Regulatory Reform in Hungary

Government Capacity to Assure High Quality Regulation

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FOREWORD

Regulatory reform has emerged as an important policy area in OECD and non-OECD countries. For regulatory reforms to be beneficial, the regulatory regimes need to be transparent, coherent, and comprehensive, spanning from establishing the appropriate institutional framework to liberalising network industries, advocating and enforcing competition policy and law and opening external and internal markets to trade and investment.

This report on *Government Capacity to Assure High Quality Regulation* analyses the institutional set-up and use of policy instruments in Hungary. It also includes the country-specific policy recommendations developed by the OECD during the review process.

The report was prepared for *The OECD Review of Regulatory Reform in Hungary* published in 2000. The Review is one of a series of country reports carried out under the OECD's Regulatory Reform Programme, in response to the 1997 mandate by OECD Ministers.

Since then, the OECD has assessed regulatory policies in 16 member countries as part of its Regulatory Reform programme. The Programme aims at assisting governments to improve regulatory quality — that is, to reform regulations to foster competition, innovation, economic growth and important social objectives. It assesses country's progresses relative to the principles endorsed by member countries in the 1997 *OECD Report on Regulatory Reform.*

The country reviews follow a multi-disciplinary approach and focus on the government's capacity to manage regulatory reform, on competition policy and enforcement, on market openness, on specific sectors such as telecommunications, and on the domestic macro-economic context.

This report was principally prepared by César Cordova-Novion, and Scott H. Jacobs, in the Public Management Service, OECD. It benefited from extensive comments provided by colleagues throughout the OECD Secretariat, as well as close consultations with a wide range of government officials, parliamentarians, business and trade union representatives, consumer groups, and academic experts in Hungary. The report was peer-reviewed by the 30 member countries of the OECD. It is published under the authority of the OECD Secretary-General.

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Can the national administration ensure that social and economic regulations are based on core principles of good regulation? Regulatory reform requires clear policies and the administrative machinery to carry them out, backed by concrete political support. Good regulatory practices must be built into the administration itself if the public sector is to use regulation to carry out public policies efficiently and effectively. Such practices include administrative capacities to judge when and how to regulate in a highly complex world, transparency, flexibility, policy co-ordination, understanding of markets and responsiveness to changing conditions.

In less than ten years, Hungary has largely completed an historic transition touching social, political, and economic aspects of life. With respect to the public sector and the state/market relationship, Hungary is now entering the mainstream of OECD countries, that is, there are continuing problems, but these are not qualitatively different from similar problems facing many other industrialised countries. Hungary's reforms have been sustained over several years. The speed of reforms has hardly declined since 1989 and even accelerated after 1995 due to efforts to close the gaps in policies and capacities before accession to the European Union. This effort has given the Hungarian government a policy credibility that substantially increases the value of its policy reforms. The challenges ahead are nonetheless difficult, since they lie in improving policy coherence and co-ordination across a multi-layered governance system, implementation of current policy directions that have not yet produced the practical results expected, and upgrading skills and embedding cultural change into state institutions.

Regulatory reform has been central to policies of democratisation, marketisation, public administration modernisation, devolution to local governments and harmonisation with EU legislation. From overarching rules of constitutional governance to economic, social and administrative regulations, Hungary now has a new legal and regulatory framework, increasingly sophisticated administrative and institutional arrangements and more efficient, transparent and accountable regulatory practices. The judicial branch has also been strengthened and modernised, though there is room for further progress.

Hungary's approach to regulatory reform has been a pragmatic re-orientation of the role of the state vis-à-vis the market and citizens. Economic structural reform beginning in the 1970s was completed in the 1990s. Since 1989, the economic reforms were complemented by a major effort to modernise public administration, including the regulatory framework. Two extensive reviews of the regulatory system eliminated thousands of unneeded regulations. In the mid-1990s, the government adopted policies to improve the processes by which new laws and regulations were developed, based on quality criteria inspired by OECD recommendations. Regulatory Impact Analysis was introduced, though it has faced much difficulty in implementation. Reform initiatives were steered from the centre of the government and were supported by the public and the business community.

Today, the new government is focusing on fine-tuning the quality of the national regulatory structure and correcting and improving capacities for implementation inside the administration. The policy includes the upgrading of regulatory management tools, the review of the role and functioning of regulatory agencies, and the reassessment of the devolution process to subnational entities. As is natural when profound reform is undertaken, changes to the practices and working methods of the public administration lag behind formal policy reforms. Attention should shift to implementation and enforcement of the regulatory reform agenda over the medium-term. Effective compliance by the line ministries with new horizontal requirements for the review of new and existing regulations is an important challenge. Some ministries and regulators have not made the cultural leap to a less interventionist role, and this is particularly true for sub-national bureaucracies. Gaps, weaknesses and shortcomings still exist in current regulatory practices and procedures and should be corrected. For instance, more transparency and accountability should be built into regulatory consultation, as well as into the devolution process of regulatory powers to municipalities and to professional organisations.

Creating a sustainable regulatory management system of high quality will permit Hungary to reap greater benefits from EU accession, and also provide it with a strong institutional basis after accession for more rapid economic and social convergence with other European countries. To these ends, the government of Hungary should:

- ***Improve political accountability for progress and co-ordination of regulatory reform by restoring the role of the Prime Minister's Office or by forming a Ministerial Committee such as that used in the Netherlands. Improve the oversight and quality of policy advice by establishing a central unit to monitor, promote and co-ordinate activity in close co-ordination with the Ministry of Justice.***

At the end of the "deregulation process," institutional arrangements for promoting regulatory reform were modified and accountability for regulatory management was transferred to the Ministry of Justice. However, regulatory management requires political discussion and resolution. Ultimately, it relies on sustained political support to ensure that government-wide policies on regulatory quality are carried out effectively and consistently (especially with respect to powerful ministries). Further, though regulatory reform, in its deregulation component, has achieved much in Hungary, regulatory quality management should be conceived as a permanent governance task aimed at ensuring that governmental regulatory functions contribute over time to the highest possible level of economic and social development. This suggests that regulatory management should be moved back to the centre of government as a core management function applicable to the whole of government. Both political surveillance and expert advice are needed. If political oversight is to be effective, a central unit with expert technical capacities and autonomy to review the activities of the ministries will be necessary.

- ***Improve the policy foundation for the efficiency, independence and accountability of new independent regulatory agencies by developing guidelines for their systems of governance, policy coherence, working methods, and relations with the competition authority. A high-level and independent review of these issues would be a useful step.***

Increased attention in Hungary to the creation of market-oriented regulatory institutions will improve the legal and administrative environment for competition and business growth. Development of a framework for efficiency, accountability, and transparency will accelerate progress in this regard. An independent expert group could review the institutional architecture for market-oriented regulation to determine if a harmonised framework would improve efficiency and competition in regulated sectors. A second aspect of the review would be to focus in improving the internal governance arrangements in each sectoral regulators so to improve their efficiency, accountability, transparency and adaptability to changes.

- ***Make mandatory the Regulatory Impact Assessment, based on OECD best practices, for all proposed regulations, adapt it to the "two stage approach", and harmonise it with the ex post enforcement reports to parliament.***

The government intends to strengthen RIA in Hungary. This is an important initiative and an opportunity to concentrate on crucial aspects to maximise RIA potential contributions, such as its mandatory nature for all proposals (laws government decrees, ministerial orders, etc.) with a targeting mechanism; a strong benefit/cost test; its integration with the public consultation process; its incorporation to the "two stage process" for taking major government decisions, and its harmonisation with the ex post mandatory evaluation required by the Act on Legislation.

- ***Promote the adoption of market-oriented policy instruments through guidance and training***.

More than many other countries, Hungary has been aware of the need to move away from rigid 'control and command' requirements to more efficient and flexible kinds of incentives. The Act on Legislation and the successive regulatory reform programmes support the use of less intrusive instruments and market-based approaches. Nevertheless, these legal and policy frameworks have not expanded much the actual use of alternatives to traditional regulations. Stronger encouragement form the centre of the government is needed, as well as support through training, networking, guidelines, cross-fertilisation and learning between sectors, and expert assistance where necessary. A promotion and monitoring programme would help regulatory bodies reduce the informational barriers to using innovative policy instruments.

- ***Improve transparency by further strengthening the public consultation process through standard procedures and criteria, and by adopting government-wide notice and comment procedures. A high-level advisory council on regulatory reform should be reinstalled.***

The new policy of expanding the use of codification committees is a positive step for Hungarian regulatory consultation. However, three initiatives could rapidly enhance the scope and quality of consultation processes, and reduce the risk of undue influence by special interests. First, a thorough clarification of the rules, criteria and parameters mandated by the Act on Legislation would harmonise the numerous and different practices now applied at the discretion of lawdrafters and ministries. The rules should also apply to ministerial orders and "grey regulations". Second, a legal requirement for 'public notice and comment' should be applied to all draft regulations. Third, to support regulatory reform and encourage a pro-reform constituency, a body akin to the Deregulation Council should be reinstalled as a high-level advisory group to the government.

- ***Improve regulatory clarity and simplicity by better lawdrafting***

Laws and regulations in Hungary are still written to be read by law specialists. This situation is rooted in the strong and deserved tradition of legal accuracy in Hungary. However, experiences in other countries have proved that the legal quality of a regulation is not impaired by the use of a user-friendly vocabulary, structures and complementary techniques. Hungary's legal and regulatory framework would thus profit if a principle of plain language drafting is adopted and quality controls are put into place for enforcing it. Training courses and a strong awareness campaign among the faculty of the law schools could also support this initiative.

- ***Strengthen accountability by reviewing discretionary powers in the interpretation and application of regulations by enforcement staff, and by strengthening the act on administrative procedure.***

Delimiting appropriate discretionary powers of regulators and enforcers is a very tricky endeavour. Setting a right balance between the use of "common sense" judgements and an extremely detailed list of micro-regulations requires time and the development of a legal culture beyond the formal legal arrangements. Nevertheless, this is a crucial task for many economies in transition where principles of legality, good faith, reasonability and proportionality of the exercise of administrative power are not ingrained in the regulators or enforcers' culture. Consequently, delegated powers can permit abuse and errors. As a transitional measure to permit the new culture to emerge, a good step for Hungary would thus be to pay extra attention to the amount, limits and accountability measures surrounding the devolution of interpretative and discretionary powers. A place to start this focused review could be in procedures of licences, permits, customs or other common formalities. Furthermore, Hungary could control the excessive discretion by incorporating general principles and explicit criteria in the Act on General Rules of Public Administration Procedures.

- ***Strengthen requirements for accountability and transparency for subnational authorities.***

Devolution of regulatory powers to local governments was a bold initiative which fostered democracy and strengthened the subsidiarity principle. However, the government should accompany this process with accountability and transparency measures to be applied before, during and after the local government's bylaws are passed to reduce the risk of harmful regulatory competition, capture by interest groups, harmful impacts on competition, and corruption problems in subnational governments.

- ***Improve implementation of the regulatory quality policy by the public administration by enhancing oversight and monitoring by the centre of government, by moving to results-oriented management, and by investing in training for skills.***

During the decade-long transition in Hungary, the implementation capacities of the civil service have lagged behind policy changes. Today, as the legal framework for a market economy is completed and the flow of policy reforms slows, modernisation of the public administration is a high priority for the overall effectiveness of the regulatory framework for both economic and social policy. Institutional mechanisms should be created at the centre of the government to monitor the implementation of policies and to improve accountability for performance. This may require clearer regulatory quality targets for each ministry that can be externally monitored. A public inquiry on the degree and trends of regulatory compliance in economic and social policy areas may raise awareness among the ministries about the real performance and the quality of their regulations and/or their implementation. The government should continue to train regulators and administrators, emphasising economic and managerial skills, and an understanding of appropriate role of the state in a market economy.

1. REGULATORY REFORM IN A NATIONAL CONTEXT

1.1. The administrative and legal environment in Hungary

Hungary has a long and strong tradition of well-developed legal frameworks, institutions, and administrative procedures, many of which are rooted in the Austro-Hungarian Dual Monarchy. These legacies were assets of enormous value at the end of the four decades of the communist period, since Hungary's task was mostly to strengthen and rebuild, rather than to create institutions from new cloth. Hungary's transition to a market democracy, while enormously difficult and risky, was faster and more secure as a result.

Though still unfolding after 10 years, the main pillars of the new Hungarian legal and administrative system are now largely completed and functioning. That so much was completed in such a brief period is a testament to the consistency of purpose of successive governments, as well as to the value of pre-existing institutional foundations. Four (usually) mutually supportive goals guided the process of state re-invention: 1) democratisation, 2) deregulation and re-establishment of a market economy, 3) decentralisation and debureaucratisation of public administration (also called de-statism), and 4) European accession.

- First and foremost, the Hungarian transformation was aimed at reconstructing its democratic institutions. This required reforms to the role, culture, institutions and instruments of the state, and opened the door to a new role and structure of civil society.

- A second goal was consolidation of a market economy. Privatisation and liberalisation transformed the relations between the state, market, and society, but they were in themselves insufficient to establish a working market. The main challenge, rather, was to build new market institutions and fill regulatory gaps. In a few years, the Hungarian state had to change a command economy into a modern regulatory state of the kind that Western countries had built over 50 years. This was a conceptual as well as a technical transformation. From government procurement laws to property rights, bankruptcy, and business start-up rules, many of the regulations and institutions needed for the smooth operation of markets have been established and secured. Today, most of the challenges facing Hungary in this field are not extraordinary, that is, they are as difficult as those facing other OECD countries, not more. One might say that the market challenges have been largely normalised.

- One of the more difficult and still uncompleted tasks has been the decentralisation of state powers both vertically and horizontally. Before the transition, a strong party controlled most of the powers of the state. With the change of regime, the other two branches of government -- the legislative and the judiciary -- emerged as powerful pillars of the state, in addition to a re-invented executive power. Through a rapid, perhaps too rapid, devolution process, more than 3 000 subnational governments with important regulatory powers were established. Their capacities do not yet match their roles and duties.

- Accession to the European Union is today a major strategic policy and drives a far-reaching process of convergence towards the harmonised regulatory and institutional framework of the European *acquis communautaire*.

Achieving these goals in practice required a near-total and rapid overhaul of the regulatory framework, incorporating both deregulation and re-regulation. Today, Hungary has a practically new legal system, though it has always retained the essential structure and tradition of a civil law system, similar to those in Germany and Austria. Since 1989, successive governments eliminated large swathes of laws and other regulations. At the same time, each year the Parliament passed more than a hundred laws; the government adopted twice as many decrees, and the ministries promulgated many hundreds of orders (See Box 2 and Figure 2 in Section 4).

Reforms have also reversed the balance between laws and subordinate regulations. The communist-era system of thousands of decrees and few laws is now a system that tends to produce extremely detailed laws as power has flowed from the administration to the legislature. The discretionary powers of the administration have systematically been reduced. While this is a desirable element of the democratisation process, and an accurate reflection of the extent to which new values of the market democracy were differently reflected in different institutions, the detail of Hungarian laws threatens, over the medium-term, to increase rigidities and costs of the legal system. The answer in future lies, not in replacing the public administration with detailed laws, but in improving the capacities, accountability and transparency of the public administration in achieving public policy goals and in establishing principles for the legal system to interpret and apply "rigid" rules flexibly.

Box 1. **Good practices for improving the capacities of national administration to assure high quality regulation**

The OECD Report on Regulatory Reform, welcomed by Ministers in May 1997, includes a co-ordinated set of strategies for improving regulatory quality, many of which were based on the 1995 Recommendation of the OECD Council on Improving the Quality of Government Regulation. These form the basis of the analysis undertaken in this report, and are reproduced below:

A. BUILDING A REGULATORY MANAGEMENT SYSTEM

1. Adopt regulatory reform policy at the highest political levels
2. Establish explicit standards for regulatory quality and principles of regulatory decision-making
3. Build regulatory management capacities

B. IMPROVING THE QUALITY OF NEW REGULATIONS

1. Regulatory Impact Analysis
2. Systematic public consultation procedures with affected interests
3. Using alternatives to regulation
4. Improving regulatory co-ordination

C. UPGRADING THE QUALITY OF EXISTING REGULATIONS

(In addition to the strategies listed above)

1. Reviewing and updating existing regulations
2. Reducing red tape and government formalities

The speed of change in legislation has created a certain degree of instability. The imperative to create a new legal order has meant frequent changes, amendments, creation and destruction. This phenomenon, called in Hungary "legislation dumping", was compounded by the alternation of four governments, three of them coalition ones. In recent years, laws in effect frequently had to be quickly amended and corrected. Although an indicator of the responsiveness of the government and parliament to the new demands of society, such a rapid legal and regulatory turnover erodes legal quality and legal security. Moreover, Hungary has not been immune to the "legislative illusion" afflicting other countries, where laws are promulgated for all possible problems, without sufficient attention to results and alternative instruments.

Another important feature of the evolving Hungarian legal and regulatory system is the increasing role of the judicial system. The courts are today constantly involved in solving issues and disputes between citizens and the government, between different levels of government, and even between parliamentary and government authorities (see Section 3.1.5). Not too remote from the US model, legal challenges are now an integral part of the regulatory process. For instance, the Constitutional Court seems to be among the busiest in the world and its judicial review of laws and regulations offers a check and balance mechanism to parliamentary and administrative powers. This is a vivid indicator of the extent to which the rule of law has been restored in Hungary.

In parallel with legal reconstruction, Hungary has taken important steps to re-build the administrative capacities of the state. A major overhaul and downsizing of the public administration[1] has apparently increased the efficiency and overall quality of the bureaucracy. However, these reforms were painful and slow, and changes in the culture, quality and efficiency of the administration have lagged legal reforms. Despite recent performance-based measures, a relative and absolute drop in public servants' remuneration has accompanied down-sizing. Salaries have declined relative to the rapid increases in the private sector. The gap has encouraged a serious brain-drain, affecting the most highly skilled and recently trained professionals. There is rapid turnover. A consequence of this is the difficulty in recruiting young professionals with skills necessary for the demands of the current government.[2]

A second challenge for the Hungarian public administration is its current knowledge base and skills. While the civil service is traditionally reputed to be highly educated, technical credentials and in particular legal knowledge predominate, rather than administrative or management skills.[3] This leads to, for instance, a strong legalistic approach to problems. This narrow skills base might also explain difficulties in replacing 'control and command' regulations by less intrusive instruments. The dominance of lawyers in the policy making structure might also hamper the need to instil greater empirical and market methods, such as *ex ante* and *ex post* evaluations, in policies and regulations.[4]

Over the course of the transition, the government has been challenged by corruption scandals in the administration. Stronger controls have been put into place, and transparency and accountability have increased. However, petty corruption at the street level, in the police forces, customs service, and local administration remains a problem.[5] Additionally, some cases of conflict of interest among high civil servants moving from the public to the private sector -- to positions in private enterprise related to former regulatory duties -- undermine the credibility and apparent neutrality of the civil service.[6]

Administrative effectiveness has also been impaired by weaknesses in policy implementation. The Hungarian public administration has strong roots in the highly centralised and hierarchical experience of the Austro-Hungarian Dual Monarchy mould.[7] The strong role of the centre at the ministerial level has helped in improving the speed and coherence of policy making. Decisions move quickly through the Cabinet, for example. However, there is little follow-up of implementation. Below the level of political policy makers, the bureaucracy becomes fragmented and not very accountable for results. This reduces the impact of reforms. Weaknesses in implementation and accountability in part reflect administrative traditions, and in part a very complex reform process. In the early phases of transition, administrative decentralisation of implementation was part of an effort to make the administration more responsive and inclusive. Encouraged by coalition governments since 1989, a myriad of committees and semi-autonomous bodies were set up with policy responsibilities. Some ministries in addition to the Prime Minister's Office played a horizontal co-ordinating role, such as the Ministries of Interior and Justice. But implementation was seen by the line ministries as their responsibility, and the ministerial administrations have resisted outside scrutiny. For instance, the European Commission found that ineffective inter-ministerial co-ordination caused stagnation and delays in developing coherent regional policy and implementing it (in particular with respect to the European regional development funds).[8] Although there are recent efforts to improve this situation by strengthening the policy oversight capacities of the PM's office (see discussion of the *Referatura* below), the Hungarian government is still faced with the paradox of strong centralised policy powers and weak implementation mechanisms by a fragmented administration.[9]

These challenges are comparable to those facing other OECD countries in their modernisation and transition to more efficient, flexible, and results-oriented public management. Experience in many countries shows that administrative renovation always lags behind legal reforms, since administrative culture is longer and harder to change. But, as the Hungarian government has recognised, weaknesses in implementation can substantially reduce and slow the gains of policy and legal reforms for economic and social policies, with negative effects on quality of life, on political will, and on public acceptance of reforms. Results-oriented implementation by more effective public sector institutions has become a high priority task.

