter at what price -he added. To create the amendment to the constitution and the act on media is of great significance, but Parliament should also pay more attention on drafting bills on businesses. Not only regulation is needed but deregulation as well. Following these guidelines Hungary could become a balanced economic legal system by 1998.

Main aim is to encourage enterprises

'The drastic cut on tax rates levied on enterprises' is one of the recommendations of the publication prepared by six research institutions for the conference. The publication (Crossed Paths) containing radical recommendations suggests to decrease the corporate tax to 25%, the mandatory social security contribution to between 15 and 25%, to eliminate the minimum tax and that the dumping of government securities must be restricted.

The six research groups (Grantees) - the Budapest University of Economic Sciences, Financial Research Ltd., Foundation for Market Economy, Institute for World Economics, Kopint-Datorg Foundation for Economic Research and the Public Policy Institute - do not agree with the declaration of the Government's crisis management program according to which the growth of the populations's consumption can be blamed for the depreciation of the balance. Compared to the growth of the households' other salary type real income of 1.9 % in total, the real reason for the deficit is the extremely quick growth of the investments of 55.6%.

BUSINESS

Poll: Free market an unpopular idea

By Mark H. Milstein
Special to The Sun

Hungarians may have decisively rejected communism five years ago, but they have yet to embrace capitalism as an alternative.

Five years after the fall of communism, only about a third of Hungarians still believe in a fully free economy, and almost half now think that some "mixture of a socialist and market economy would be the most attractive option," according to a new study.

The study, 18 months in the making, was released by the Center for International Private Enterprise (CIPE) as part of a two-day conference on policy reform.

In spite of the mixed, sometimes contradictory feelings echoed by Hungarians polled by CIPE, the study urges the government to press forward with market reforms begun shortly after the 1989 collapse of communism.

"Hungary has been proudly held as a model of reform and economic progress," the study's authors wrote. "Continued attention to these vital issues is needed if Hungary is to remain the standard-bearer for reform and economic development in Central Europe."

In contrast to the near-euphoric optimism that existed in 1990, polls commissioned by

CIPE show that at the end of last year two out of three Hungarians were not satisfied with the direction of economic changes.

From among the various social groups polled, only entrepreneurs desire an even freer economy. But even they favor restricting foreign acquisition of some property in Hungary.

The study emphasized that for those committed to a market economy, the poll results are a warning sign that supporters of private enterprise are in the minority.

At the same time, the study noted, the average Hungarian does not reject "out of hand" elements necessary for basic change in the system.

"Although their number has decreased, almost two-thirds still approve of the establishment of a multiparty system and are not against political efforts to form a market economy," the study said.

Regarding the Hungarian government's relationship with the banking and tax systems, approximately two-thirds of the public at large, and more than 90 percent of entrepreneurs, think that not enough official support is given to new enterprises.

In addition, the study went on, more than 80 percent of the entrepreneurs surveyed

are not satisfied with the loans available for start-up enterprises.

There is a widespread belief, the study concluded, that the Hungarian tax system is unfair and restricts growth.

Other major roadblocks to business development cited by those entrepreneurs polled included poor access to telephones, the slow pace of banking operations, and the almost absolute lack of market information.

Lastly, the study noted that "inevitably there must be a point where the paths to privatization and to private-sector growth cross.

"Policy-makers must also puzzle out necessarily interrelated conundrums such as how to reconcile tax revenue with social spending and how to withdraw the state from the marketplace without throwing too many people out of work or into the informal sector."

CIPE was chartered by the U.S. Chamber of Commerce in 1983 to "promote and strengthen emerging democracies through the promotion of private enterprise." It receives most of its funding through the U.S. Agency for International Development.

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CONGRESSIONAL RECORD—*Extensions of Remarks*

July 27, 1994

There are no American citizens being held in Haiti against their will. There is no Communist threat. There is no economic benefits to be won or lost in Haiti. There is no one who will reimburse our war chest. There is, however, a political threat regarding Haiti, and that is the threat to President Clinton's face. Soldiers should not be left to defend the character of a U.S. President. Soldiers should not be left without a Congress that lacks courage.