1.2. Recent regulatory reform initiatives to improve public administration capacities

Hungary's approach to regulatory reform has been a pragmatic transformation of the role of the state vis-à-vis the market and the citizens. The starting point and the speed for reform of the two relations have differed. Economic reforms, concentrating on the type and extent of state intervention, preceded the reforms to the public administration. The economic reforms have gone further, with more success. In both, depending on political opportunities, gradualism has been mixed with bold initiatives.

Through a sustained effort spanning decades, Hungary developed a well functioning market economy.

Two decades of cautious economic change laid the foundations for a successful transition in 1989. Hungarian regulatory reforms extend back several decades. Reflecting political conditions, waves of reform were separated by pauses.[10] A major step was taken in 1968 when Hungary introduced the New Economic Mechanism to increase enterprise autonomy and the role of markets in economic decisions. Although the role of the state was maintained, its means of intervention changed from command to regulation. Regulatory and monetary instruments gradually replaced central planning. Direct controls over enterprise actions, such as market entry and exit, were reduced, and indirect instruments such as controls over price, wages, exchange rates, taxes and subsidies were introduced. Foreign direct investment was permitted in 1972 and a first local government act was passed. However, by the mid-70s, the reforms were slowed or reversed. A second wave in the early 1980s permitted the regularisation of small private co-operative ventures. In 1984, Hungary embarked on a third wave of reforms definitively anchored in principles of a market economy. A competition law was enacted that year, a comprehensive banking reform was launched a year later, and price and trade liberalisation was undertaken during 1988 and 1989.

The 1989 change of regime accelerated the pace and content of reforms. The new government consolidated the economic infrastructure of a market system through mutually-reinforcing policies: privatisation, deregulation, re-regulation, institution building, and consolidation of competition and trade-oriented economic policies. These reforms had major implications for restructuring of the Hungarian economy, and hence major social impacts. Generally, due to effective timing and sequencing (while not always deliberate) and formation of state-of-the-art policies, Hungary moved faster and with fewer mistakes than many other transition countries.

Restructuring, under the IL of 1992 Bankruptcy Act, led to the closure of many non-profitable companies and an increasing shift over the decade to more efficient production methods. Slow in the first half of the decade, privatisation under the Privatisation Act accelerated after the 1995 macro-economic stabilisation package. Mass privatisation and other "big bang" approaches were avoided. Most of the process was based on negotiated transactions, management buyouts, auctioning, and fixed term concessions. Further liberalisation of state infrastructure occurred through Built-Operate-Transfer contracts in transport and energy production, among other sectors.[11] Deregulation reduced the intervention of the government in huge areas of the economy. This was done through strengthening competition policy under the aegis of a strong and independent authority (see Background report to Chapter 3).

Marketisation of the economy proceeded in parallel with construction of an economic legal and regulatory framework based on historical and comparative models. Regulations were reformed to guarantee the legal security necessary for economic activities and the operation of the market. These reforms supported and accelerated privatisation. In particular, price liberalisation and rebalancing proceeded steadily. Today, remaining price controls concern services provided by lingering legal and natural monopolies, including postal, railroad, telephone, household gas and electricity tariffs (see Background reports to Chapters 5 and 6). Reforms have continued in the area of the capital market and financial services.

In market openness, considerable progress has been made in creating conditions necessary for free movement of goods (see Background report to Chapter 4). Tariffs and many non-tariff barriers have been removed. A gradual and planned deregulation of restrictive measures relating to foreign trade is underway. Steps were also taken concerning the free flow of goods, the regulation of patents to suit the requirements of a market economy, and the regulation of accreditation of the certifying and supervisory organisations of technical norms. The prospect of accessing the EU markets has framed and strengthened the whole process (see section 2.3).

Through these mutually supporting reforms, most economic sectors are now exposed to market forces. The private sector accounts for about 80% of GDP (29% in 1989), one of the highest shares in the OECD. Chapter 1 details the impacts of these economic reforms on economic performance in Hungary. This result, made at great effort and cost, strengthens the credibility of future reform processes.

Reform and modernisation of the state came later and results are slower to appear.

In Hungary, economic and political reform preceded administrative and social reforms. Although some basic laws existed before 1989 such as the 1957 General Rules of Public Administrative Procedures Act and the 1987 Act on Legislation, after the regime change the government rapidly focused on rebuilding governance capacities, that is, the architecture of the state. A major overhaul of the 1949 Constitution was the first priority to create a new state based on democratic institutions, the rule of law, constitutional safeguards, and the clear separation of powers (parliament, government and judiciary). A large number of new and critical institutions were created, such as the parliamentary ombudsmen, the constitutional court, the establishment of local self-government, and legislative provisions for the status of the civil servants.

Two important reform initiatives of the central administration merit special attention. It was recognised as essential to restore trust in the institutions of governance, which had been discredited under the former regime, and at the same time increase the overall efficiency of the public sector. Both goals required establishment of a politically neutral, efficient civil service. First among other central and eastern European countries, Hungary adopted in 1992 a new Civil Service Act.[12] This law and its 1995 and 1996 amendments re-define the duties and entitlements of public employees, and regulate and control the work of civil servants. The Act includes rules on assessment of personnel performance, promotion and right of appeal, open recruitment by contests, obligations of confidentiality, severance from political affiliation, and ethical conduct. It also creates a system of long-term planning and funding for training civil servants. In many ways, the Act contributed to the creation of a modern public administration as a solid pillar for the new state. The new law played a stabilising role during the transitional period, although progress is still needed to implement and consolidate a new culture for a modern and efficient public administration.[13]

In October 1996, after a wide and open consultation spanning two years, the government launched 21 programmatic actions to further reform the state structure and public administration,[14] grouped into five pillars: (i) fine-tuning the civil service law, (ii) further development of the system of local government, (iii) administrative simplification, (iv) extension of information technology tools, and (v) an

ambitious programme of regulatory review of existing and new laws and regulations (see Section 2 below).[15] Relevant aspects of these reforms for regulatory management and reform are discussed in detail below.

An important step was Hungary's assumption of the European Agreement of 1994, and its commitments to bring its existing stock of regulations into legal harmonisation with EU regulations and directives. The process co-ordinated by the Ministry of Justice was led and prepared by a systematic comparison of the domestic stock of laws with the *acquis communautaire* (see Section 2.3).

Box 2. **Selected reform legislation relating to regulatory reform in Hungary**

- The General Rules of Public Administrative Procedures Act (IV of 1957), amended 1981 and 1991
- The Economic Associations Act of 1988
- The Constitution of 1949, amended comprehensively in 1989 and 1990, as well as in 1993, 1994, 1995 and 1997
- The Deregulation Act (XXII/ of 1990)
- The Bankruptcy Act (IL of 1991)
- The Privatisation Act (XXXIII of 1991)
- The Act on the Prohibition of Unfair and Restrictive Market Practices (the Competition Act) of 1984, amended in 1990 and 1996 (LVII of 1996)
- The Local Self-Government Act (LXV of 1990); amended in 1994.
- The Administrative Jurisdiction Act (XXVI of 1991)
- The Civil Service Act (XXIII of 1992); amended in 1995 and 1998
- The Parliamentary Ombudsman for Civic Rights Act (LIX of 1993)
- The European Accession Agreement Act (I of 1994)
- The National Standards Act (XXVII of 1995)
- The Regional Development and Regional Planning Act (XXI of 1996)
- The Registration of Companies, Public Company Information and Court Registration Proceedings Act (CXLV of 1997)

2. DRIVERS OF REGULATORY REFORM: NATIONAL POLICIES AND INSTITUTIONS

2.1. Regulatory reform policies and core principles

The 1997 *OECD Report on Regulatory Reform* recommends that countries adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation.[16] The 1995 *OECD Council Recommendation on Improving the Quality of Government*

Regulation contains a set of best practice principles against which reform polices can be measured.[17] In Hungary, improvement of capacities to promote regulatory quality has consistently moved toward OECD good practices, though there are gaps and important areas remain to be implemented.

Consistent with the sequencing of regulatory reform concepts followed in most OECD countries (deregulation to regulatory quality to regulatory management[18]), government policy has evolved from a pure economic deregulation approach to the establishment in recent years of a regulatory management system. Three programmes have made most of the progress.

The first programme (1989 – 1991) aimed for massive deregulation of obsolete laws and regulations. Under the responsibility of two parallel Deregulation Councils, one of which reviewed economic regulations, and the other, public administration regulations, the government organised a "sweeping eradication of all measures exposing citizens to unnecessary control from the government and to devolve power to the lowest level possible of authority".[19] However, a change in government halted the programme between 1991 and 1994.

In August 1994, following an election commitment, the new government launched a more structured three-year policy. The policy was prepared in three steps. First, a Government Commissioner was nominated and a single Deregulation Council established.[20] Four months later, the Commissioner presented a first preliminary deregulation programme. Finally, in September 1996, the government published a regulatory policy as part of the 21 action programme for reforming the state and the administration.[21] Although still based on a piecemeal approach, the new policy included a series of actions, timetables for reporting progress and specific requirements which gave coherence to the exercise. Considered as a first phase of a long-term approach, the policy mainly focused on concluding deregulation. Nonetheless, the programme established seven goals consistent with OECD best practices. That is, it aimed to:

- Review laws and regulations governing the functions and powers of the public administration.
- Review and justify existing laws and regulations ("controlling the stock").
- Review the establishment of new laws and regulations ("controlling the flow").
- Improve law enforcement and implementation of regulations through an administrative simplification programme.
- Encourage and support local government regulatory reform initiatives.
- Promote new forms of organisation of public administration services, such as outsourcing and contracting out.

Further, the policy established principles of 'good regulation' as explicit standards for regulatory quality to guide the review of existing and new regulations, in part inspired the OECD *Recommendation on Improving the Quality of Government Regulation*. The Hungarian policy listed familiar threshold questions as tests for new or existing regulation: (i) Can the regulation be avoided? (ii) Is there an alternative to the proposal? (iii) Do the benefits justify the costs of the regulations; (iv) Is the implementation of the regulation feasible? (v) Has the public been consulted? (vi) Is the regulation consistent with the legal and regulatory framework? (vii) Will the regulation be supported by adequate communication?[22] To assess those questions, the Government Commissioner, with the help of the Ministry of Justice, prepared a voluntary regulatory checklist and guideline widely distributed across the government (see Section 3.3).[23] The Government Commissioner also recommended setting up specialised "deregulation units" in each Ministry.

Although the deregulation part of the programme was successful in eliminating a huge number of existing laws and regulations (see Section 4.1), the implementation of new capacities for quality regulation within the administration was unsatisfactory. At a maximum, the review process reduced "regulatory inflation", but it did not ensure a satisfactory and growing quality of new laws and regulations.[24]

In May 1999, directly flowing from the experience of the previous programme, the incoming government presented a new two-year programme.[25] As in the previous administration but with a new institutional arrangement, the regulatory reform policy is imbedded into a public service development strategy. The government emphasises that the new policy is intended to fine-tune and "further improve" the quality and efficiency of government work. It is explicitly a forward-looking programme aimed at building institutional capacities for effective regulation and implementation. Revision and elimination of existing regulations takes a lower priority. Agenda 2000 for EU accession acquires a prominent role. Specifically, the new programme covers four priorities:

- Review of competencies and tasks of regulatory institutions;
- Review of the devolution process to match capacities with responsibilities, in particular identify how to strengthen the regional level;
- Expand the adoption of new technology in the public sector; and
- Improve the quality of the administration's human resources.

Four major actions are particularly noteworthy due to their potential effects on regulatory capacities. First, the government proposes in 2000 to reform the Act on Legislation (XI/1987) to improve *ex ante* and *ex post* impact assessment of draft regulation. Second, the government has launched a review of the General Rules of Public Administrative Procedures Act (IV/1957) to strengthen individuals' guaranties and rights with respect to appeals, decisions, delays, and so forth. Third, the general review of regulatory agencies and bodies provides an opportunity to strengthen the independence, transparency and accountability of sectoral regulators, although at this time the aim of the review is not clearly indicated. Fourth, the programme proposed major reforms to sub-national government and strengthening of institutions at the regional level (see Section 2.3). However, a major gap in the 1999 programme is that it does not improve the enforcement of quality principles for regulation nor the institutional arrangements needed for quality assurance at the centre of government in charge of regulatory management.

2.2. Mechanisms to promote regulatory reform within the public administration

Reform mechanisms with explicit responsibilities and authorities for managing and tracking reform inside the administration are needed to keep reform on schedule, and to avoid a recurrence of over-regulation. As in all OECD countries, Hungary emphasises the responsibility of individual Ministries for reform performance within their areas of responsibility. The Act on Legislation states that line ministers play a decisive role in the direction of their sectors and that there should not be an hierarchical relationship between the prime minister and line ministers.[26] But it is often difficult for ministries to reform themselves, given countervailing pressures, and maintaining consistency and systematic approaches across the entire administration is necessary if reform is to be broad-based. Since 1990, Hungary has used different solutions to manage and control the regulatory system. All of them share one characteristic, namely, that the Prime Minister's Office and the Ministry of Justice have played prominent roles.

Until 1998, the Prime Minister's Office (PMO) had the main responsibility for deregulation and regulatory reform policy. In 1994, a **Government Commissioner for the Modernisation of Public Administration** was nominated to prepare the strategic programme, organise public consultation and communication activities, develop recommendations and government policies, and co-ordinate individual ministries' proposals through the completion of an agreed plan. The Government Commissioner operated a central unit employing 18 officials – though only a small team was dedicated to regulatory affairs. Government decrees gave him two significant powers. First, he attended, with the same rank, weekly Administrative State Secretary meetings. Second, he could prepare a "supplementary report to the government focusing on the full range of costs, benefits and impacts" on all ministries' submissions to the government.[27] An advisory Council for Deregulation -- formed 1/3 by administration representatives and 2/3 by participants coming from academia, business and other non-governmental sectors -- supported him. The Ministry of Interior nominated the members of the Council, subject to the concurrence of the Ministry of Justice and the Ministry of Finance.[28]

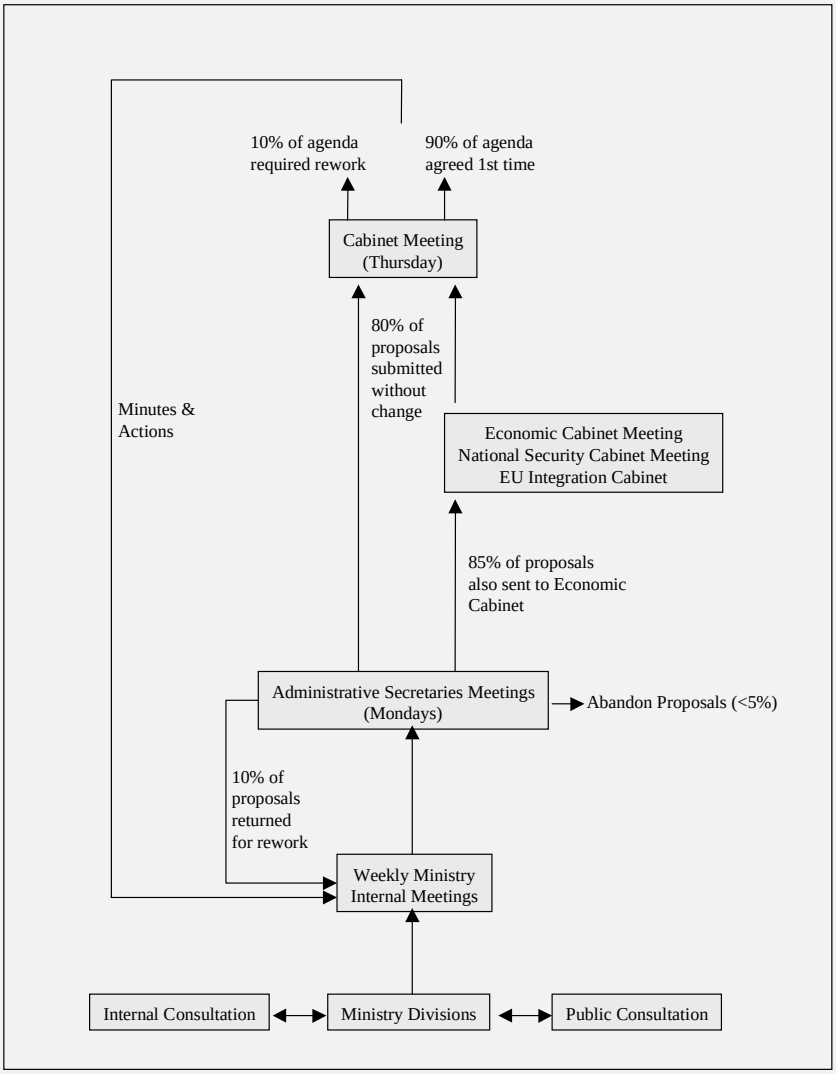
The government did not renew the Government Commissioner position in 1998. Its co-ordination and management responsibilities were transferred to the **Ministry of Justice**.[29] However, the strategic and policy-making aspects on regulatory reform and public administration were kept in the PMO under the responsibility of a Political State Secretary. The PMO hosts the secretariat of inter-ministerial commissions and cabinets. Among these, the weekly meeting of the Administrative State Secretaries plays an essential co-ordination, debate and decision-making role on regulatory affairs (see Box 3 and Figure 1).[30] The main purpose of this meeting is to agree on the issues to be discussion by the government at cabinet level. Without the approval of this meeting, items may only be included on the government's agenda with the permission of the Prime Minister. The administrative state secretaries of all ministries attend the meeting, which is organised, convened and presided over by the PMO's administrative state secretary.

In November 1998, a new system of policy co-ordination called the ***Referatura*** was created in the PMO. This special body, modelled on one existing in the German Chancellery, is composed of a group of experts who shadow each Ministry's activities. The objective is to have experts representing the central perspective involved in the preparation of ministries' documents and proposals from the early stages. The Head of the *Referatura* also attends the weekly Administrative State Secretaries Meetings. Each ministry's desk officer within the *Referatura*, together with a lawyer from the PMO Legal Department, prepares a joint note on all submissions. The joint note describes the proposal; the outcome of inter-ministerial consultations; unresolved issues; and proposals for improvement. The PMO administrative state secretary uses this brief to resolve any outstanding disputes. This arrangement is too new to be evaluated, though the *Referatura* seems to be functioning more as an information source than as an independent analyst of proposals or dispute mediator. In other words, it enhances co-ordination but does not serve a challenge function.

Box 3. **The "two stage process" of regulatory review**

The government relies on a two stage process to prepare important legal proposals to parliament and draft government decrees. The weekly Administrative State Secretaries meeting discusses at least twice all higher-level regulations: first, in the form of a policy "concept" and second, as a concrete legal text. Prior to the meeting, Administrative State Secretaries receive the drafts and attached documents (see Section 3.1.1). In some specific cases, the "concept" may be discussed and approved by the political state secretaries, who meet every other week, acting as an advisory forum before being discussed by the administrative state secretaries. The Government's current regulatory reform programme intends to expand the use of the two-stage process to a larger group of subordinate regulations, in particular as a way to foster discussions on alternatives to regulations.

Figure 1. **The organisation of policy making in Hungary**



Source: World Bank, *Public Administration Development in the EU Accession Context: The Civil Service in Hungary*, Washington, forthcoming, p. 36.

With the new re-organisation of regulatory management powers, the Ministry of Justice has become in practice the principal administrator of the regulatory system, and thus the last "technical filter" to ensure the quality of the regulation before final decisions are made at the government level. Indeed, as guarantor of the legality of the administration, the Ministry of Justice is responsible for the legal quality of draft laws and government decrees and is notified of new ministerial orders. It has a right of veto (rarely exercised) on the preparation of laws and government decrees.

As in most OECD countries, ministers are responsible for the preparation and drafting of the text. However, as a central element of the Hungarian normative process, the Act on Legislation establishes the responsibility of the Ministry of Justice in preserving the harmony of the legal system and ensuring the legal quality of the individual drafts. Accordingly, the Minister of Justice must:

- Present, to the government (*i.e.* the Administrative State Secretary meeting), together with the proponent ministry, the draft of a proposed law;
- Authorise, before it is presented to the government, the draft of a government decree;
- Be notified when a minister wants to publish a ministerial order.

The Ministry is also in charge of four related missions.[31] First, the Ministry prepares the biannual, annual and tri-annual legal programmes of the government, and monitors and facilitates implementation. Second, in co-ordination with the Ministry of Foreign Affairs, it is responsible for the legal harmonisation with the European Union. Third, the Ministry is the depository of the legal instruments of the state. It is in charge of publishing the catalogue of laws and subordinate regulations, and assigning the identification nomenclature of the major legal instruments of the government. Fourth, it prepares and communicates guidelines and instructions to promote the quality of legal drafting (Section 3.1.4). Traditionally, the Ministry of Justice has enjoyed a high technical reputation in the Hungarian administration. This influence will be critical in the enforcement of enhanced regulatory tasks, as neither new budgetary and human resources nor powers accompanied the new tasks delegated in 1999.

The Act on Legislation also requires that proposed laws be sent to the Attorney General and, depending its nature, to the President of the Supreme Court if the legislation affects the scope of authority of the courts, and to the county and capital municipalities if it may impact significantly the activities of the local governments. The Government Resolution 1088/1994 requires also that drafts of rules should be sent to the eight National Associations of Self-governments, which represent the municipalities. In total, this mechanism means that hundreds of legal and regulatory drafts circulate each year across the government.

The Standing Orders of the Government lay down the procedure for co-ordinating policy, and include time scales for consultation and submission of proposals for inter-Ministerial clearance.[32] Before the discussions at the Administrative State Secretary meetings, the proponent ministry circulates the draft legislation and government decrees across the government, either in the form of policy "concept" or as a drafted text (see Box 3 on the "two stage regulatory process"). In the second stage, the proponent ministry circulates the draft after agreement with the Ministry of Justice. Article 29 of Standing Orders of the Government specifies that, as a main rule, a minimum of 15 natural days should be provided for internal consultation on a text. However, in practice, ministries set a period of 5 days or less for receiving comments.[33] Normally, ministries provide written comments, but a significant number of face-to-face discussions and inter-ministerial meetings may be organised. During the Administrative State Secretary meetings, the remaining differences and controversies are resolved before final decision is taken at the cabinet of Prime Ministers level. This process applies only for draft laws and government decrees.

However, in practice, the system varies according to ministers and ministries. Proponent ministries have a certain amount of discretion in selecting the list of official recipients. No specific rule or criteria exist about the attached documents, the minimum amount of time for inter-ministerial consultation, record keeping obligations or answering comments. In part due to this, some failures in the internal circulation of the drafts have occurred in the recent past. In some cases too little time for commenting has been allocated, and some important agencies, as for example the competition authority did not received regulations that have impacts on their policy area.[34]

Two other government ministries supplement the oversight mechanisms of the PMO and the Ministry of Justice. The Ministry of Finance approves all measures with budgetary and fiscal impacts, and the Minister of Foreign Affairs co-ordinates international and European substantive issues.

Outside the Executive branch, a series of other bodies exert essential regulatory powers and influence in the development and improvement of the legal and regulatory environment. The **Hungarian Competition Office** (HCO), an independent public institution responsible to parliament, has strong competition advocacy powers. For instance, its annual report to parliament and frequent research reports have raised important competition issues in existing and proposed regulations.[35] Further, albeit never used, the HCO may challenge in court particular actions and decisions, but not normative acts produced by any agency, ministry or municipality, under the competition law. It may also bring a constitutional court action too; whether that could be done against a normative act in the abstract, rather than a particular application of it, is constitutionally debatable. The HCO president attends the cabinet meetings and the Vice President the Administrative State Secretaries ones. On both meetings, the HCO has the right to comment on any proposals discussed. However, its views have no binding effect. The HCO may also delegate representatives to other regulatory bodies, for instance to the Public Procurement Council pursuant to the Public Procurement Act, and to the Customs Tariff Committee or the Privatisation agency. However, the relationship and competition responsibilities between the HCO and the sectoral regulators require further clarification (see Background report to Chapter 3).

Finally, the **Parliament**, as the main law drafter, and the **constitutional court**, as supreme legal reviewer, play key roles in the legal and regulatory system in Hungary.[36] Transformed from its role under the former regime as an enactor of government decisions, the Parliament has become the main forum to channel public demands, find compromise, and assure accountability. At present, a dozen "field experts", with a similar status to civil servants, support the tasks of the parliamentary committees. Their small number and lack of resources, combined with an overloaded legislative agenda, may have had a negative impact on the quality of legislation in the past decade.[37] The constitutional court has played a very active and visible role in Hungary. For instance, the court recently rejected several laws in a package of amended legislation on fighting organised crime as unconstitutional.

2.3. Co-ordination between levels of government

The 1997 OECD Report advises governments to "encourage reform at all levels of government." This difficult task is increasingly important as regulatory responsibilities are shared among many levels of government, including supranational, international, national, and subnational levels. High quality regulation at one level can be undermined or reversed by poor regulatory policies and practices at other levels, while, conversely, co-ordination can vastly expand the benefits of reform. In Hungary, the past decade has seen a variable devolution of power from the centre to sub-national governments and growing harmonisation with European levels. The policies and mechanisms for co-ordination between levels of administration are thus becoming increasingly important for the development and maintenance of an effective regulatory framework.

National – local co-ordination. The principle of local self-government was reintroduced in 1989-90 as an expression of commitment to democracy. The devolutionary process was among the more comprehensive and liberal in post communist countries.[38] The speed and scope of its development, and its enduring political and popular support are proof of its popularity. The main vehicle for devolution is the Local Self-government Act LXV of 1990 which established a two-tier system: a lower tier of 3 172 "self-governing local authorities" (municipalities) consisting of villages, towns and metropolitan districts and a higher level of 19 "counties" and Budapest.[39] The few specific powers allocated to the latter, however, have causes some analysts to describe the system as two-level: national and self-governing local levels.[40]

Municipalities have broad administrative powers in many policy areas, which they exert with considerable independence from the central administration. In general terms, the municipalities are responsible for public policies at local level in environmental quality, local development, and economic infrastructure. They also provide important public services, such as housing, primary education, health care and social security. They take responsibilities on matters of local concern not covered by the statutory responsibilities of another authority.[41] They can also collect taxes, set public services tariffs and provide fiscal subsidies (although in practice they have been reluctant to impose local taxes). The municipalities control extensive assets. According to the Ministry of Interior, their total assets exceed one fourth of the national wealth.[42]

The role of the 19 counties is mainly as a provider of services to municipalities. The 1990 Act reduced considerably the authority and competence of this thousand-year-old institution. In practice, municipal decisions and agreements define the counties' functions.[43] The main areas of activity are environmental protection, tourism, regional employment and professional training. Counties also collaborate in the provision of public services beyond the boundaries of small settlements (chiefly in public health and general education and culture). It is important to note that counties are functionally but not hierarchically different from the municipalities. That is, the judiciary system, including the constitutional court, intervenes in disputes between counties and municipalities.[44]

For planning and statistical purposes, Hungary was further divided in 1996 into seven administrative regions under the Regional Development Act.[45] Each region now possesses a regional development council. Presently, the Parliament is considering amendments to this act to increase the management capacities of the development council in the use of regional development funds. This may result in a reorganisation of functions with the Territorial Offices and in some cases with counties and municipalities.

In parallel with the devolution process to local government, since 1994 the central government has deconcentrated authority to **Territorial Offices** corresponding to the 19 counties plus Budapest. Under the responsibility of the Prime Minister's Office, the Territorial Offices perform budgetary and some administrative functions, such as exercising legal control, undertaking non-political activities and acting as authorities of second instance in specified matters. The offices are vehicles for implementing some regulations in areas reserved to the central government.[46] In the first years after the reform, many municipalities had difficulties in effectively exercising the new responsibilities transferred from the county level. Thus, many line ministries began to build their own decentralised organisation at local and regional level in parallel to Territorial Offices. Recently, the government under budgetary pressures has been reducing the number of these offices though some overlap still exists.[47]

The processes of devolution and deconcentration have meant that Hungary is increasingly administered at local levels. However, real and potential problems of regulatory duplication, overlapping, and inefficiencies have been created. In addition to inefficiencies arising from municipalities too small to reap economies of scale, and transitional problems of creating, maintaining and improving an effective municipal civil service, two major regulatory problems can be detected.[48] First, the Act and subordinate

regulations do not provide precise definitions of the mandatory functions and content and level of the services to be provided by municipalities. As a result, significant confusion and overlap exist at local levels.[49] Secondly, the lack of separation of ownership and regulatory functions of municipalities has raised important economic, competition and ethical problems. Municipal service providers in areas such as water and sewage utilities, district heating, local public transport, waste collection and disposal or the operation of cemeteries, compete directly with private enterprises (sometimes previously owned by the municipalities). This situation is aggravated by the fact that even when property rights are clear, municipalities have price-setting authority and thus can intervene in markets and investment flows.

The existing control and accountability mechanisms over local governments are not easy to use. To resolve some of these problems, the government depends on judicial review and voluntary co-ordination mechanisms.[50] As indicated, municipalities are not subordinate to the central government. Thus, the latter, as other parties such as the competition authority, may exert *ex post* legal control only through the judiciary and basing their acts on the unconstitutionality of the bylaws. As a preventive mechanism, the Local Self-Government Act of 1990 provides an *ex ante* notification mechanism. Municipalities forward their bylaws before enactment to the Territorial Office, which may request amendments. However, if a municipality rejects the amendments, the head of the Territorial Office may appeal to the Constitutional Court to annul the local government bylaw (or its provisions). The Territorial Office is not entitled to declare any decision void or amend it.

Second, the government has encouraged co-operation, and attempted to raise awareness and provide tools to help local governments produce better regulations. During the 1995-1998 regulatory reform programme, the government commissioner supported the review and improvement of municipalities' bylaws and regulations through guidelines and training material.[51] Since September 1998, the Political State Secretary of the Prime Minister's Office set up a forum for local self-governments where the National Association of Municipalities, the Chamber of Civil Servants and the Association of Notaries participate. Through this forum the government informs them about its regulatory plans and programmes. In addition, the central government can provide assistance on regulatory matters.

Nevertheless, such mechanisms appear to be insufficient for quality regulatory management between levels of governments. Major concerns are the lack of clear dispute resolution mechanisms with the administration and the slowness of the judicial system in appeals. Although the rate is diminishing, dozens of appeals against municipalities are still entangled in long and cumbersome judicial proceedings. Usually, challenging a municipality in court takes years, while the bylaw remains in effect. Accordingly, taking advantage of cumbersome enforcement powers of the Territorial Offices, entrepreneurial mayors take the risk of implementing objectionable regulations, hoping that any redress will happen when the political local environment has changed.[52] This might explain, for instance, the "competition" between municipalities to attract investment based on a "race to the bottom" on regulatory and fiscal issues or, more tellingly, on environmental enforcement policies.[53] Likewise, consultation with the National Association of Municipalities or main counties is by nature advisory and does not provide robust enough dispute settlement mechanisms and an efficient co-ordination between system the central government and municipalities and between municipalities.

In part to solve these issues, the government has initiated studies for further amendments to the Self-Government Act.[54] An important proposal under study is to change the burden of proof in the regulatory controls carried out by the Territorial offices. Without impeding the right of appeal of the concerned municipality, the Territorial Office could suspend the introduction of faulty local bylaws before their application. Additionally, the central government has proposed to parliament some amendments to the Regional Policy and Development Act and to the Self-Government Act to strengthen the powers of the intermediary level of government, that is, of the seven regions.[55] The main purpose is to improve compatibility with the regions of other EU countries (*i.e.* NUTS II level), and to enhance efficiency of the regional public administration.

Co-ordination with European institutions. As one of its highest policy priorities, Hungary's commitments and continuing negotiations with the European Commission have been a major force in shaping regulatory reform in most economic, social and administrative sectors, and in the administration's capacities to produce high quality regulations. Accordingly, the strategy, institutions and processes to incorporate the European *acquis communautaire* (see Box 4) into the Hungarian legal and regulatory system, called the Approximation Process, have been fundamental elements of regulatory reform.

Box 4. The European *acquis communautaire*

The *Acquis* ***communautaire*** comprises the entire body of legislation of the European Communities that has accumulated, and been revised, over the last 40 years. It includes:

- The founding Treaty of Rome as revised by the Maastricht and Amsterdam Treaties.
- The Regulations and Directives passed by the Council of Ministers, most of which concern the single market.
- The judgements of the European Court of Justice.

The Acquis has expanded considerably in recent years, and now includes the Common Foreign and Security Policy (CFSP) and justice and home affairs (JHA), as well as the objectives and realisation of political, economic and monetary union.

Countries wishing to join the European Union must adopt and implement the entire *Acquis* upon accession, though there is some flexibility as to timing. The European Council has ruled out any partial adoption of the *Acquis*, as it is felt that this would raise more problems than it would solve, and would result in a watering down of the *Acquis* itself.

In addition to transposing the body of EU legislation into their own national law, candidate countries must ensure that it is properly implemented and enforced. This may mean that administrative structures need to be set up or modernised, legal systems need to be reformed, and civil servants and members of the judiciary need to be trained.

The Approximation Process has followed different phases and steps. In December 1991, Hungary signed an Accession Agreement with the European Union and its Member States on in which it assumed responsibility to harmonise its legal system with the European Union framework.[56] In the following years, the government intensified its relations with the European State members and with EU institutions. On the European Union side, a blueprint for accession, called Agenda 2000, was approved in 1995, and the European Commission was assigned to negotiate and monitor progress.

This first phase culminated in March 1998, when the accession negotiations were formally launched at a meeting in Cyprus between the EU Member States, the European Commission and the other applicant states. In advance of this meeting, the European Commission published a country-specific Accession Partnership for Hungary to support preparations for its membership. This preliminary screening was based on an Hungary's draft version of the National Programme for the Adoption of the *acquis* (or "Legal Harmonisation Programme") which described in more detail the actions needed to reach the objectives set out in the Accession Partnership.

The Legal Harmonisation Programme is implemented through short-term government decrees. Since 1995 and 1998, six government decrees have been promulgated to execute the Programme. These decrees set mandatory steps that build upon and replace each other. They contain detailed provisions for the legal areas affected by European Law, the scheduling of the legal harmonisation and the estimated financial implications to implement them. They are also the basis for the legislative plans of the ministries and the government. The current programme published in November 1998 runs until December 31, 2001.[57] Each August, the government sends a report to parliament prepared by the Ministries of Justice and Foreign Affairs on progresses in the implementation of the Harmonisation Programme.

Table 1. **Community legislation in force on 1 January 1998**

Chapters of the EU Legal Repertory	Regulation (1)	Directives (1)	Decisions (1)
1. General, financial and institutional matters	40	3	120
2. Customs Union and free movement of goods	108	6	99
3. Agriculture	222	128	73
4. Fisheries	50	1	10
5. Freedom of movement for workers and social policy	17	59	34
6. Right of establishment and freedom to provide services	8	121	9
7. Transport policy	49	51	30
8. Competition policy	16	5	338
9. Taxation	2	30	1
10. Economic and monetary policy and free movement of capital	15	5	18
11. External relations	169	4	427
12. Energy	12	16	89
13. Industrial policy and internal market	25	262	98
14. Regional policy and co-ordination of structural instruments	12	0	6
15. Environment, consumers and health protection	29	112	40
16. Science, information, education and culture	8	9	56
17. Law relating to undertakings	4	18	0
18. Common, Foreign and Security Policy	4	0	26
19. Are of freedom, security and justice	0	0	9
20. People's Europe	2	5	2
Total	792	835	1485

(1) Legislative basic acts. Some acts may belong to different chapters of the Repertory.
Source: Statistical description of the *acquis communautaire* communicated by the European Commission based on the Celex Database. And Euro-Lex http://europa.eu.int/eur-lex/en/index.html.

The complexity of the process has meant the creation and subsequent evolution of an elaborated web of institutions. Three main ministries oversee the programme. On substantive aspects, the Ministry of Foreign Affairs follows the main diplomatic, economic and trade issues (before 1998, the Ministry of Trade was responsible of this portfolio) and is directly in charge of the negotiations with Brussels. An Interministerial Commission on European Integration under the Ministry of Foreign Affairs, where each ministry has a representative, is responsible for co-ordinating the government's positions.

On legal and regulatory aspects, the Ministry of Justice oversees compliance with the Legal Harmonisation Programme and, most importantly, reviews the conformity of the draft texts (see Sections 2.2 and 3.1.1) and provides assistance with the drafting tasks. The ministry also updates a detailed database monitoring the degree of compliance with EU legislation, which is sent to Brussels every two months. The Prime Minister's Office also co-ordinates funding programmes, such as the UK Know-How-Fund and the World Bank fund, and the twinning programme (see Section 3.4).[58] A Minister without Portfolio in the Prime Minister's Office was also assigned in 1998 to co-ordinate the EU Phare Programme.