There is absolutely no reason for my son to be put in jeopardy in Haiti. Democracy and its freedoms must be fought for, first, by native sons and daughters. This is not happening in Haiti. Show me one piece of rationale that I can lay at my son's grave or carve on his tombstone. Then, and only then, will I sleep at night with the comfort that a supreme sacrifice could be justified.

Mr. Speaker, I agree with Mr. Burt's position on this issue. While I support the restoration of democracy in other countries, I will not support military intervention to accomplish this unless vital American interests are clearly at stake. The situation in Haiti does not meet this criteria, and thus a United States invasion of Haiti would be unwarranted. American men and women should not be sent into combat as a substitute for sound foreign policy.

PERSONAL EXPLANATION

HON. JAMES L. OBERSTAR

OF MINNESOTA

IN THE HOUSE OF REPRESENTATIVES

Wednesday, July 27, 1994

Mr. OBERSTAR. Mr. Speaker, last Friday the House of Representatives considered the bill H.R. 3838, housing and community development authorization for fiscal year 1995 and fiscal year 1996, and my vote was not recorded on the Kim amendment as amended and on final passage.

During the consideration of this important legislation, I was attending several meetings in Minnesota to announce the resumption of work at National Steel Pellet Co. in my congressional district.

Had I been present, I would have voted "nay" on the Kim amendment as amended, rollcall vote 348, and I would have voted "aye" on final passage for H.R. 3838, rollcall vote 349.

CIPE'S PROJECT IN HUNGARY

HON. BENJAMIN A. GILMAN

OF NEW YORK

IN THE HOUSE OF REPRESENTATIVES

Wednesday, July 27, 1994

Mr. GILMAN. Mr. Speaker, I would like to take this opportunity to commend the Center for International Private Enterprise, an affiliate of the U.S. Chamber of Commerce and one of the core institutes of the National Endowment for Democracy, on its participation in producing "Crossed Paths: Strengthening the Road to Private Sector Growth." This study was produced as a part of CIPE's legal and regulatory reform in Hungary project with funding from the U.S. Agency for International Development.

The most exciting part of CIPE's project was that it forged a strategic partnership between seven leading Hungarian think tanks and set up an advisory board of Hungarian business,

media, and academic leaders. This kind of real partnership is all too rare in our foreign assistance efforts and I commend USAID for supporting this work.

The joint study issued a set of recommendations, including a decrease in corporate taxes of up to 30 percent, major social security reform, and a national land registry and mortgage loan system. The organizations making these recommendations were the Budapest University of Economic Studies, real estate market, Financial Research, Ltd., financial sector, the Foundation for Market Economy, informal sector; the Institute for World Economics; Blue Ribbon Commission Foundation, privatization process, the Kopint-Datorg Foundation for Economic Research, tax system; and the Public Policy Institute, private sector development and local government.

CIPE will sponsor a conference in Budapest in September, which will produce a more complete analysis. The final report will be disseminated to leading Hungarian policymakers.

To date, the list of recommendations of the report include:

In order to channel more personal savings into privatization, the dumping of government securities must be restricted.

A customer-friendly network of local branch banks must be established where local bankers and small entrepreneurs can prepare business plans together.

The corporate tax should be decreased to 30 percent and the minimum tax must be eliminated.

Capital investments, especially as regards the application of advanced technology, must be promoted with tax allowances and accelerated depreciation.

Basic social security reform is inevitable. The mandatory social security contribution, which entitles contributors to the basic services, should be decreased to between 15 and 25 percent.

Venture capital companies, following the successful example in some Asian countries, and regional or sectoral companies should be formed to promote investment into small enterprises.

In order to boost the market for turnover to land, a new system of land valuation and registration must be developed and adhered to. An inevitable prerequisite for a workable mortgage system is the establishment of an up-to-date, legitimate land registry system.