Accession negotiations between Hungary and the European Union take place under the aegis of the Association Council, which meets once a year and is the main political co-ordination body of the European institutions. An Association Committee also meets several times a year to oversee the general negotiation. A system of subcommittees functions as a forum for more technical discussion. In parallel, a Joint Parliamentary Committee comprising representatives of the Hungarian and European parliaments meets at least two times a year. Last, a meeting of the Joint Consultative Committee comprising economic and social representatives from the EU's Economic and Social Committee as was as relevant Hungarian bodies meets at least once a year.

On the European side, the Commission prepares and publishes each fall a *Regular Report on Hungary's Progress towards Accession*. The reports assess three to four main criteria for membership: political, economic, ability to assume the obligations of Membership and administrative capacity to apply the *acquis communautaire*. The last criterion was requested by the Madrid European Council in December 1995, and focuses on "the judicial and administrative capacities of the candidate countries to adapt their administrative structures so as to guarantee the harmonious implementation of the Community policies after membership".[59]

The strategy, programme, and institutional arrangements in Hungary have been considered effective by the European Commission in ensuring strong co-ordination, and permitting high quality and rapid policy decisions. The government has self-imposed a deadline for the transposition table of the entire Acquis before 2001. This is ambitious and will require considerable and sustained effort, since many of the most difficult issues have been left to the last phase. The most recent EU report indicates that Hungary has made steady progresses in implementing the *acquis communautaire*, but that some delays had occurred. In particular, the European Commission considered that the "slowdown in the pace of transposition in certain sectors such as the environment, has been accompanied by an increased focus on strengthening implementation structures. This suggests that the objective application, rather than simply transposition is being meaningfully pursued".[60]

This strategy appears realistic and defensible, since it seems to put more emphasis on results than on symbolic legislation. A rush to formal transposition might create unforeseen indirect impacts and a very low regulatory compliance rate. In the next few years, adequate implementation will increasingly be relevant on the overall quality of the regulatory regime. Experiences from recent EU accessions show that regulatory burdens or low levels of compliance are directly connected to the quality and mechanisms of transposing the *acquis communautaire* into the national regulatory system and subsequent administrative application. This is particularly true for new social and environmental regulations. This should be even more relevant for Hungary who might expect comparatively lower levels of European structural and cohesion funds to smooth the impacts of higher regulatory standards.

3. ADMINISTRATIVE CAPACITIES FOR MAKING NEW REGULATION OF HIGH QUALITY

3.1. Administrative transparency and predictability

Transparency of the regulatory system is essential to establishing a stable and accessible regulatory environment that promotes competition, trade, and investment, and helps ensure against undue influence by special interests. Transparency also reinforces legitimacy and fairness of regulatory processes. Transparency is not easy to implement in practice. It involves a wide range of practices, including standardised processes for making and changing regulations; consultation with interested parties; plain language in drafting; publication, codification, and other ways of making rules easy to find and understand; controls on administrative discretion; and implementation and appeals processes that are predictable and consistent.

In the past ten years, Hungary has put particular attention on increasing transparency and accountability in all spheres of government and judicial actions, erasing the opacity of the previous regime and building trust in the new democratic government. Moreover, two years before the change of regime and earlier than many other OECD countries, Hungary enacted in 1987 a stable procedure to create laws and regulations in the form of the Act on Legislation. In its Preamble, it stressed the need to improve the rule of law, control over-regulation, reduce legal instability and improve the efficacy of the legal system.[61] Since then, the law has been only slightly amended, in particular to adapt it to the new democratic circumstances.

3.1.1. Transparency of procedures to create new laws and regulations

Transparent and consistent processes for making and implementing legislation are fundamental to ensuring confidence in the legislative process and to safeguarding opportunities to participate in the formulation of laws. In Hungary, the Act on Legislation establishes the limits to legislative action, defines the different types of regulatory instruments -- mandatory and non-mandatory directives -- regulates the process of preparing them, distributes the responsibilities of the different bodies involved in the process, and sets out other important aspects such as the use of public consultation.[62] For some important laws and government decrees, a previous "conceptual" phase is also contemplated (see Box 3 on The two-stage regulatory process) and regulated by the Government Decision 1088/1994 (IX. 20.) on the Procedural Rules of the Government.

For the preparation of complex, particularly sensitive or major laws with important political and economic considerations, the government, by proposition of the sponsoring ministry, can establish a "**codification committee**". The role of these working parties is advisory, but they often have a strong influence on the outcome. They are formed of professors and leading experts, affected government bodies, social organisations and organs representing special interests, and representatives of the affected scientific discipline. Although encouraged since the 1995 policy, the government has set only one in 1996-1997 for the reforms of the Act of Justice where complex legal aspects (additional reforms to the constitution and seven other acts) needed the involvement of law professors and judges.

The case of technical requirements and standards. The Act on Legislation does not cover the preparation of technical requirements (mandatory) and standards (voluntary), which are regulated by a specific Standards Act.[63] As it is often the case, the process for preparing standards is more elaborated, detailed and transparent than for preparing laws and regulations. In particular, the Hungarian system has recently been thoroughly reformed as result of the rapid harmonisation with EU Community directives (see Background report to Chapter 4). In Hungary, a National Accreditation Committee certifies the standardisation committees and the rules and procedures they use. The Hungarian Institute for Standardisation (MSZT) is in charge of preparing the standards.

The case of "informal regulations". The elaboration of instructions, guidelines and other requirements is partially covered by the Act on Legislation. However, as they are considered not mandatory for the public but only for the administration they are subject to fewer accountability and transparency disciplines. For instance, their publication is not obligatory (Section 33-34) -- although many ministries and agencies publish the more significant ones in their own official gazettes.[64] Nonetheless, experiences from other OECD countries show that this type of "informal rules" has important indirect impacts on society and the economy and may be the vehicle for excessive discretionary power in the hands of lower-level enforcers. For instance, the design and selection of information requirements to be included in the format of a licence can create significant paperwork burdens for an SME. The interpretation of guidelines may foster large differences in the application of import tariffs.

As part of the current regulatory policy, the Ministry of Justice is preparing a major revision of the Act on Legislation, which should be passed in 2000. To provide new mechanisms for improving the legal harmonisation with the European Union, the programme has targeted three particular aspects. First, to increase the role and use of the codification committees. Second, to strengthen the quality of the *ex ante* impact assessment of the proposed regulations (see Section 3.1.3), and thirdly to expand the use of "two stage process" for lower level regulations. Strengthening some of the steps with concrete requirements concerning the internal distribution of drafts and further transparency of "informal regulations" could certainly enhance such initiatives. The oversight of the impact assessment and the generalisation of the "two stage process" will also have an impact of the nature and intensity of the regular work of the Administrative State Secretary meetings and its secretariat.

3.1.2. Transparency as dialogue with affected groups: use of public consultation

A strong trend toward renewal and expansion of public consultation in regulatory development is underway in OECD countries. Public consultation gives stakeholders the opportunity to provide active input in regulatory decisions and thus should be considered as a central part of the capacities to create high quality regulations. As a central part of building a democratic state and of strengthening trust in government, the Hungarian government has invested heavily in improving public consultation and fostering participation of citizens and businesses. This has resulted in an institutional and procedural infrastructure for involving interest groups. However, cultural reactions and traditions ingrained in the old reflexes of the administration and a sceptical and passive public have impaired the effectiveness of these innovative and active consultation initiatives.

Forward planning. Hungary has developed a complex forward planning system of legislative and regulatory actions that is more advanced than systems in most OECD countries. Currently, two forward regulatory planning procedures are in place. The Act on Legislation (Section 21 and 22) requires that the government establish a five-year programme listing all the laws and major government decrees to be prepared. Every year the government (*i.e.* the Ministry of Justice) reports to Parliament progress in the implementation of the programme. Due to the discrepancy between a five-year programme and a four-year parliamentarian cycle, such long-term plans have mostly acted as the government's political commitments.

To remedy this inconsistency, the government has developed shorter-term legal programmes spanning from six months to three years. These plans are important tools for internal and external consultation. By law, the government consults it with the Supreme Court, the Public Prosecutor, social and business representatives, local governments in addition to the central administration. After approval, the government makes public the programmes in the official gazette and in the mass media. Additionally, each six months the Ministry of Justice updates the legislative plan, reporting the progresses to the Parliament, improving through this mechanism the management of its the legal responsibilities.

Public consultation of draft texts. The Act on Legislation regulates the public's rights to participate in the rule making process (article 27). It stipulates that any persons, social organisations (civil organisations and bodies representing special interests), and all other persons that need to comply should be involved in the preparation of a "legal rule" which may affect their interests.

Although the Law does not distinguish among "legal rules," in practice, consultation is mainly used for proposed laws and some important government decrees. In general terms, a proponent ministry sends the text and specifies a deadline for receiving comments. In some cases, a justification analysis and a summary are attached to the legal draft. The setting of the deadline depends on the volume of the draft and the nature of the "legal rule." No general criteria exist to determine how consulted persons are selected, nor to define the additional material to be attached to the legal draft. During discussions at the Administrative State Secretary meeting or even at the cabinet level, further specific consultations may be requested.

Either as a complement or as substitute to sending draft texts, ministries often organise consultation meetings with all the organisations deemed interested -- in group or separately -- for further discussion and comments. In addition, some laws have set up specific consultations for the preparation of subordinate regulations, for instance the Public Procurement Law created the Public Procurement Council. In addition, numerous advisory bodies are attached to ministries to provide them advice and an open forum for regulatory discussion. In these cases, ministers decide on their remit and membership. A typical consultation body is the National Environmental Council, which meets once a week, and has a secretariat run by the Ministry of Environment. The Council is made up of equal shares of leading scientists, business sector representatives and environmental NGOs. The Council's opinion is published in the Official Gazette; in the case of lack of consensus, both majority and minority opinions are published.[65]

Last, non-government organisations can register in the Parliament's official roster of associations set up under the Standing Orders of Parliament. Through this, organisations receive automatically the draft legal proposals which affect their interests, and they can be invited to parliamentary hearings. However, no official criteria have been developed to define the quality of "affectedness".[66]

Based on all the opinions, the drafter of the proposal then harmonises the text and informs the government of the remaining differences. There is no requirement for publishing written comments or for providing and publishing the ministry's answers.

Two other forms of public consultation have been used in Hungary. In some instances, ministries have organised 'notice and comments' procedures of high impact laws (see Box 5 on consultation on environment regulations). Such an approach has also been used in certain high profile cases through the publication of the legal text in newspapers, for example the draft acts on the Civil Service, on the Protection of non-smokers, or on Sports were published in such a way. Alternatively, in the case of wide-reaching regulations, the government and the ministries have organised public hearings.[67]

Box 5. **Public consultation for environmental regulations in Hungary**[68]

In the mid-1990s, the Ministry of the Environment established a high-quality practice for public consultation of proposed laws and regulations that may be an important precedent for harmonised national procedures. The rules were specified in a September 1996 "Announcement" published in the Ministry's gazette stipulating, among other elements that:

- The ministry would publish a list of draft acts and decrees on which it is currently working twice a year (on 15 February and on 15 September).
- Environmental NGOs and other interested groups could apply to be involved in the process of law and regulation drafting if a letter expressing such an interest (either for a specific piece of legislation or in general) was sent to the ministry within 30 days of publication of the list.
- That registered NGOs (on what is referred to as the 'lobby list') could make suggestions for modifications to the drafts within a certain deadline.

The ministry also began posting the texts of draft legislation on the public electronic bulleting boards of the Zold Pók (Green Spider) network together with a submission deadline.

Commitment to public participation was also evidenced by the extent of consultation organised during the preparation of the reform programme. An array of university professors, local governments, private representatives and international organisations participated in consultations organised in the form of public hearings, discussion groups, and even public contests for suggestions. The programme itself was published in a newspaper and suggestions and comments were requested.[69] By and large, a high degree of satisfaction with the consultation process prevails in Hungary and few complaints have been aired on this issue. On the contrary, examples of long and difficult open negotiations of draft laws, such as the Waste Management Act, showed how the government has been responsive to businesses, experts, the public and NGO sectors, as well as national and international parties.[70]

An important weakness concerns the short time allotted to preparing and sending comments. This situation is aggravated by the massive flow of new proposals reaching the understaffed and under-resourced representations of the various sectors of the public. Other limitations have also been noted, which if corrected would further improve the consultation process as a useful and enriching source of input into high quality regulatory decisions. The top priority should be to harmonise and mandate the different and divergent practices of each ministry and administration. Establishment of common and transparent standards (*e.g.* documents to be consulted, response to comments, time of consultation, etc.) would also reduce the possible vulnerability to capture by particular interests.

In addition, new mechanisms for active consultation could be devised. Consultation not only plays an important role in supporting democratic values and building consensus, but is also an essential tool to retrieve vital information for the successful application of a law or a regulation. The mandatory use of 'notice and comment' requirements such as those in place since 1946 in the United States would strongly back the democratic nature of the process, and effectively provide safeguards for other consultation mechanisms.

3.1.3. Transparency in implementation of regulation: communication

Transparency and regulatory compliance require that the administration effectively communicate the existence and content of all regulations to the public, and that enforcement policies are clear and equitable. Hungary has been active in improving the accessibility to the population of its regulatory environment. Attention to this dimension has grown in importance as the complexity and rapid evolution (and turn over) have reduced predictability and legal certainty in the regulatory framework.

As an integral part of the regulatory process, the Act on Legislation, (Section 14) requires that all laws and regulations be published in the official gazette, the *Magyar Közlöny*, to be valid. Additionally, the government has relied on complementary official bulletins sponsored by ministries and agencies to publicise regulatory decisions and "informal" regulations. For further clarity and to ease understanding, the Ministry of Justice also publishes consolidated versions of laws and regulations when they are comprehensively amended. The Act on Legislation (Section 60) also requires that the Minister of Justice and the Office of the Prime Minister publish annually a compendium with all the laws and decrees enacted ("Collection of Acts and Decrees" and every five years a "Collection of Legal Rules in Force" (*Hatályos Jogszabályok*). The government also prepares a trilingual official gazette in Hungarian, English, and German. The most important pieces of legislation are published by the individual journals of the ministries, in many cases together with explanations, in a number of foreign languages with a predetermined periodicity. In recent years, these formal channels of communication have been supplemented by the increasing number of IT companies which have specialised in publishing and regularly updating all new laws and regulations - practically the entire legal system - on CD.

A second important dimension of an effective regulatory communication strategy concerns the extent of the use of "plain language" in drafting regulations. The Act on Legislation stipulates that legal provisions should be drafted in accordance with the rules of the Hungarian language and that they should be clear and understandable to the public. The Minister of Justice is responsible for enforcing such requirement during its revision. To perform this task, it has for instance developed special guidelines "For Drafting Laws and Regulations".

However, concerns remain. Perhaps due to the legal culture existing in the drafting departments of ministries, and to the absence of proper resources to develop training programmes on "user friendly" clarity, the policy has hardly reduced the complexity and in some times the obscurity of the legal texts.[71]

3.1.4. Compliance, application and enforcement of regulations

Adoption and communication of a law or regulation set the framework. But such framework can only achieve its intended objective if the regulations are implemented, applied, enforced and complied with. A mechanism to redress regulatory abuse must also be in place, not only as a fair and democratic safeguard of a rule-based society, but as a feedback mechanism to improve regulations. Hungary in most of these issues shows commitment and progress, though significant challenges still persist, indicating that proper implementation has lagged the production of good laws.

Despite a strong legal basis, application and enforcement are weak. In advance of many other countries, Hungary developed in 1958 a fundamental tool to regulate the duties and procedures of the public administration. The General Rules of Public Administrative Procedures Act contains key elements to regulate the interface between the citizens and the authority – in some part in a meticulous way.[72] The Act has very few exceptions, and covers most of the authorities acting in the filed of public administration, although specific laws can adapt and develop particular procedures to their policy areas.

In addition, the Act on Legislation (Section 44 and 45) requires that the ministries prepare an *ex post* study on how every "legal rule" has been applied and problems encountered during its application. Such reports should be sent to the Ministry of Justice together with the annual legislative programme. This seems to be an outstanding procedure which is probably unique among OECD countries. Thoroughly done, this procedure should permit to evaluate the performance of the legal and regulatory framework and analyse all possible regulatory compliance trends and problems. However no general application rules have been set up to enforce it and no general assessment has been done on this obligation.

Despite these efforts, the application and enforcement of laws and regulations have lagged behind the establishment of modern regulatory capacities at the centre, imposing unnecessary costs and uncertainties and allowing scope for unethical behaviour. A significant issue relates to the wide interpretation and discretion still existing at the lower levels of the bureaucracy -- aspects covered only partially by the General Rules of Public Administrative Procedures Act.[73] For instance, a study of licensing of private schools in Hungary found that discretion played a major part in the way decisions were made and that substantive decisions varied greatly from one district to another.[74] Similarly, important discrepancies between procedures of distinct custom offices still hamper exports and imports, notwithstanding efforts to simplify and modernise the system.[75] Some commentators have also indicated that a double standard exists in the enforcement of some regulations, differentiating large multinational firms from SMEs.

Enforcement mechanisms are inadequate in part due to severe budget constraints. For instance, in the environmental area, "… emission and discharge levels are often determined solely through reporting by the polluters themselves, without further inspection. Fines are usually too low to provide incentives to cease violation. There is little way to prevent repeated and permanent violations. Despite recent improvements, inspectorates have inadequate resources for their important role in ensuring implementation of environmental policies."[76]

Regulatory compliance may erode as further requirements are established. Low regulatory compliance threatens the effectiveness of laws and regulation and ultimately the credibility of government actions. In Hungary, compliance issues have so far received little attention, though a certain number of important signs and circumstances show that compliance stresses may exist. First, the rapidly changing legal framework creates difficulties in understanding the new regulatory environment. Second, though many rules were eliminated, the new regulatory system is more complex and regulations often require higher standards. Third, Hungary possesses a very large SME sector, and as many studies have shown, this sector has greater difficulties to adjust to and comply with regulations. Indicators of the informal sector may provide an idea of the scope of the compliance challenges: the significant black or grey sector may account for about 1/3 of GDP.

The government has launched some initiatives combining better enforcement and improved implementation and simplification. In particular, the Finance Ministry introduced in 1997 an optional flat-rate income tax much simpler to administer and to comply with. This seems to have reduced tax avoidance and stabilised the grey sector.[77] Nevertheless, further efforts may be needed. In particular, in the context of implementing new and stringent EU requirements, the government might improve compliance through alternative to regulation and well design application mechanisms adapted to the SMEs sector.[78]

A third crucial element in the effectiveness of the legal and regulatory framework is a timely and effective appeal system. Appeal mechanisms are slow and complex, though recent reforms to the court system may bring important improvements. As in many civil law countries, Hungary's appeal process relies first on administration procedures solutions before turning to the court system.[79] In 1997, the government reformed extensively the whole system through reforms to the Constitution, to the General Rules of Public Administrative Procedures Act and to the Administrative Jurisdiction Act.[80] Instead of the four levels of appeal previously available (two involving public administration and two judicial), the current system only consists of two administrative and one judiciary authorities.[81]

The first stage for seeking redress is to complain directly to the administration. The General Rules of Public Administrative Procedures Act sets the rules to be followed and divides the procedures into two phases. Basically, the first stage consists of the right to have a decision reconsidered by the authority that made it. Only afterwards does the appeal mechanism start. The appeal is lodged with the original authority who must pass it to a supervisory authority within eight days. The superior authority must resolve the appeal under 30 days. Once the plaintiff has exhausted the right of administrative appeal (or if such an appeal is excluded under precise circumstances), a court review may be launched.

The recent reforms concentrated on establishing a more independent and more efficient judiciary. First, a clear separation between the executive and judicial branches was established. In particular, the courts became independent from the Ministry of Justice and a specific management body for the judiciary, called the National Judicial Council, was set up to execute a larger budget to modernise the courts, emphasising IT capacities, to organise training programmes and to oversee judges activities and take eventual disciplinary actions. Additionally, to improve efficiency and rapidity throughout the system, the government added a new level to the three-layer system involving local, county and supreme courts. Although not yet funded, the new level of courts inserted between regional courts and the supreme court will hear appeals in cases against decisions of the local or regional courts.

These reforms respond to the numerous criticisms of the past few years concerning the slowness and cost of the system. Usually, a plaintiff needs two or three years for a first decision; and this can extend to five years in complex cases. Consequently, an important backlog of cases accumulated in the courts, particularly at the local and supreme level. More independent management should also tackle the other two major weaknesses of the system. The first concerns the material conditions of the courts which often lack support-staff and technical facilities. Second, the new National Judicial Council should be able to focus on the long term challenge of improving judgements through better selection, training and skills of judges with skills to work in a market economy. On this issue, important steps could be made in stressing the economic aspects of the law in legal curricula, as well as broader knowledge of international precedent and professional practices such as handling confidential information.

It is too early to evaluate if these reforms will satisfy the expectations of the government and society. Some encouraging results have been reported, for instance, the backlog of cases was reduced by 4% one year after the reforms took effect, though reducing the backlog of approximately 15 000 cases pending for more than two years is still a daunting task.[82] The government will need to continue to concentrate attention to this area. First, the inefficiency of the judiciary weakens enforcement mechanisms. Violators can play against time. For instance, failure to collect fines in due time hampers the clout of the competition authority (see Background report to Chapter 3). Difficulties in impeding damaging municipal bylaws have imposed unnecessary costs to citizens and firms. Second, the fact that larger firms are increasingly using arbitration mechanisms outside the court system to avoid long judiciary procedures may become an unfair discrimination against smaller entities who tend to rely exclusively on the courts for redress.

Additionally, further reform could concentrate on administrative appeals. Appeal to the courts can only occur once all internal administrative procedures have been exhausted or where specific laws allow direct recourse. This approach differs from that taken by some countries where judicial supervision is regarded as an alternative to internal administrative appeals. Moreover, according to an international expert, the whole appeal system might still be too complicated, and a more simplified and systematic approach could be devised.[83] On the positive side, Hungary has a rich array of check and balance mechanisms in which constitutional bodies protect citizens against administrative abuses, and in particular regulatory excesses (see Box 6).

Box 6. **Alternative appeal mechanisms and institutions**

As a complement as well as a substitute to the administrative and judicial system described above, a plaintiff in Hungary can use three other venues and institutions to complain against a regulation or a regulatory decision.

The *Public Prosecutor's Office* is entitled to examine the legality of an agency's decisions and may initiate a formal motion to review the decision. If the agency does not agree with its findings, the Public Prosecutor may turn to court or submit motions to the Constitutional Court for rulings on constitutional issues. An important point is that the Prosecutor's role goes beyond a pure supervision of legality, as he or she can act as a public attorney in the course of judicial proceedings. An advantage compared to the judiciary review is that it can intervene at an early stage, to investigate a potential unlawful action or practice and recommend redress. Another interesting feature is that the Public Prosecutor has local branches in addition to its headquarters in Budapest.

The *Ombudsmen* perform activities quite similar to those of the Prosecutor but are mainly concerned with violations of constitutional rights. They are appointed by the Parliament and report exclusively to it. Special ombudsmen have been set up to protect certain constitutional rights, such as the rights of ethnic minorities and data protection. The Ombudsmen can also act independently in their designated field.[84] In the case of an appeal, the ombudsmen, who have very high moral reputation among the population and the media, may propose redresses to the Constitutional Court. Based on past complaints, the Ombudsmen have suggested changes to laws and regulations in their annual report to the parliament.

The *Constitutional Court* has played an outstanding role since the change of regime. As in most countries, a specific procedure permits individuals to directly appeal to the Constitutional Court against alleged violations of their rights by a law or regulation. Additionally, if a court rules that a certain procedure violates the Constitution, it has the right to suspend such procedure through an injunction and turn the case to the Constitutional Court, which may review and annul the measures.

3.2. Choice of policy instruments: regulation and alternatives

Much reform is based on the use of wider range of policy instruments that work more efficiently and effectively than traditional regulatory controls. The range of policy tools and their use is expanding as experimentation occurs, learning is diffused, and understanding of the markets increases. At the same time, administrators often face risks in using relatively untried tools, bureaucracies are highly conservative, and there are typically strong disincentives for public servants to be innovative. Reform authorities must take a clear leading and supportive role, if alternatives to traditional regulations are to make serious headway into the policy system. In Hungary, decades of 'command and control ' approaches and traditions have been a cultural obstacle to experimentation and wide-scale dissemination. Progress is seen in two areas: environmental protection and self-regulation of professional bodies.

Use of alternatives to traditional regulations is in many countries such as the United States, the Netherlands and Denmark, more developed in the area of environmental protection.[85] Similarly in Hungary, new environmental instruments – in particular economic ones -- have been introduced. They include several charges (*e.g.* on the use and extraction of water, for waste collection and disposal, for mining and changes in use of agricultural land, and product charges); deposits-refund schemes (in Budapest, around 10 000 highly polluting two-stroke Trabant cars were taken out of circulation in exchange for public transport tickets); eco-taxes, and direct subsidies on energy products and for environmental expenses.

Additionally, Hungary has started to rely on information strategies to achieve regulatory goals. A national voluntary programme of eco-labelling, called "Environmentally Friendly Product" was introduced in 1994. The Ministry of Environment supervised the system that has permitted to certify around a hundred products (a fee for the use of the logo is paid to the ministry). Although emergent, 100 businesses, mostly foreign firms, are also using ISO-14000 standards.

Perhaps the single most notable initiative to find alternatives to government regulations has been the devolution of regulatory powers to chambers of commerce and industry and other semi-private bodies. The economic and professional chambers are now entitled to regulate the internal relations of their industry within the framework of the law. In particular they manage start-up licences, and regulate a significant array of activities and processes. They also issue standards and criteria for members often under "ethical" and professional requirements.

The Public Prosecutor's Office and the ministry in charge of the sector or policy area supervise the self-regulatory powers of the chambers. For instance, the Minister of Justice supervises the activities of the Bar Council. In case of infringement of a law or regulation, the government, through the ministry, can take them to court.

These self-regulatory powers have nonetheless raised important problems. Some chambers of commerce and similar professional bodies, through their so-called 'Code of Ethics' have created obstacles to competition. For instance, some chambers have set minimum levels for the fees of some services or have prohibited comparative advertising between members. On several occasions, the competition authority has been forced to intervene.[86]

The general picture about alternatives to traditional regulation is rather uneven. It is true that during its deregulation programmes the government has tried to raise awareness of the need to find alternatives, to rely on self-regulation, and in general to reduce the use of government requirements. Yet regulators in most policy areas do not seem persuaded. On the other hand, the regulatory policies may have permitted self-regulation without proper accountability. In such a situation, the government may need to re-focus its approach for disseminating better and faster alternative instruments. The new attempts to assess new international regulations and reviewing new regulations to reduce enforcement costs and increase compliance should be an opportunity for a renewed priority in this field.

3.3. Understanding regulatory effects: the use of Regulatory Impact Analysis (RIA)

The 1995 *Recommendation of the Council of the OECD on Improving the Quality of Government Regulation* emphasised the role of RIA in systematically ensuring that the most efficient and effective policy options were chosen. The 1997 *OECD Report on Regulatory Reform* recommended that governments "integrate regulatory impact analysis into the development, review, and reform of regulations." A list of RIA best practices is discussed in detail in *Regulatory Impact Analysis: Best Practices in OECD Countries*[87].

Earlier than many OECD countries, Hungary showed interest in evaluating the effectiveness of its laws and subordinated regulations. The Act on Legislation of 1987 stipulates that prior to the approval of a regulation the minister should analyse and inform the legislature of the "social-economic circumstances to be regulated, the observance of rights and obligations of the citizens, the expected effects of the regulation and the conditions of enforcement … based on scientific findings". The Act also requires assessment of alternative instruments to legislation for achieving the objective. It also requests that regulatory bodies in charge of implementing and enforcing regulations submit to the Ministry of Justice a report assessing the real impact of regulations one year after enactment.[88] (As other countries, Hungary has a procedure, co-ordinated by the Ministry of Finance, to assess budgetary impacts of draft laws and regulations.)

For the presentation of draft laws to Parliament, the Procedural Order of the Government regulates this legal obligation by specifying that a memorandum, in practice 5 to 10 pages long, describing qualitatively must introduce the legal text. A similar requirement also applies to government decrees and resolutions.[89] In addition, past governments have issued government resolutions to further implement these requirements in ways that are more concrete and, in part, based on OECD recommendations. For instance, in 1992, based on a German questionnaire, the Economic Deregulation Council published a regulatory checklist. Interestingly, this first tool included questions on the anti-competition effects of the regulations, discriminatory impacts on groups of people, and if a similar regulation existed in another country. Additional improvements to this checklist were made in 1994. The second regulatory reform programme of 1995 made further steps to improve RIA. The Government Decree 1110/1996 (Articles 4 and 5) gave the right to the Government Commissioner to require a "detailed comprehensive impact assessment and/or cost/benefit analysis". It also gave him the power to attach a critical report before evaluation of the regulatory proposals by the Administrative State Secretary meeting. The Decree empowered him also to implement a checklist to be answered by ministries for all existing and new laws and subordinate regulations, which should be returned with sufficient time in advance to the Government Commissioner.[90]

Despite the Act and the efforts in developing appropriate tools, the overall result of RIA has been disappointing in Hungary. The checklist was rarely completed. RIAs were never prepared for subordinate regulations. The *ex post* assessment has mostly been complied randomly, without a harmonised methodology and only for certain laws or regulations to be amended. However, the current regulatory management policy, Government Resolution 1052/1999, prescribes a comprehensive review of the Act on Legislation to include an *ex ante* and *ex post* RIA, as well as the preparation of a new RIA guideline by the Ministry of Justice. (The Ministry of Economic Affairs together with the chambers of commerce and industry also plans to establish a system to evaluate the impact of existing and new regulations on SMEs.[91]) This re-examination of the RIA should be a good opportunity to rethink its objectives as well as its implementation and enforcement procedures. The following section, which assesses the most recent experience with the RIA programme against OECD best practice recommendations, provides directions for improvement.

Assessment against best practice

Maximise political commitment to RIA. Use of RIA should be endorsed at the highest levels of government. The Hungarian system rates relatively high on this criterion. Since the early 1990, Parliament has required an impact assessment in the Act on Legislation and government decisions have backed RIA through successive government decrees.

Allocate responsibilities for RIA programme elements carefully. To ensure "ownership" by regulators, while at the same time establishing quality control and consistency, responsibilities for RIA should be shared between ministries and a central quality control unit. As in virtually all countries, the responsible ministers are the primary drafters of the RIA and the Government Commissioner and Minister of Justice the quality controllers. However, the 1110/1996 Government Decree did not provide a clear mandate to enforce the programme. The oversight agencies lacked the resources and power vis-à-vis powerful ministries who mostly ignored the requirement. Moreover, the Commissioner operated at the same hierarchical level, but in practice at a lower one than other cabinet members belonging to line ministries. Ministries and agencies considered the special report of art 5b) of the Government Decree 1110/1996, which is the assessment of the answered checklist, as one comment among all received during the internal consultation. They also sent their draft text, with our without the checklist completed, with too little time in advance for a proper assessment before the Administrative State Secretaries meetings.

Train the regulators. Regulators must have the skills to do high quality RIA, including and understanding of the role of RIA in assuring regulatory quality, and an understanding of methodological requirements and data collection strategies. A guideline prepared by the Ministry of Justice was attached to the Hungarian checklist. This document was rather legalistic and did not provide methodological elements. Though some training programmes were announced when the programme was launched, resources constraints impeded the Government Commissioner from organising them. Since 1998, this task has been delegated to a working party of the PMO, the Ministry of Interior, the Ministry of Justice and the Hungarian Institute of Public Administration. One of its first activities was to translate and distribute a RIA manual based on an OECD publication of international best practices.

Use a consistent but flexible analytical method. The 1996 checklist had a section focusing on a "detailed cost-benefit analysis" and included questions on enforcement costs, budgetary costs, alternative costs, etc. However, the guidelines did not provide specific methodological standards and guidance to answer the questions. In fact, the complexity of the questions reduced the overall impact of the tool. Experiences from other countries indicate that establishing a standard too high without providing other complementary incentives tends to reduce the compliance of regulators and turn the questionnaire into another paper formality. In its current programme, the PMO and the Ministry of Justice have been mandated to publish a new methodological guideline to assist in preparing regulatory impact assessments.[92] Attention to developing detailed requirements for RIA, and supporting them with relevant training, guidance and expert assistance, is key if RIA is to achieve its potential in improving the quality of Hungarian legislation.

Develop and implement data collection strategies. An essential part of a successful RIA programme consists of establishing a data collection strategy. A RIA confined to qualitative analysis may not fulfil the potential of this decision-making instrument. The government has stated that enhancing the economic evaluation capacities of the public administration has become a priority in the regulatory reform programme. Significant investment in developing these strategies would thus be a crucial step, as most of the professionals involved in the regulatory process are lawyers. The use of external economists to gather as well as analyse the data could be a solution in the short term. In the first months, closer co-operation with the well-trained economists of the competition authority might provide a fertile base on where to start.

Target RIA efforts. RIA efforts should be targeted at those regulations where the impact is greater and where the prospects are best for altering outcomes. In all cases, the amount of time and effort spent on regulatory analysis should be commensurate with the improvement in the regulation that the analysis is expected to provide. A flaw in the first Hungarian checklist was that it covered all ministers' submissions, that is, the checklist was to be completed for reviewing existing regulations and for assessing new measures, for draft laws and subordinate regulations. The unfeasibility of responding to the 54-item-long checklist prompted the Commissioner to prepare a second, simpler and shorter checklist that focussed on potentially more costly measures. This new checklist was not successful either, perhaps because incentives for compliance and enforcement mechanisms were unchanged.

An interesting approach for Hungary could be the one implemented by the Mexican government in 1997. This approach is characterised as "partially targeted", in that, while the RIA requirement applies to all new laws and regulations, three broad levels of analytical rigour and effort are distinguished, by guidelines, depending on the importance of the regulation. The regulators choose the level and answer the questionnaire accordingly. However, the Mexican oversight body has the power to contest the chosen level and request a more thorough analysis. The threat of preparation of a second RIA has become a deterrent to inadequate analysis the first time around.

Box 7. **The quality of Regulatory Impact Analysis**

This synthetic indicator (based on self-assessments) of the application and methodology of regulatory impact analysis looks at several aspects of the use of RIA and ranks more highly those programmes where RIA is applied both to legislation and lower-level regulations, where independent controls on the quality of analysis are in place and where competition and trade impacts are identified, as well as the distribution of effects across society. It also ranks more highly the use of RIA documents for consultation purposes, RIA programmes where benefits and costs are quantified and where a benefit-cost test is used in decision-making. Hungary has a lower score on this indicator, trailing both the OECD average and the average of the newer OECD countries. This outcome is explained by the lack of use of quantified, benefit/cost analysis, application of RIA to some policy areas, and the fact that no external body, inside or outside the government, reviews the quality of RIA.

Source: Public Management Service, OECD, 1999.

Integrate RIA with the policy making process, beginning as early as possible. Integrating RIA with the policy making process is meant to ensure that the disciplines of weighing costs and benefits, identifying and considering alternatives and choosing policy that meets objectives are a routine part of policy development. A major problem of the Hungarian RIA programme was that the checklist was applied at the end of the "pipeline" in a very busy legislative period. Answers were sent at the very last moment to the Government Commissioner. Consequently, submissions tended to be *ex post* justifications of decisions, rather than objective assessments of alternatives. However, the Hungarian system seems to have developed a potentially powerful tool in the "two stage process" for regulatory review (see Box 3 above). The government has indicated its intention to expand this system. The use of RIA should be strengthened in this mechanism at both stages to improve the quality of policy discussion.

Involve the public extensively. Public involvement in RIA has several significant benefits. The public, and especially those affected by regulations, can provide the data necessary to complete RIA. Consultation can also provide important checks on the feasibility of proposals, on the range of alternatives considered, and on the degree of acceptance of the proposed regulation by affected parties. The Hungarian RIA system does not contain any provisions for public consultation, while existing public consultation procedures require only that the draft legal text be made public, and not any background or explanatory materials. A powerful way to improve the quality of information on new regulations, and therefore the quality of the regulations themselves, would be to publish RIAs along with the draft texts.

Apply RIA to existing, as well as new regulation. RIA disciplines are equally useful in the review of existing regulation as in the *ex ante* assessment of new regulatory proposals. Indeed, the *ex post* nature of regulatory review means that data problems will be fewer and the quality of the resulting analysis potentially higher. The Hungarian RIA checklist was supposed to be used for the deregulation process for existing regulations. Though this is conceptually a sound approach, it encountered in practice the same difficulties as RIA application to new regulations, and achieved disappointing results. Unusual among OECD countries, Hungary's Act on Legislation requires a yearly *ex post* assessment. As previously noted this requirement has not yet been fully implemented and the current programme has targeted new regulations rather than the stock of existing regulations, which are deemed to be "deregulated".

In sum, despite strong policy commitment to RIA, the use of RIA in Hungary is still in its infancy. However, the Act on Legislation and the experience gained in the past years with checklists are strong bases for further progress in integrating this tool into the regulatory system. Proper accountability, consultation, and enforcement mechanisms will be vital to increase incentives to comply, together with further investment in the guidelines, checklist, training and quantitative methods.

3.4. Building administrative skills through training

Many governments have adopted policies of regulatory reform without investing in a skilled and trained civil service able to implement the new policies. The Hungarian government, on the other hand, has considered further training to be important both for skills acquisition and to foster cultural change among regulators. Since the early 1990s, a series of initiatives has been launched. In 1995, the Government Commissioner initiated training seminaries on the RIA checklist, later suspended due to lack of resources. Recently, the government began a series of training programmes funded by the EU and World Bank. The goal is to train 10 000 management-level public servants on EU topics. A final exam would certify their proficiency and be used for career advancement. Furthermore, Hungary has participated in the EU "twinning programme" where one agency of an EU Member provides direct administrative and technical help to the correspondent ministry in the accession country. For the moment, four policy areas have been selected: agriculture, environment, finance and justice and home affairs.[93] Lastly, the Prime Minister's Office has indicated its intention to re-initiate in the next few months training courses on RIA.