A national network of mortgage loan and land loan financial institutions must be established having the overriding mandate to serve the needs of the entire agricultural community.

"All in one", one-stop offices must be created where representatives of all the applicable agencies and authorities, together with the banks, are housed under one roof so that a candidate may establish a company with minimal effort.

TRIBUTE TO EUNICE CASTRO

HON. LINCOLN DIAZ-BALART

OF FLORIDA

IN THE HOUSE OF REPRESENTATIVES

Wednesday, July 27, 1994

Mr. DIAZ-BALART. Mr. Speaker, I would like my colleagues to join me in recognition of Eunice Castro's fine work as a journalist for the Galena section of *El Nuevo Herald* as well as her authorship of a series of biographical

novels—in particular your work on Jose Marti—I would like to extend my sincerest congratulations to her.

The nature and success of Ms. Castro's work truly is commendable. Her writings have served as a bridge to unite the Spanish speaking communities throughout the Americas, and have earned her recognitions from the Argentine and Canadian Governments. Eunice Castro's work has served as an inspiration for many in our community.

I would like to publicly congratulate her and extend to her my sincerest admiration, for all this and much more. I wish Eunice Castro and her family continued success and good fortune.

HON. DOUG BERETTER

OF NEBRASKA

IN THE HOUSE OF REPRESENTATIVES

Wednesday, July 27, 1994

Mr. BERETTER. Mr. Speaker, this Member commends to his colleagues an editorial which appeared in the *Omaha World-Herald* on July 19, 1994.

[From the *Omaha World-Herald*, July 19, 1994]

AMERICA NEEDS TO REGAIN VISION IT TOOK TO ACHIEVE MOON LANDING

For many Americans, the memories are sharp, inked in black and white like the pictures on the front pages of newspapers across the country.

Neil Armstrong, fresh-scrubbed farm boy from Ohio, Ungainly in a pillowy white space suit, step-hopping down onto the surface of some place that was not the Earth. Dust fountaining up from his boot in slow motion. Footprints on a world where no foot had ever set down before.

Twenty-five years has passed since that moment. Twenty-five years since Apollo 11, years full of significant events—wars, death, births, changes for the better, changes for the worse.

When Astronauts Armstrong, Buzz Aldrin and Michael Collins were strapped into their small space capsule atop an enormous Saturn rocket, they flew more than the first mission to the moon.

The technological wizardry that boosted them so high, so fast was staggering. The Soviet Union had launched Sputnik, the first orbital satellite, hardly more than 10 years before. The United States played catch-up for only a short while. Then it began leading—to the moon.

With the launch, July 16, 1969, went the prayers and hopes of millions of Americans. The mission unified the nation at a time of dissension. People were awestruck at the feat. Everyone wanted it to succeed.

And it did. Armstrong bounced down on the moon's surface. Aldrin followed. They cavorted playfully in the moon's lighter gravity. They planted a rigid U.S. flag where no breeze would ever blow. They gathered moon rocks. They came back to their home planet, Earth, as the first men who had touched another world.

How audacious it was, that journey. How magnificently bold. For millions of years, the moon had hung in the heavens, waxing and waning with the days. Airless, waterless, a place of love songs and dreams.

And aspirations. Just as, not a decade before, Orion John Glenn's first orbit of the Earth inspired a generation, so did Armstrong's "small step for (a) man." But where