3.5. Building regulatory agencies

Implementing systems for regulatory scrutiny and review is necessary but not sufficient for a successful programme of regulatory management and reform. Also of primary importance is the development of well-designed regulatory institutions. The key issue is how accountable and independent institutions, which resist capture by interest groups, either public or private, can be established. These issues are now under discussion in Hungary, but as yet there is no clear government policy on the issue. Some issues are emerging. The EC noted in 1998 that the respective roles of the principal regulatory authorities, the Ministry of Transport, Telecommunications and Water Management and the Communications Authority (HIF), were not clearly defined. Similarly, controversies arose when the Minister of Economic Affairs chose not to follow the Hungarian Energy Office electricity price proposals and revised electricity prices downward in the final Decrees. (See Background reports to Chapters 5 and 6)

The current regulatory reform programme launched a review of the competencies of sectoral ministries to explore the possibility of transferring to independent enhanced regulatory powers.[94] This is a welcome step, as the move to establish independent bodies offers great potential in improving regulatory efficiency. In other countries, specialised and more autonomous regulators have created important "checks and balances" to match the powers of ministries and interest groups and increase the speed and quality of regulatory decisions. Their operation tends to be more transparent and accountable. An important contributor to the quality and effectiveness of the new regulatory bodies will be the training of regulators to work within a market environment. Experience in OECD Member countries shows that other key design principles for successful independent regulatory bodies include the establishment of the regulatory body via specific legislation, with key regulatory objectives explicitly stated; appointment mechanisms for chief regulators and other key staff that insulate them from pressures from political sources or vested interests, particularly the use of fixed terms and limited grounds for dismissal; principles for regulatory decision-making, as well as key process elements, that are clearly defined and included in laws; limited and highly specific grounds for Ministerial direction to regulators; and transparency in relation to key decision elements.

In addition, a key threshold question on the design of independent regulators is whether separate bodies should be created for each key sector (the model adopted, for example, in the United Kingdom[95]) or whether an overarching body should be created with authority over many sectors (as in Australia). The former model is held to allow more easily for the development of sector specific expertise and insight, as well as providing for a clearer set of regulatory objectives. However, overarching regulators are thought to be less susceptible to regulatory capture by incumbent interests, due to their broader remit and wider set of regulatory objectives. Further key benefits of an overarching regulator would be to enhance consistency in regulatory decisions in different sectors and make better use of a limit amount of experts and industrial economists who are attracted by working in the public sector.

4. DYNAMIC CHANGE: KEEPING REGULATIONS UP-TO-DATE

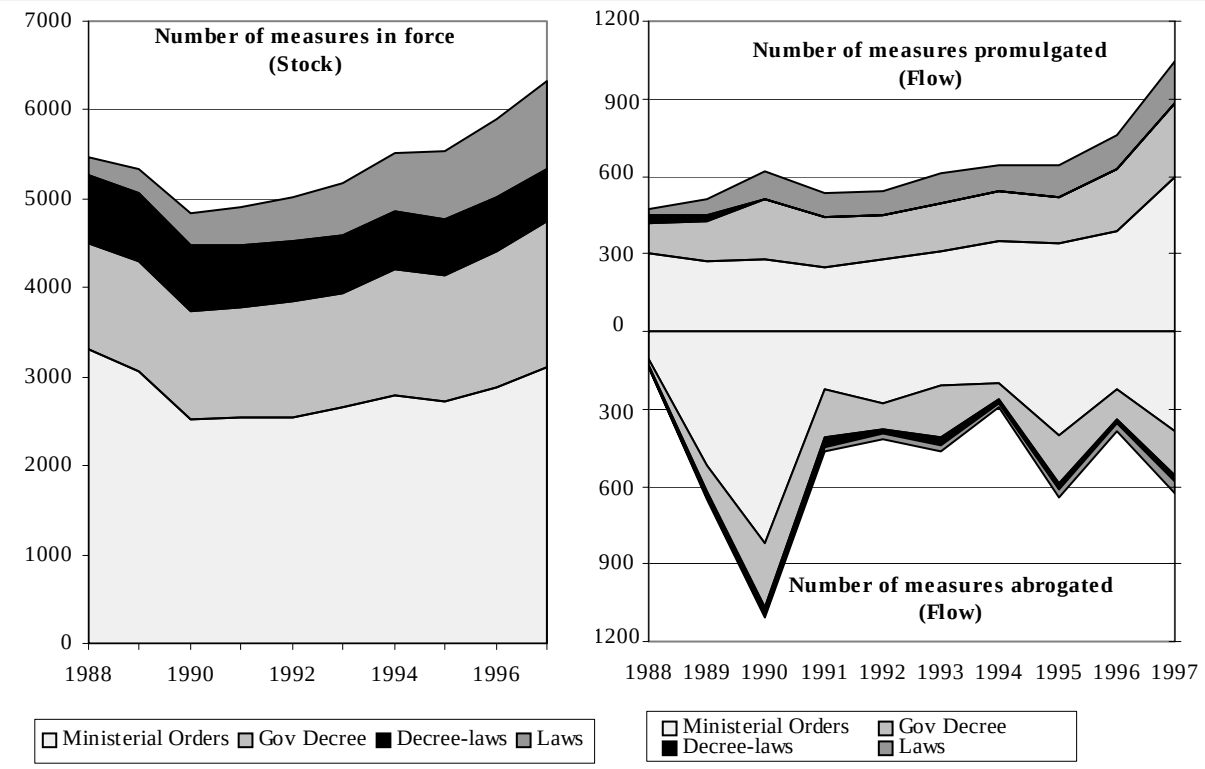
Regulations that are efficient today may become inefficient tomorrow, due to social, economic, or technological change. Most OECD countries have enormous stocks of regulation and administrative formalities that have accumulated over years or decades without adequate review and revision. The *OECD Report on Regulatory Reform* recommends that governments "review regulations systematically to ensure that they continue to meet their intended objectives efficiently and effectively."

4.1. Revisions of existing regulations, laws and subordinated regulations

Hungary has dedicated an extraordinary amount of energy to review, eliminate and replace regulations not consistent with a market democracy. Since 1989, two comprehensive deregulation reviews took place, 1989-1991 and 1995-1998. These two reviews eliminated hundreds of legal provisions (see Figure 2). During these processes, two objectives were sought: a clear elimination of regulation, called "technical deregulation", and the replacement, improvement or the implementation of new market-oriented regulations, called "deregulation of merit".

Figure 2. **The "stock" and the "flow" of laws and subordinated regulations in Hungary (1988-1997)**

Under the Constitution, the legal structure is comprised of a pyramid-like system of laws, law-decrees (temporary laws enacted by the government in case the Parliament is not in session), and government decrees, departmental and ministerial orders, and local government bylaws.[96] In addition, the government, ministers and Secretaries of State can also issue "other legal means of state control decisions", which have many forms (*i.e.* government resolutions, ministerial instructions, etc.) At present, 6 823 laws and regulations are in effect. 799 of the 983 existing laws in Hungary were adopted after 1990.



Source: Otto (1998), Bekefi, Osszesített Jagoszabály-statisztika (1988 - 1997), Közigazgatás Korszeüsítési, Kormánybiztos Titkársága, Budapest, február.

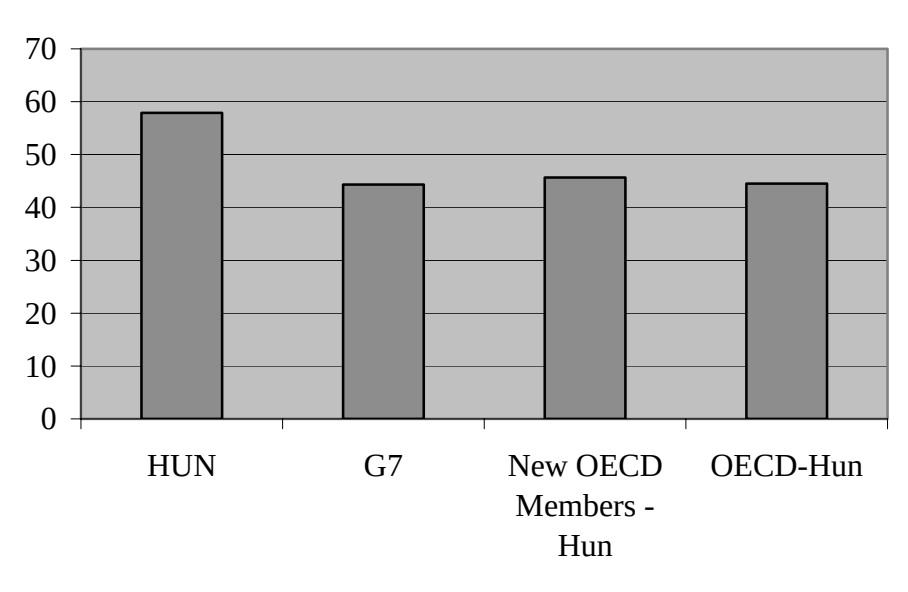
As previously indicated, the two deregulation processes followed different institutional and strategic approaches. The first revision was highly centralised in two deregulation councils (one for economic regulations and the other for public administration regulations) that worked as task forces daily reviewing laws.[97] The second approach was co-ordinated by a central unit, the Government Commissioner, assisted by a small secretariat and advised by a Deregulation Council which met once or twice a month. In addition, the second review was based on a three-year planned schedule of ministerial submissions and included subordinated regulations as well as laws.[98]

Key elements of the second review are worth noting. The revision was divided into two stages. The first 18 months concentrated on laws and regulations existing before 30 June 1990; the next 18 months focused on the review of regulations enacted after that date. An important element of the programme was the preparation by the Ministry of Justice of a precise inventory of existing laws and regulations. Based on this inventory, the Government Commissioner and the horizontal ministries presented a detailed schedule covering the whole three years government's period. A submission process was designed which in theory included a RIA checklist (albeit seldom used, see Section 3.3). A special justification memorandum was requested for maintaining regulations enacted before 23 October 1989. The Government Commissioner could recommend that the government reject such regulations or could ask for further analysis. Last, the Ministry of Justice was charged with preparing a specific "deregulation instrument" to be issued by the government or presented to the Parliament listing unnecessary regulations abrogated.[99]

In parallel to this item-by-item approach, the government took a comprehensive approach to a few key policy areas vital to the proper functioning of democratic and market-oriented systems. For example, the civil code was reviewed in its entirety under the "deregulation of merit" process. Due to the size, complexity and impact of such codes or "codex", the revision was organised through working groups that work for two or three years. The reviews consisted not only of amending and replacing whole sections but also of re-organising texts which in some cases, like the Civil Code of 1959 had been reformed more than twenty different times since 1990. This comprehensive approach is a good practice that could be replicated in other important areas to ensure that the regulatory system is coherent and, taken all together, supportive of policy goals.

Box 8. **Effectiveness of regulatory review processes in selected OECD countries**

This synthetic indicator (based on self-assessments) of regulatory review processes looks at several aspects of methodological quality in the review and reform of existing regulations. It ranks more highly reviews that are open to the public, subject to independent quality checks, based on known decision criteria and use of RIA discipline. The indicator includes a self-evaluation measure of the frequency with which reviews have led to concrete changes. Hungary ranks above the average on this score. It loses points due to the absence of 'sunsetting' clauses, less relative use of RIA, and the lack of an independent check on the quality of reviews.



Source: Public Management Service, OECD, 1999.

Although the final number of measures eliminated may be misleading, according to the government the 1995-1998 review was more successful than the first in going beyond "dead wood". Clear timetables and programme objectives, leading up to omnibus "deregulation measures," concentrated ministries' efforts and provided greater visibility and accountability to achievements. It was particularly interesting that mechanisms were used to boost the outreach of the programme and implicate a wider public in the national effort. The Deregulation Council and the Government Commissioner commissioned from renowned academics and researchers a series of studies on deregulation topics. To encourage public involvement in the programme, they launched massive public campaigns to "turn deregulation into an national event", through hearings and consultation meetings at national and regional level. They also arranged a national contest in the newspapers where nearly 400 proposals were presented. Prizes of up to 100 000 Forints rewarded useful ideas. "Deregulation days" were launched, with the participation of regulators, professional organisations, and citizens, where the best presentations and proposals were published in the "Deregulatory Forum" column of the "Magyar Közigazgatás " newspaper.[100]

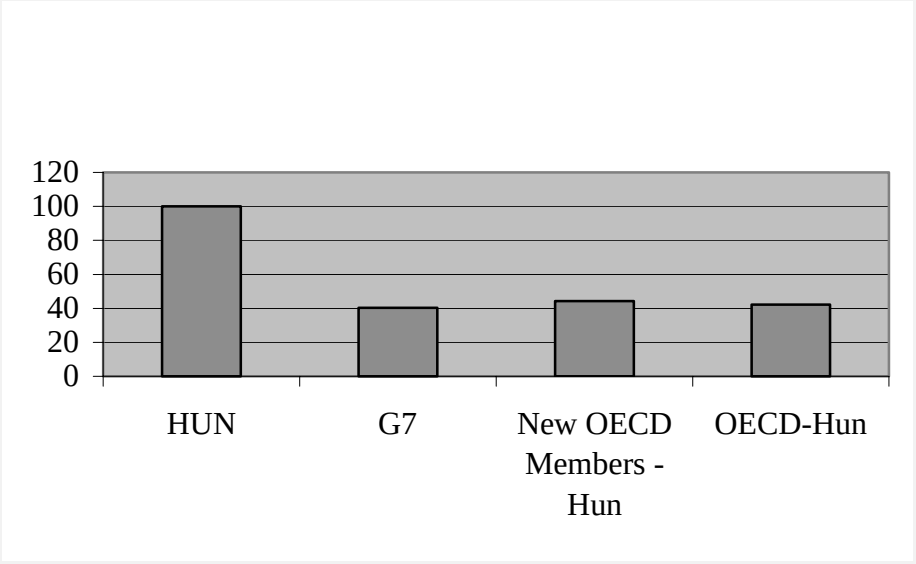
4.2. Reducing administrative burdens

Reducing the administrative and paperwork costs of compliance with regulation and taxes has been part of the policy thrust since the start of regulatory reform. During the 1995-1998 deregulation programme, the ministries were required to review whether it would be possible to reduce the burden of administrative responses by providing official formats and simplifying procedures.[101]

In 1997 the Government Commissioner together with the Ministry of Interior organised a benchmarking exercise to compare the number and type of Hungary's 1 460 authorisations and to reduce their number. The *French Centre d'Enregistrement et de Révision des Formulaires Administratifs* (CERFA) assisted this review. In parallel, Hungary continued to strengthen existing legal and procedural aspects of the licensing system of the General Rules of Public Administrative Procedures Act. For instance, it requires that within 30 days from the submission of an application or from launching a procedure *ex officio*, a decision must be made. Exceptions to this rule can only be granted by law or government decree. For some policy areas, such as in tax administration, the reporting periods have been extended and simpler filing formats made available on the Internet.

Box 9. **Simplifying business licences and permits**

This synthetic indicator (based on self-assessments) of efforts to simplify and eliminate permits and licences ranks more highly those programmes where countries use the "silence is consent" rule to speed up decisions or to have set up one-stop shops for businesses, where there is a complete inventory of permits and licences; and where there is a specific programme, co-ordinated with lower levels of government, to review and reduce burdens of permits and licences. Hungary ranks very high on these scores relative to other G7, new OECD members and OECD countries.



Source: Public Management Service, OECD, 1999.

A second area where the government has launched initiatives to reduce administrative burdens is the establishment of one-stop shops and integrated start-up systems across the country. Recently a "telehouse" programme, co-ordinated by the Prime Minister's Office and involving the Ministries of Transport, Communication and Water Management and of the Interior, was launched to connect a web of decentralised offices across the country to the central administration. These one-stop shops should provide regulatory and administrative information to the general public and SMEs. Another major recent initiative has consisted in adapting the French registration system to Hungarian circumstances, which should reduce significantly the time and costs to start up of small businesses (see Box 10).

These initiatives have lowered administrative and paperwork burdens for start-ups in Hungary. Compared with other OECD countries, the administrative burdens seem overall lower.[102] The multitude of small and medium-sized enterprises that have been established so far suggest that significant administrative obstacles to launching businesses have been reduced.[103] However, even if the cost of setting up a new venture is comparatively low, significant burdens seem to exist in operation. Moreover, some difficulties and excessive red tape in taxation formalities, customs and local government authorisations, for instance on land use, continue to be reported. A business survey conducted in 1997 by the Institute for Small Business Development on over 2 000 enterprises concluded that the major factors obstructing entrepreneurship in Hungary were, first, "high rates and taxes", and second "incalculable regulations".[104] The persistence of an important grey and black economy is probably also connected with continuing administrative burdens and barriers to growth. Further harmonisation with higher standards and improved enforcement mechanisms related to EU accession should be carefully monitored with respect to their administrative compliance costs on SMEs.

Box 10. **Business registration system in Hungary**

In 1997, through extensive use of IT, the government reformed the regulatory framework and "reinvented" administrative mechanisms for registering start-up enterprises.[105] Based on the French model, the government developed a system to complete a mandatory registration form and send it electronically to the Court of Registration through the Chambers' offices. A computerised system run by the Company Registration and the Company Information Service of the Ministry of Justice co-ordinates the system.

Schematically, the system works in three steps. First, the applicant fills out a form at a registration module located in a Chamber of Commerce or a county's Territorial Office. Second, the data is electronically sent to the tax, social security and statistical central or regional agencies or ministries requesting approval. Finally, the agencies or ministries remit an official answer confirming the applicant's number.

The system is slowly improving the reliability of the Company Registry, although important investments in IT are as still to materialise.[106] In the near future, expansions to the system are planned. Reforms of the Company Act would permit further electronic administration of additional permits and licences as well as a central depository of all general information that currently is often duplicated in various government formalities.

5. CONCLUSIONS AND RECOMMENDATIONS FOR ACTION

5.1. General assessment of current strengths and weaknesses

In less than ten years, Hungary has largely completed an historic transition touching social, political, and economic aspects of life. With respect to the public sector and the state/market relationship, Hungary is now entering the mainstream of OECD countries, that is, there are continuing problems, but these are not qualitatively different from similar problems facing many other industrialised countries.

Hungary's reforms have been sustained over several years. The speed of reforms has hardly declined since 1989 and even accelerated after 1995 due to efforts to close the gaps in policies and capacities before accession to the European Union. Hence, the Hungarian government enjoys a policy credibility that substantially increases the value of its policy reforms. The challenges ahead are nonetheless difficult, since they lie in improving policy coherence and co-ordination across a multi-layered governance system, implementation of current policy directions that have not yet produced the practical results expected, and upgrading skills and embedding cultural change into state institutions.

Regulatory reform has been central to policies of democratisation, marketisation, public administration modernisation, devolution to local governments and harmonisation with EU legislation. From the overarching rules of constitutional governance, to economic, social and administrative regulations, Hungary now has a new legal and regulatory framework. It has also started to install many of the administrative infrastructures to produce quality regulations and to promote and continue to carry out beneficial regulatory reform. Increasingly sophisticated administrative arrangements and more efficient, transparent and accountable regulatory practices are in place and working.

However, gaps, weaknesses, contradictions, and shortcomings still impair regulatory and institutional capacities, and thus reduce the quality of the new regulations and their efficient implementation. The government acknowledges these challenges, and recently has proposed further efforts to fine-tune the reform tools. This report supports this shift, noting, however, that a fine-tuning exercise may be as difficult and complicated as over-arching policy reforms. Reforms to date have put into place a vast new framework, that is usually but not always internally consistent; the future will consist of making the framework work reliably, consistently, and as intended. The new phase will need to struggle with entrenched habits and limited skills in a public administration that itself has not made the cultural leap to a new market-oriented state.

Hungary's regulatory reform experiences offer positive lessons for other OECD countries. A major strength is the strategic sequencing of reforms. Based on pre-transition foundations, Hungary concentrated in the first few years in general governance issues needed for the working of a democratic rule-based state. Constitutional changes strengthened check and balance mechanisms between government, parliament, judiciary, local governments and society. Privatisation and deregulation were done competently and placed Hungary on a par and even in advance of many other OECD countries in crucial economic sectors. Reviewing and deregulating the previous legal framework was done in phases. Recently, the government embarked on improving the quality of new regulations. Regulatory reform avoided the pitfall of an uncontrolled "big bang". Important aspects of the welfare state were preserved or modified gradually to keep popular support. Regulatory costs of transition were spread over time. As much as possible, the government avoided creating legal voids that tend to foster corruption and abuse. This successful sequencing could have not been possible without support from the highest level of government and parliament in a medium and long-term perspective.

A second strength is that the main elements of the framework for effective regulatory reform based on high quality capacities are now in place. Basic laws such as the Act on Legislation and the Act on General Rules of Public Administration Procedures are solid foundations for producing high quality regulations. They contain mandates for *ex ante* and *ex post* justification of laws and subordinate regulations, forward regulatory planning, intra-governmental and public consultation requirements which are consistent with OECD good practice recommendations. The "two stage process" to regulatory decision-making -- in which policies are debated conceptually and then the regulation itself is reviewed -- seems to be another good practice contributing to policy quality and coherence. The Ministry of Justice has well conceived tools to monitor the legal and regulatory framework through a comprehensive database on laws and subordinated regulations including permits and licences.

This progress augurs well for the next phase of reforms. Hungary should give attention to five major challenges to deepen reforms and make them sustainable in the medium and long-term.

- *Implementing reforms is still a major challenge.* As is often recognised, Hungary has been better at producing laws than at enforcing and applying them. Administrative reform lags legal reform, and thus reduces the expected results. Implementation weaknesses are also related to a high amount of discretion in applying regulations. This implementation challenge also applies to the reform policy itself. As was seen in the first programmes launched by the Netherlands in the 1980s and by other countries, Hungary has relied too much on directives, guidance and good intentions, and not enough on enforcement and institutionalised pressures.

- *The regulatory review process controlled existing regulations but not new regulations.* In many ways, deregulation was spectacular. Thousands of measures were eliminated with little negative effect (which might suggest that these regulations were already irrelevant to contemporary economic and social conditions). However, the reviews were not able to control "legislation dumping" and restrain the flow of new regulations and laws. Establishment of RIA and clear advocacy for use of alternatives to regulations were unsuccessful in practice.

- *Powerful ministries opposed the central oversight institutions.* Although politically supported, the oversight institutions lacked real power to carry out administration-wide reforms. They tended to work more like think tanks rather than a watchdog or quality assurance mechanism. A more rationalised institutional architecture with a range of positive and negative incentives, together with more resources in the central unit, will help overcome the scepticism and resistance by line ministries.

- *The reform of the public administration is not yet complete.* There is a clear and positive trend in the efficiency and accountability of the civil service. Yet the Hungarian public administration still struggles against major challenges. Cultural change has not permeated the bureaucracy. Most government actions still rely on excessively legalistic approaches with little attention to economic perspectives and policy performance. Points that need strengthening include the local level administration and, to some extent, the judiciary branch.

- *Devolution of regulatory powers without adequate control mechanisms.* A fundamental step in the re-invention of a democratic governance structure was rapid devolution of powers to local governments. However, this process was done with too few functioning accountability and transparency controls. In fact, it extensively relied on the judiciary to check abuses at the local level. This approach introduced uncertainties, wide administrative discretion at the local level, and carried transitional costs due to the need to reconstruct the court system. Moreover, even if the adjustment of the judiciary had been achieved faster than expected, such a review could only work as an *ex post* check. Efficient and effective preventive or *ex ante* mechanisms are still lacking.

5.2. Potential benefits and costs of further regulatory reform

The benefits of further steps to improve the capacity of the public administration to ensure that new regulations are of high quality will be substantial. Hungary will need not only to provide efficient economic regulations to support its accession and convergence with European economies, but also to assure the highest affordable standards of environmental protection, health and safety, consumer protection and other social goods. Improving the use of regulatory quality assurance tools will enhance the government's ability to deliver higher standards at lower costs. Better regulatory capacities will permit Hungary to finalise the transition of the state from owner and commander to regulator and arbiter of the rules of the game.

These reforms cannot be carried out "on the cheap." Reform will mean extra expenditures and adjustment for some sectors and political costs for the reformers. The implementation of new capacities will mean additional budgetary resources to be allocated to the regulatory reform policy. Running an impact assessment task force can easily require an annual budget of millions of Euros. Training of the civil service in new economic and managerial tasks can be expensive. Re-inventing the regulatory administration may be connected to finding and dealing with redundancy issues of the human resources endowment. Such expenditures should be considered as investments and efficiency-driven initiatives.

5.3. Policy options for consideration

This section identifies actions that, based on international consensus on good regulatory practices and on concrete experience in OECD countries, are likely to be beneficial to improving regulation in Hungary. They are based on the recommendations and policy framework of the 1997 OECD *Report to Ministers on Regulatory Reform.*

- ***Improve political accountability for progress and co-ordination of regulatory reform by restoring the role of the Prime Minister's Office or by forming a Ministerial Committee such as that used in the Netherlands. Improve the oversight and quality of policy advice by establishing a central unit to monitor, promote and co-ordinate activity in close co-ordination with the Ministry of Justice.***

As a priority objective of the transition process, deregulation and regulatory policy were managed from the centre of the government – the Prime Minister's Office (PMO). In the current regulatory policy, the focus was to shift to regulatory management, as the deregulation phase was deemed over. As such, the institutional arrangement was modified and accountability for the regulatory management policy was transferred to the Ministry of Justice. However, regulatory management requires a large amount of political discussion and resolution. Ultimately, it relies on sustained political support to ensure that government-wide policies on regulatory quality are carried out effectively and consistently (especially with respect to powerful ministries). Further, though regulatory reform, in its deregulation component, has achieved much in Hungary, regulatory quality management should be conceived as a permanent governance task aimed at ensuring that governmental regulatory functions contribute over time to the highest possible level of economic and social development. This suggests that regulatory management should be moved back to the centre of government as a core management function applicable to the whole of government. Both political surveillance and expert advice are needed.

A high-level political forum on regulatory quality is one step. Current arrangements rely mainly on the Administrative State Secretary meetings. However, this meeting oversees a multitude of day to day governmental issues, including regulatory ones. For the sake of transparency in regulatory decisions the establishment of a permanent body would permit more focused discussions. It would also permit a closer co-ordination of regulatory management and other related policies such a competition advocacy, SMEs promotion etc. A Ministerial Committee with a strong backing from the economic ministries (*i.e.* the Ministries of Finance and of Economic Affairs) and the Ministry of Justice could be established along the lines of the Ministerial Committee on Markets, Deregulation and Legislative Quality (MDW) of the Netherlands. This high level political forum, could also be supported by an advisory and independent council reflecting the views of the business sector and of the social and environmental organisation similar to the defunct Deregulation Council (suggested below).

Moving from a line ministry to the centre of the governmental machinery will also have implications for the content and scope of the programme. For instance, requiring that the high political body approve an annual report to parliament, assessing results on explicit and comprehensive set of objectives for regulatory reform will improve accountability.

If political oversight is to be effective, a central unit with expert technical capacities and autonomy to review the activities of the ministries will be necessary. Although acting more like a consultant to the government, the Government Commissioner has played an active role in co-ordinating regulatory reform, raising awareness and improving the managerial capacities throughout the Hungarian administration. With its mandate not renewed and its reviewing powers transferred to the Ministry of Justice, effective implementation and enforcement of the policy seems to have suffered. A horizontal ministry is often too weak to confront line ministries, and what is more, the tradition, speciality and core competencies of the Ministry of Justice do not prepare it to review economic impact assessments (including cost benefit or risk analysis). There is a case for the establishment of a leading body at the centre of government with direct accountability to the government. The challenge in the Hungarian context will nevertheless be to develop a model that fits with the complementary and important work on legal quality performed by the Ministry of Justice.

The proposed unit or agency should have a close relationship with the PMO or the Ministerial Committee proposed above. Its institutional setting should provide enough independence, budgetary capacities and prestige to attract the best professionals. Its governance status should strengthen the autonomy and non-partisan view needed to objectively "challenge" regulators' proposals under strict quality criteria. It should have powers to review the RIAs, to initiate, conduct or manage reviews of existing regulations and to report to government on the achievement of its regulatory reform objectives annually set. The unit could be assisted in reviewing new regulations under a 'notice and comment' process (suggested below). Moreover, the unit can be charged with designing thematic and sectoral programmes of reforms throughout the administration and with local governments (*i.e.* developing performance targets, benchmarking of local capacities, timelines and evaluation requirements). To successfully complete the above tasks, the unit should also have sufficient financial resources to collect and assess information and buy the expertise of private think tanks and scholars, and its staff a strong background in economic and public policy analysis.

A useful precedent for the design of such a unit could be the Office of Economic Competition (HCO) and in particular its working structure in charge of the successful competition advocacy tasks. A close relationship between the two institutions would further enhance regulatory reform in Hungary.

- ***Improve the policy foundation for the efficiency, independence and accountability of new independent regulatory agencies by developing guidelines for their systems of governance, policy coherence, working methods, and relations with the competition authority. A high-level and independent review of these issues would be a useful step.***

Increased attention in Hungary to the creation of market-oriented regulatory institutions will improve the legal and administrative environment for competition and business growth. This is even more consequential when new markets are opened in areas formerly reserved to monopolies. However, the Hungarian government has not yet prepared any framework for efficiency, accountability, and transparency and, as in most countries, institutions are being developed on an *ad hoc* basis. The current government intends to review the mandate of all agencies, including regulatory ones. However, this review will mainly be based on the agencies self-assessment. An independent expert group should rather be charged of reviewing concentrating in two dimension: first, the institutional architecture for market-oriented regulation in order to determine if a new harmonised framework would improve efficiency and competition in regulated areas of the economy. For example, it may be useful to evaluate the feasibility in Hungary of a multi-sectoral regulatory institution to share resources, facilitate learning across industries, reduce the risk of industry or political capture, and deal with blurring industry boundaries. Recent experiences in the United Kingdom, where a *Green Paper* was recently prepared,[107] and the in-depth work done by the inter-ministerial commission of Chile could be models. A second aspect that could be reviewed concern the governance system of each agency or sectoral regulator. Here the focus should be on how transparency and accountability can be improved in the selection of head executives, staffing policy, internal procedures, decision-making processes of the agencies.

- ***Make mandatory Regulatory Impact Assessments based on OECD best practices, for all proposed regulations, adapt it to the "two stage process", and harmonise it with the ex post enforcement reports to parliament***

The government intends to strengthen RIA in Hungary. This is an important initiative. In particular, the new RIA should be improved in five key aspects to maximise its potential contributions to regulatory quality. First, the RIA should be made mandatory to all proposals (law, government decrees, ministerial orders, etc.) with a targeting mechanism, for instance, through a system of authorisation/notification according to clear and objective thresholds. Second, a strong benefit/cost test should be adopted, together with implementation strategies (training, data collection techniques, etc.). Third, the RIA process should be fully integrated into the public consultation process, with RIA outcomes being made available as key inputs to the consulted parties, and the results of consultation feed into refining the RIA and the proposal. Fourth, adapt a simplified RIA, with an additional attention to alternatives to regulations, for the review of regulatory "concepts" during the first phase of the "two stage process". Fifth, integrate RIA to the *ex post* evaluation required by the Act on Legislation. *Ex post* RIA should not only be modelled on the *ex ante* system but also be part of the management responsibilities of the reviewing unit. For instance, by keeping track and comparing individual *ex ante* and *ex post* RIA, the government could improve regulations and the RIA procedure itself, as well as detect law drafting shortcomings in sectors or ministries.

As in the short run, the Hungarian public administration may be challenged by the lack of economic evaluation capacities of its law drafters. The RIA system needs thus to be implemented step by step. Implementation could start with feasible steps such as costing of direct impacts and describing benefits qualitatively. Progressively, over a multi-year period, additional requirements and more rigorous quantitative forms of analysis could be included. The mandatory requirement of publishing the RIA in the Internet would be a powerful incentive for regulators to improve the quality rapidly. The RIA can also be complemented and improved by user panels, such as those organised in Denmark, and surveys. However, to make RIA operational as soon as possible, a training programme and support capacities should be launched, in addition to the new guideline just prepared by the Prime Minister's Office.

- ***Promote the adoption of market-oriented policy instruments through guidance and training.***

More than many other countries, Hungary has been aware of the need to move away from rigid 'control and command' requirements to more efficient and flexible kinds of incentives. The Act on Legislation and the successive regulatory reform programmes support the use of less intrusive instruments and market-based approaches. Nevertheless, these legal and policy frameworks have not expanded much the actual use of alternatives to traditional regulations. Stronger encouragement from the centre of the government is needed, as well as support through training, networking, guidelines, cross-fertilisation between sectors and expert assistance where necessary. A promotion and monitoring programme would help regulatory bodies reduce the informational barriers to using innovative policy instruments. An annual report to parliament on the alternatives adopted during the past year could help monitor progress. Such a report could assess use of categories of alternatives such as performance based regulations; process regulations; co-regulation; self regulation; contractual arrangements; voluntary commitments; tradable permits; taxes and subsidies; insurance schemes and information campaigns, etc.

Improve transparency by further strengthening the public consultation process through standard procedures and criteria, and by adopting government-wide notice and comment procedures. A high-level advisory council on regulatory reform should be reinstalled.

The new policy of expanding the use of codification committees is a highly positive step for regulatory consultation. The committees will provide a valuable opportunity to involve a variety of experts and stakeholders with potential gains in terms of quality, legitimacy and future compliance. Clear representativeness of the committees' members and its internal governance system (*i.e.* circulation of information, voting system, minority opinions, etc.) will further assure the transparency of the instrument. However, three initiatives could rapidly enhance the scope and quality of consultation processes, and reduce the risk of undue influence by special interests. First, a thorough clarification of the rules, criteria and parameters mandated by the Act on Legislation would harmonise the numerous and different practices now applied at the discretion of law drafters and ministries. The rules should also apply in a simplified form to ministerial orders and "grey" or informal regulations. For instance, the consulted parties should have direct access to the RIA in addition to the draft legal text, the minimum time of 15 calendar days for consultation should be respected and lengthened; written responses to comments should be prepared and published. Overall Internet dissemination could provide an enormous possibility to expand consultation, as the Ministry of Environment showed in the past administration.

Second, a legal requirement for 'notice and comment' should be established for all proposals. Other countries' experiences show that this mechanism can complement active and *de officio* procedures as a safeguard against possible abuse. Adoption of a general requirement covering all drafts (law proposals, government decrees, ministerial orders and even local government bylaws) would promote both the technical values of policy effectiveness and the democratic values of openness and accountability. The effectiveness of the 'notice and comment' requirements would be further enhanced with the provision of better information, in the form of an accessible RIA. Moreover, the adoption of notice and comment procedures would also permit a central unit, such as the agency recommended above, to review new all new regulatory measures. Lastly, the time constraints of a 'notice and comment' procedure would also bring a good discipline for law drafters to cool down their production zeal.

A third initiative that would support regulatory reform and in particular encourage a pro reform constituency, would be to reinstall a high level advisory group, such as the Deregulation Council which functioned during the last administration, perhaps broadening its mandate to a Regulatory Improvement Council. However, care should be taken in selecting the representative members of the business society and civil society to provide an accurate representation with informed and articulated views. The government could also attach a media forum to the Council as a communication and awareness-raising instrument.

- ***Improve regulatory clarity and simplicity by better law drafting***

Laws and regulations in Hungary are still written to be read by law specialists. This situation is rooted in the strong and deserved tradition of legal accuracy in Hungary. However, experiences in other countries have proved that the legal quality of a regulation is not impaired by the use of a user-friendly vocabulary, structures and complementary techniques. Hungary's legal and regulatory framework would thus profit if a principle of plain language drafting is adopted and quality controls are put into place for enforcing it. Training courses and a strong awareness campaign among the faculty of the law schools could also support this initiative.

- ***Strengthen accountability by reviewing discretionary powers in the interpretation and application of regulations by enforcement staff, and by strengthening the act on administrative procedure.***

Delimiting appropriate discretionary powers of regulators and enforcers is difficult. Setting the right balance between the use of "common sense" judgements and a detailed list of micro-regulations requires time and the development of a legal culture beyond the formal legal arrangements. Nevertheless, this is a crucial task for economies in transition, because principles of legality, good faith, reasonability

and proportionality of the exercise of administrative power are not ingrained in the administrative culture. Consequently, delegated powers can lead to errors, unpredictability, and corruption. As a transitional measure to permit the a more accountable and transparent culture to emerge, a good step for Hungary would be to focus attention on the amount, limits and accountability measures surrounding the devolution of interpretative and discretionary powers. A place to start this focused review could be in procedures of licences, permits, customs or other common formalities, where excessive discretion and interpretative powers have important consequences for SMEs. Furthermore, Hungary could control excessive discretion by incorporating general principles and explicit criteria in the Act on General Rules of Public Administration Procedures.

- ***Strengthen requirements for accountability and transparency for subnational authorities.***

As a major shift away from a powerful central government, Hungary has fostered 'self-regulation' endorsing a strong devolutionary process in favour of local governments. Such policies are bringing benefits in terms of cost and effectiveness of regulations, as well as on democratic grounds. But as other countries' experiences show, adequate safeguards should accompany devolution. Local entities may use their new powers to limit competition and increase incomes and, hence, consumer prices. Overall, they are closer to, and sometimes vulnerable to, well-organised lobbies and rent seekers. They might also have resource limitations that make it difficult to ensure that the bylaws they produce are of good quality, diminishing any improvement achieved at the national and central level.

In the past few years, the central government and the competition authority have focussed on controlling abusive practices. The court system has been the major redress and review mechanism. However, as indicated previously, the efficiency of the judiciary is not high, and current reforms may take years to really have an impact on the speed and quality of resolutions. Furthermore, a judicial review only works as an *ex post* control, redressing the faulty regulation months, if not years, after it came into effect. Hence the need to complement these *ex post* mechanisms with *ex ante* quality ensurence procedures preventing the problems to arise in the first place.

The government should accompany judicial review with accountability and transparency measures to be applied before, during and after the local governments bylaws are passed to reduce the risk of harmful regulatory competition, capture by interest groups, harmful impacts on competition, and corruption problems in subnational governments. For instance, 'notice and comment' procedures should be required before the "rules" and bylaws are passed, local RIAs programmes should be encouraged with funds and training. Benchmarking regulatory frameworks, such as the number and quality of business licences, in important municipals could also be provide a strong incentives to detect best practices or shame laggards. In parallel to these measures, administrative arbitration or dispute resolution mechanisms, swifter than those of the judiciary, could be devised and agreed before new powers are devolved.