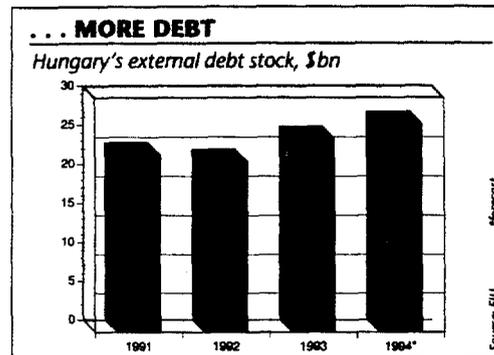
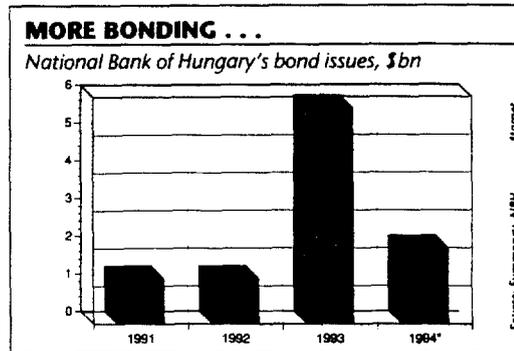
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Hungary's sovereign borrowing

Leveraged transformation

There are two ways of looking at Hungary's spectacular showing – by Central European standards – on the international bond markets last year. One is that the National Bank's ability to raise \$5.7bn in 18 issues in eight different markets proves that investors have confidence in Hungary's economic future. The other is that Hungary is scrambling for money to make repayments, a vicious debt circle that large amounts of borrowing can only worsen.

The Bank's deputy president, Frigyes Hárshgyi, rejects the scare theory out of hand. The large-scale borrowing last year, he claims, was a well-grounded strategy. For a start, he was able to achieve three policy goals: keeping foreign exchange reserves high – they grew to around \$7bn from less than \$5bn last year, despite the growing current-account deficit; demonstrating Hungary's ability to attract the money it needs; and diversifying the supply of capital away from the Japanese and German markets.



The plethora of issues towards the end of the year – there were eight in the

final quarter – was merely making use of excellent conditions on the markets before the inevitable sobering that finally arrived in February, when US interest rate were raised. The Bank, says Mr Hárshgyi, used around 20% of last year's credit for pre-payments and some also for refinancing, evening out the debt-servicing bump that would otherwise have hit hard in 1996.

Investors appear to agree that Hungary's a good bet. The spreads over domestic sovereign issuers – in other words, the extra interest that Hungary as a higher-risk issuer has to offer investors – dropped from an average of 270 basis points to around 220 at the end of the year (a fall of around half a percentage point). This year's two issues – \$70m in Luxembourg francs in March and \$85m in Austrian schillings in May – have stayed at the 220 level, despite the generally unfavourable market conditions. Maturities also lengthened from an average of 6.5 years in the first half of 1993 to nine years in the second half.

The ratings agencies, though cautious, are also not fazed by last year's borrowing spree. "If we had doubts, we wouldn't give Hungary a BB+, which is the highest speculative rating," says Helena Hessel, East European analyst for Standard and Poor's. "The pre-bor-

WHAT SHOULD HUNGARY'S NEW GOVERNMENT DO?

Here's what a recently published report*, prepared by leading Hungarian think-tanks and the Washington-based Center for International Private Enterprise, suggests:

- Restrict the the dumping of government securities in order to channel more personal savings into privatisation.
- Reduce the operating expenses of state-owned enterprises.
- Quickly privatise the state-owned banks and companies whose debts have been written off.
- Don't ease up on the present bankruptcy rules.
- Restructure the expenditure side of the budget, so as to make tax reduction possible.
- Cut corporate profit tax to 30% and eliminate the minimum tax on turnover.
- Promote capital investments, especially for advanced technology, with tax allowances and accelerated depreciation.
- Lower the mandatory social security contribution to 15-25% (from 43% now).
- Pitch the average personal income tax liability at between 28% and 32% (with a maximum rate of 40%).
- Close the huge gap between VAT rates (present rates are

10% and 25%), and simplify filing procedures.

- Stop making frequent and contradictory changes to the tax code.
- Encourage the formation of venture capital companies, following their success in some Asian countries.
- Develop a new system of land valuation and registration, and stick to it, in order to boost the market for and turnover of land. A workable mortgage finance system needs above all an up-to-date, legitimate land registry system.
- Establish a national network of mortgage-loan and land-loan financial institutions to serve the needs of the entire agricultural community.