Improve implementation of the regulatory quality policy by the public administration by enhancing oversight and monitoring by the centre of government, by moving to results-oriented management, and by investing in training for skills.

Since the early days of the transition, the government has been setting up strategic visions and policies to modernise the public administration. Undoubtedly things have changed for the better. Nevertheless, room for improvements still exist. Hungary is well known for its quality in developing coherent diagnosis and strategic visions of reform. But the implementation capacities by the civil service have often lagged behind policy decisions. Cultural inertia, budgetary constraints and insufficient training can in part explain this situation. At the same time institutional aspects may account for the lack of support by line ministers and individual regulators and enforcers.

The complexity of the issues merits an array of initiatives. The *Referatura* system established in 1998 at the centre of the government will definitively improve the overall effectiveness of the administration. However, it should concentrate as much attention to the monitoring of the implementation of agreed policies as on the planning and preparation of the policies. Second, together with additional resources and powers, new institutional arrangements to manage the government's human resources would improve the coherence and efficiency of the whole governments (including at local level).[108] Linking a more precise surveillance of outcomes and an improved human resources management, together with clear enforcement and sanction mechanisms, would definitively reduce any obstruction raised by individual ministries, departments or agency and offer a strong basis for performance management initiatives. Third, a public inquiry, maybe organised by the Public Prosecutors' Office, the Ombudsmen or and independent commission, on the degree and trends of regulatory compliance of a dozen key existing regulations may also raise awareness among the ministries about the real performance and the quality of their regulations and/or their implementation. On the other hand, to avoid skewing this reform with only negative incentives, the government should continue a pace with training of regulators and administrators' programmes emphasising non-legal managerial and economic skills and with a transparent performance payment system.

5.4. Managing regulatory reform

The impressive regulatory reform of the past decade has permitted Hungary to virtually complete its transition. Economic performance and good governance are vivid proofs of its success. Improvement of its regulatory management institutions and tools will permit to enter with confidence the new phase. In the May 1999 strategy, the government has indicated its willingness to further strengthen these capacities. However, the ultimate success of regulatory reform will depend not only on the policy content of the reform but also on the accompanying policies and transitional arrangements to bring popular and political support to accomplishing the remaining tasks and creating a virtuous circle of quality improvement.

While public support to join the European Union is strong and a pro-reform constituency exists to drive the next phase, some concerns have been raised about a possible backlash and the emergence of a "reform fatigue" in some sectors of the economy. Until now, regulators and population have supported reforms. Memories of the previous situation and the recent economic growth have provided a fertile soil for the re-emergence of sound legal habits in the country. However, continuous changes are creating strains. The fact that some sectors of the economy have not yet received their full share of benefits may pose additional challenges for further reforms in the mid and long term. In particular, a large proportion of SMEs has not hitherto attained the competitive levels needed in an economy exposed to the forces of globalisation. Moreover, a fear exists of the possibility of a dual economy emerging and consolidating along a divide between export-oriented firms and in-ward, low-growth SMEs. Such a situation could be accentuated by the fact that Hungary is in the middle of a bridge trying to join a moving target in the form of higher European standards while competing fiercely for investment against other emerging economies.

This suggests that support for Hungary's fine tuning strategy could be strengthened into two directions. A particular focus should continue to be given to the integration of SMEs into the new modern economy. Readability, communication, and stability of the legal framework would need to be balanced with the renewed efforts to reviewing and drafting old and new laws and subordinate regulations. Extra attention in particular should be put into the overall degree of regulatory compliance, before an informal economy and law avoidance culture undermine the regulatory framework. Moreover, the regulatory polity could need to integrate the new challenge confronting Hungary which might not one of seeing investment leaving the country but one of a decrease in the incentives for re-investing the profits of past investment that should trickle down into the economy. Secondly, the attitude and support for reform will be further consolidated and sustained if the public is convinced that the final aim is not only an economic one, but also a venture to foster a permanent, transparent, democratic and empirical decision-making process on regulatory affairs.

NOTES

1. A main feature of the transformation has been a reduction in size and a slight re-distribution between levels of governments. Between 1990 and 1997, the number of civil servants dropped 17%. The current government recently announced a further reduction of 3% in the next two years.

2. However it is interesting to note that some parts of the public service, such as the competition authority or the units in the different ministries in charge of the European accession dossiers, have continued to recruit and provide interesting careers to young and brilliant professionals.

3. World Bank (1999), *Public Administration Development in the EU Accession Context: The Civil Service in Hungary*, Washington, forthcoming.

4. SIGMA (1999), *Hungary Country Profile*, p. 5. (http://www.oecd.org/puma/sigmaweb/pubs.htm).

5. European Commission (1998), *Regular Report from the Commission on Hungary. Progress Towards Accession*, Brussels, p. 9 (http://europa.eu.int/comm/enlargement/report_10_99/intro/index.htm) and Commission of the European Communities and Council of Europe (1998), *Corruption and Organised Crime in States in Transition. Final Recommendations and Guidelines for Action*, Strasbourg, October, p. 2.

6. The Economist Intelligence Unit (1999), *Country Report 1st Quarter*, p. 15, SIGMA, 1999, *Briefing Notes*, p. 5. Keraudren, Ph., H. Van Mierlo, 1998, "Reform of Public Management in Hungary. Main Direction" in T. Verheijen and D. Coombes (eds.), *Innovations in Public Management. Perspectives for East and West Europe*, Edward Elgar, Cheltenham, UK, p. 145.

7. World Bank (1999), p. 5

8. European Commission (1999) *Regular Report from the Commission on Progress towards Accession of Hungary*, October 13, Section 3.5).

9. Keraudren, Ph., H. Van Mierlo (1998), p. 145. The case of implementing across ministries a coherent human resource policy is documented in World Bank (1999).

10. Reforms can even been traced to a reaction to the 1956 revolution and invasion by Russian troops. For instance, the very important procedure law was first enacted in 1957.

11. The privatisation process itself if drawing to a close. At the end of 1997, the Hungarian Privatisation and State Holding Company APV Rt) had shares in 211 companies, down from 493 in the previous year, with its average holding equal to about one-third of total equity. Of those it is legally obliged to retain its holdings in 92 companies, of which it ahs full ownership of 21 and between 25 and 75% holdings plus golden shares in the remainder. These companies span a number of sectors, most notably electricity, water supply, and transportation, post and telecommunications. OECD (1999) *Economic Survey of Hungary*, p. 77-78. Privatisation of state assets raised $ 6 billions and the stock of inward foreign investment (FDI) reached just under $ 18 billions by the end of 1998 (The Economist Intelligence Unit (1999), Country Profile 1999-2000, London, p. 22, 26.

12. The Civil Service Act (XXXII of 1992).

13. Blaho, A.P. Gal (1997), "Hungary" in Desai, P. (10997), Going Global Transition from Plan to Market in the World Economy. The MIT Press, Cambridge Massachusetts, p. 135-146, Baka, A (1998), in T. Verheijen and D. Coombes (eds.), *Innovations in Public Management. Perspectives for East and West Europe*, Edward Elgar, Cheltenham, UK, p. 137, Hazafy, Zoltan and Zsofia Czoma (1999), "Civil Service Reform in Hungary", SIGMA, 5(2), March/April, pp. 6-7

14. Government Resolution 1100/1996.

15. Baka, A (1998), p. 137. Verebelyi, I. (1996), *Main Directions for Renovating Administrative Activities*. In the United Nations Conference on The Role of Public Administration Promoting Economic Reform, Berlin, January.

16. OECD (1997), *The OECD Report on Regulatory Reform*. Paris.

17. OECD (1995), "Recommendation of the OECD Council on Improving the Quality of Government Regulation," incorporating the OECD Reference Checklist for Regulatory Decision-Making, OCDE/GD(95)95, Paris.

18. OECD (1997), "Regulatory Quality and Public Sector Reform," in *The OECD Report on Regulatory Reform: Sectoral and Thematic Studies*, Paris.

19. GoH (1999), Responses to the Regualtory Reform Questionnaire, Part 1, p. 4. Conceptually, the officers in charge of the reforms were inspired by international events. In particular, major conferences in 1989 and 1995 of IISA, "Free local government, Deregulation, Efficiency, Democracy" and the work on regulatory reform of the OECD.

20. Government Resolution 112/1994.

21. Government Resolution 1100/1996.

22. Government Resolution 1004/1995, Article 9*a*).

23. GoH, (1997) Detailed and Simplified Guidelines of the Deregulatory Supervision of Legal Regulations and Other Legal Instruments of State Administration, as well as for the Preparation of drafts for Legal Regulations, April.

24. Communication with the OECD by the GoH (1999).

25. Government Resolution 1052/1999.

26. Baka, A. (1998), p. 140.

27. Government Resolution 1004/1995, Article 5*a*.

28. Government Resolution 112/1994, Article 1*b*.

29. Government Resolution 157/1998.

30. In every ministry there are two state secretaries: an administrative state secretary who is the highest ranking civil servant and is considered politically neutral, and a political state secretary who represents the minister in parliament and other interministerial committees, and is the political counsellor of the minister (SIGMA (1999), *Hungry Country Profile*, p. 10)

31. Most of these tasks are derived from the Act on Legislation (XII/1987).

32. Government Resolution 1088/1994.

33. GoH - Ministry of Justice (1999), Direct Communication, October, p. 7.

34. GoH (1999), Responses to the Regualtory Reform Questionnaire, Chapter II, p. 11. See other malfunctioning cases in the EU integration process in World Bank (1999), p. 45.

35. GoH (1999), Responses to the Regualtory Reform Questionnaire, Chapter III, p. 10

36. Other institutions that guarantee the lawfulness of the administration and the maintenance of the rule of law are the Presidency, the Constitutional Court and the National Audit Office, and the Ombudsmen (see Box 6).

37. Keraudren, Ph., H. Van Mierlo (1998), p. 144.

38. Illner, Michael (1999), in Kimball, J. (ed.) *The Transfer of Power. Decentralization in Central and Eastern Europe*, Local Government and Public Service Reform Initiative, Budapest, p. 22.

39. Budapest, with 20% of the population, has some additional powers than the other local governments.

40. Hegedus, Joszsef, and Peteri Gabor (1999), "Local Finance and Municipal Financial Management in Hungary" Country Report and Reform Proposal in the World Bank Conference Preparatory Documents: *Mondernization of Local government Finances and Financial Management*, http://www1.worldbank.org/wbiep/decentralization/fdi/htm., p. 25.

41. Keraudren, Ph., H. Van Mierlo (1998) p. 149.

42. GoH, Ministry of Interior (1999), Direct Communication.

43. Hegedus, Joszsef, and Peteri Gabor (1999), p. 25.

44. Baka, A. (1998), p. 132.

45. See The Regional Development and Regional Planning Act (XXI of 1996) and the Regional Development Conception Act (XXXV of 1998). In October 1999, the Parliament approved a new Regional Development Act.

46. In the early 1990, some of the old regional governments' functions were transferred to the 8 regional Commissioners of the Republic; later the commissioners were abolished and replaced by the Territorial Offices

47. Hegedus, Joszsef, and Peteri Gabor (1999), p. 25.

48. The Constitutional right for all citizens to create their own " self governing local authority" spawn a myriad of small entities with insufficient capacities and economies of scale to exert adequately their devolved powers. As a result, the territory is fragmented into small entities with ineffective administrative jurisdiction. More than half or the local authorities have a population of less than 1000 inhabitants. Even the small size of counties is creating constraints for managing European funds. Keraudren, Ph., H. Van Mierlo (1998), p. 151, The Economist Intelligence Unit (1999), Country Report 2nd Quarter, London, p. 17. Baka, A. (1998), p. 132.

49. GoH (1999) Responses to the Regualtory Reform Questionnaire, Chapter III, p. 3; Hegedus, Joszsef, and Peteri Gabor (1999), p. 14, and 6 and Keraudren, Ph., H. Van Mierlo (1998), p. 149.

50. On financial and budgetary issues, the central government has additional co-ordination and control instruments over municipalities through funds and entitlements. The State Audit Office, which reports to the parliament, is also in charge of controlling the self-governing authorities. However, this body has insufficient resources to be able to effectively control the 3 000 municipalities, Baka, A (1998), p. 132.

51. GoH (1999), Responses to the Regualtory Reform Questionnaire, Chapter II, p. 10 and Government Decrees 1004/1995, Article 8*a*) and 1100/1996 art 2(c), pt. 12).

52. Keraudren, Ph., H. Van Mierlo (1998), p. 151.

53. Interviews with the OECD Secretariat, June 1999.

54. Terms of Reference of the Government Resolution 1052/1999.

55. See also the Government Resolution 2166/1998.

56. The Accession Agreement was made public as Act I of 1994.

57. Government Resolution 2212/1998.

58. The Phare funds concentrate on institution building and investments in other areas than agriculture, environment and transport. The Prime Minister's Office is also the main contact for the Support for Improvement in Governance and Management in Central and Eastern European Countries (SIGMA) programme run by the OECD with support from the EU Phare funds.

59. European Commission (1998), p. 34.

60. European Commission (1998), p. 33.

61. Act on Legislation (XI of 1987), Preamble of the Law.

62. The drafter must also consider the Ministerial Decree 12/1987 (mandatory) and the Directives 7001/1988 (not mandatory), issued by the Ministry of Justice, as well as the Law XX/1949 on the Constitution, Decree 46/1994 on Rules and Procedures of the parliament and Government Resolution 1088/1994 and Government Decree 27/1994 on International Treaties, as well as any Constitutional Court Decree Concerning the Legislative Faculties of the Government.

63. The Standard Act (XXVIII of 1995).

64. SIGMA (1997) *Administrative Procedures and the Supervision of Administration in Hungary, Poland, Bulgaria, Estonia and Albania*, SIGMA Paper No.17, p. 28.

65. OECD/ENV (1999), *Environmental Performance Review of Hungary*, p. 79.

66. GoH - Ministry of Justice (1999), Direct Communication, October, p. 7 and 14.

67. However, in 1990, as part of a democratisation measure of the law, the overcomplicated section regulating "social debate was eliminated as these "public hearings" were replace by more open debate.

68. Caddy, Joanne (1998), *Sowing the Seeds of Deliberative Democracy? Institutions for the Environment in Central Europe: Case Studies of Public Participation in Environmental Decision-making in Contemporary Hungary.* Doctoral Thesis, European University Institute, Florence, May.

69. GoH (1999), Responses to the Regualtory Reform Questionnaire, Chapter I, p. 10.

70. ENV/EPOC/WMP(98)4.

71. SIGMA (1997), p. 27. See also the text of the Government Resolution 1004/1995.

72. Act on General Rules of Public Administration Procedures (IV of 1957).

73. SIGMA (1997), p. 24.

74. Baka, A. (1998), in D.J. Galligan, C. Nicondrou and R. Langan (eds.), 1998, *Administrative Justice in Central and Eastern Europe*. P. 58 and 61 and p. 151

75. Davis, O. (1999), "Crossing Fingers and Borders", *Business Hungary*, June, 13(6), p. 5.

76. OECD/ ENV (1999) p. 83.

77. European Commission (1998), p. 22 and GoH - Ministry of Economic Affairs (1999), *Evaluation of the SME Sector Programme in Hungary*, p. 22.

78. The government has estimated that the total amount to satisfy with European and other international environmental requirements would be EUR 5 billion over the period 1997 to 2002, and an additional amount of EUR 10 to 15 billions, representing an 1% of GDP effort over the next two or three decades, OECD/ENV (1999), p. 84.

79. Hungary relies on a special division of the ordinary civil courts for administrative appeals and has not considered creating a special administrative court, although the Constitution permits this possibility SIGMA (1997), p. 22.

80. Act on Administrative Jurisdiction (XXVI of 1991).

81. SIGMA (1997), p. 22.

82. National Council of Justice (1999), Role and tasks of the Office of the National Council of Justice, June and Interviews with the OECD Secretariat, June 1999.

83. Prof. Galligan refers to this as a remnant of the old regime where administrative reviews were performed by the administration itself and SIGMA (1997) p. 36.

84. Baka, A. (1998), p. 63-64.

85. OECD/ENV (1999), p. 84- 94.

86. GoH (1999), Responses to the Regualtory Reform Questionnaire, Chapter III, p. 3.

87. OECD (1997), Paris.

88. The Act on Legislation (XII/1987), Section 18.

89. Government Resolution 1088/1994, Article 10.

90. The drafters were asked to prepare and send the answers in addition to the Government Commissioner to minister, and the ministries' deregulation unit, if this existed. A simplified questionnaire could be filled out, in case a proposed of law or subordinate regulation was prepared under urgency procedures. But, 60 days after entering into effect a justification statement should be provide. GoH - Ministry of Justice, (1997), *Detailed and Simplified Guidelines of the Deregulatory Supervision of Legal Regulations and Other Legal Instruments of State Administration, as well as for the Preparation of drafts for Legal Regulations*, April.

91. GoH – Ministry of Economic Affairs (1999), *The Hungarian Government's Strategy for Supporting Small and Medium-sized Enterprises. Entering the New Millennium*, Budapest, p. 7.

92. Government Resolution 1052/1999, activity 3*b*).

93. European Commission (1998), p. 38.

94. Government Resolution 1052/1999, activity 1*a*).

95. Although in 1998, the UK gas and electricity regulators, Ofgas and OFFER, were recently merged into a single regulator under a new name: the Office of Gas & Electricity Markets.

96. Some laws have a constitutional attribute and need a ¾ of the vote to be modified. As well, a few laws are organised into codes.

97. Government Resolutions 1143/1989 and 1103/1990.

98. Government Resolutions 112/1994, 1004/1995 and 1100/1996.

99. Council of Ministers Decrees 39/1990, 44/1990, 88/1990, 45/1991,and the Deregulation Act (XXII/1990).

100. GoH (1999), Responses to the Regualtory Reform Questionnaire, Chapter I, p. 14.

101. Government Resolution 1004/1995, article 1*c*).

102. UNIDO (1996), *Comparative Analysis of SME Strategies, Policies and Programmes in Central European Initiative Countries.* http://www.clusters.org/smespp/.

103. 770 000 businesses operate in Hungary. 96% of those have less than 10 employees. Today SMEs generate approximately half of Hungary's GDP while accounting for two thirds of workplaces (GoH – Ministry of Economic Affairs (1999), *The Hungarian Government's Strategy for Supporting Small and Medium-sized Enterprises. Entering the New Millennium*).

104. Institute for Small Business Development (1998), *State of Small and Medium-sized Business in Hungary, 1998 Annual Report*, Budapest, and p. 172.

105. Act on Company Registration (CXLV of 1997), the Act on Public Access to Company Information and the Court Registration Act.

106. European Commission (1999), *Regular Report from the Commission on Progress towards Accession of Hungary,* October 13, Section 3.5).

107. DTI (1998), *A Fair Deal for Consumers. Modernising the Framework for Utility Regulation*.

108. See the World Bank recommendation on "relocating the Civil Service Department [from the Ministry of Interior] to the PMO (if necessary with its own Minister and Counsellor) and to consider rationalising the Civil Service Department with the Public Service Department (Ministry of Labour)". World Bank (1999), p. 11.