Contributing organisations: The Budapest University of Economic Sciences, Financial Research Ltd, The Foundation for Market Economy, Blue Ribbon Commission, Kopint-Datorg, Public Policy Institute and Medián.

* Crossed Paths: Straightening the Road to Private Sector Growth, contact: John Sullivan, CIPE in the US; Fax: (202) 887 3447



U.S. Chamber of Commerce
1615 H St., NW
Washington, DC 20062

Media Relations Department (202) 463-5682

NEWS

Contact: Thomas Love

FOR IMMEDIATE RELEASE

RECOMMENDATIONS PREPARED FOR NEW HUNGARIAN GOVERNMENT

WASHINGTON, May 11 -- After Hungary's parliamentary elections, that country's leading think tanks have united to present a coherent set of policy recommendations to the new government. The recommendations have been published in *Crossed Paths: Strengthening the Road to Private Sector Growth* by the Legal and Regulatory Reform in Hungary Project of the Center for International Private Enterprise, an affiliate of the U.S. Chamber of Commerce, with funding from the U.S. Agency for International Development.

In releasing this report, Willard A. Workman, U. S. Chamber of Commerce vice president, international, said, "These measures are important to regenerating the stalled Hungarian economy and to help Hungary regain its economic leadership position in the region."

Key recommendations call for a decrease in corporate taxes to 30 percent, major social security reform, and a national land registry and mortgage loan system.

The organizations that made these recommendations are:

- The Budapest University of Economic Sciences (real estate market)
- Financial Research, Ltd. (financial sector)
- The Foundation for Market Economy (informal sector)
- The Institute for World Economics/Blue Ribbon Commission Foundation (privatization process)
- The Kopint-Datorg Foundation for Economic Research (tax system)
- The Public Policy Institute (private sector development and local government)

The USAID grant for this project is designed to improve the legal and regulatory environment for small and medium private businesses in Hungary. The project will publish a more complete analysis this summer and will hold a conference in Budapest in September, where these recommendations will be formally discussed, developed and disseminated to Hungarian policy makers.

Attached are the recommendations from the publication.

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(Copies of the publication are available from Media Relations.)

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Here is a sampling of the recommendations to be found within:

- In order to channel more personal savings into privatization, the dumping of government securities must be restricted.
- A customer-friendly network of local branch banks must be established where local bankers and small entrepreneurs can prepare business plans together.
- The corporate tax should be decreased to 30 percent and the minimum tax must be eliminated.
- Capital investments, especially as regards the application of advanced technology, must be promoted with tax allowances and accelerated depreciation.
- Basic social security reform is inevitable. The mandatory social security contribution, which entitles contributors to the basic services, should be decreased to between 15 and 25 percent.
- Venture capital companies, following the successful example in some Asian countries, and regional or sectoral companies should be formed to promote investment into small enterprises.
- In order to boost the market for the turnover of land, a new system of land valuation and registration must be developed and adhered to. An inevitable prerequisite for a workable mortgage finance system is the establishment of an up-to-date, legitimate land registry system.
- A national network of mortgage loan and land loan financial institutions must be established having the overriding mandate to serve the needs of the entire agricultural community.
- "All in one", one-stop offices must be created where representatives of all the applicable agencies and authorities, together with the banks, are housed under one roof so that a candidate may establish a company with minimal effort.

The Center for International Private Enterprise (CIPE), an affiliate of the U.S Chamber of Commerce. CIPE was established in 1983 as part of the United States's efforts to assist in the development of market-oriented democratic societies around the world. CIPE has provided financial support and technical assistance for over 300 projects in 45 countries. CIPE and the United States Information Agency also co-publish *Economic Reform Today*, a magazine focusing on public policy and economic reform issues in Spanish, English, and Russian. Funding for CIPE's programs comes from the National Endowment for Democracy, the U.S. Agency for International Development, and private foundations.