

CIPE in Hungary: Paving the Road to Reform

In 1989, while the Berlin Wall crumbled, CIPE was quietly laying the groundwork for a modest program in Hungary designed to encourage legal and regulatory reform. CIPE's program in Hungary was part of a regional initiative that included a small grants program and support to indigenous business organizations in Hungary and Central and Eastern Europe. With cautious support expressed by the government of Hungary, CIPE and its Hungarian partners took the first steps toward building a sound, long-term relationship.

Today, a decade later, CIPE's programs in Hungary are seen as an unqualified success and a model of cooperation in Central and Eastern Europe. Attila Chikan, Hungary's former Minister of Economy, says he is "convinced that among the institutions which promoted Hungary's transition, CIPE has definitely been playing a major role from the very beginning. CIPE managed to find the key areas where important debates and discussions could be held."

Peter Medgyessy, a former Minister of Finance and current Chairman of the Hungarian Economic Association, agrees: "The studies and related discussions prepared by CIPE were a tremendous contribution to Hungary's efforts to trans-

form its economy and overcome the economic crisis."

Since 1989, CIPE has provided funding to more than 20 Hungarian organizations, enabling CIPE and its partners in Hungary to undertake over 35 projects in that country. These programs have affected thousands of decision-makers in Hungary, slowly but surely changing perceptions and policies in ways that will be felt there for decades to come.

CIPE's work in Hungary came to a conclusion in 1999, and it is instructive to look back on a remarkably productive decade. This period can be divided into three basic phases, each of which is highlighted below.

Phase I: Legal and Regulatory Reform (1989-94)

With funding from the National Endowment for Democracy and the US Agency for International Development (USAID), CIPE initiated the Legal and Regulatory Reform in Hungary (LRRH) project) in the late 1980s and early 1990s. Working with six partner organizations in Hungary, the initial focus of the reform effort concentrated on the financial sector, the informal sector, the real estate market, privatization, tax policies, local government's role in private sector development, and the impact of public

opinion on reform.

The major objectives of the LRRH project included:

- ▶ framing the economic debate in Hungary by promoting reforms based on sound research and the country's principal economic policy requirements;
- ▶ accelerating the pace, focus, and direction of reforms through a coordinated advocacy effort led by indigenous institutions; and
- ▶ developing the skills of independent business organizations and public policy groups and, through greater cooperation among these institutions, encouraging advocacy for legal and regulatory reforms.

By 1993, with the Hungary programs solidly on track, CIPE opened an office in Budapest, its first office overseas. CIPE's Budapest office played an instrumental role in helping to coalesce Hungary's disparate analysts and policymakers into a single voice for economic reform. Opening a CIPE office in Hungary was a critical step in three ways: it brought CIPE and Hungary's reformers into direct, first-hand contact on a regular basis; it stimulated the formation of a solid policy community for economic reform; and it reinforced the development of new advocacy techniques suitable for Hungary.

The following year, CIPE and its Hungarian partners produced a groundbreaking report, *Crossed Paths: Straightening the Road to Private Sector Growth*. The report served as a "road map" for Hungary's leading decision-makers in the public and private sectors as they sought to achieve meaningful economic reform. Today, five years after the report was issued, the Hungarian government has adopted nearly two-thirds of the report's 41 recommendations. Equally important, these reforms have proved to be successful and sustainable over

ally, said, "none has made as good use of my time and expertise as CIPE has." Moreover, CIPE's association with several of Hungary's top thinkers and opinion-makers conferred credibility to the activities and projects it sponsored. Former board members now become effective agents to carry forward the basic concepts and approaches CIPE has introduced.

One of the biggest success stories to grow out of the LRRH program has been the role CIPE and its partners played in bringing about pension reform in Hungary. The

Phase II: Small Business Development (1994-96)

In October 1994, with the LRRH program firmly in place, CIPE began developing the second phase of its work in Hungary. With growing recognition among Hungarian policymakers that it was important to shift away from large state-owned companies toward small- and medium-sized enterprises (SMEs), CIPE once again was in a position to provide business development expertise. Unlike the LRRH program, which focused on the macroeconomic picture in Hungary, CIPE's Small

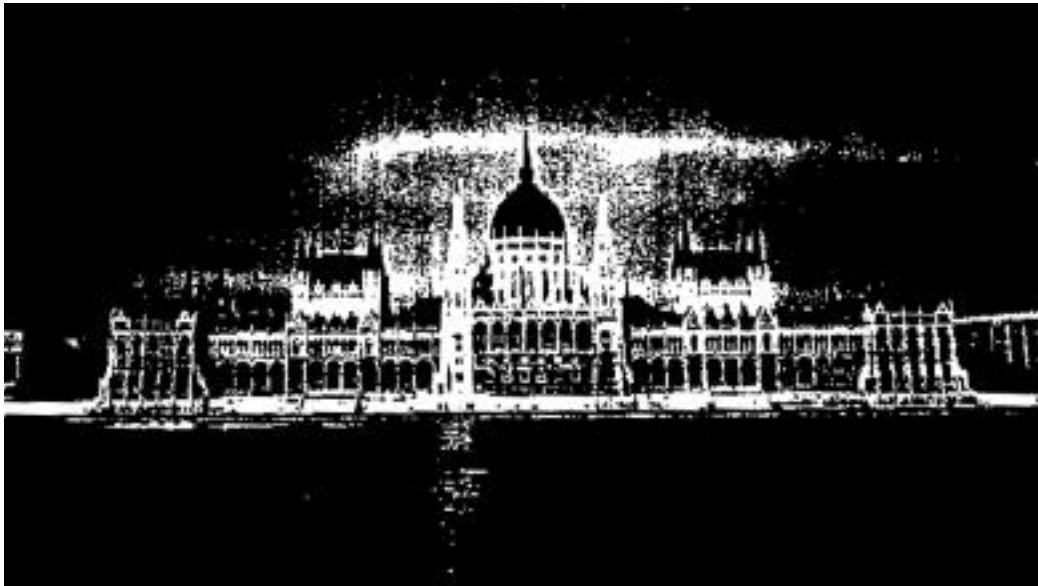


Photo: Steve Rogers

Hungarian lawmakers need to eliminate mandatory membership associations.

time, with no indication that Hungary's leadership has any interest in rolling back the reforms.

Providing overall guidance for CIPE's Hungary program was an advisory board comprising Hungarian business luminaries and leading economic experts, who assisted CIPE in identifying issues, steering it to potential grantees, and helping to design conferences, roundtables, and publications. As interactions between CIPE and its board intensified over time, listening to the board became a key ingredient of CIPE's success. One board member, connected to several advisory boards in Hungary and international

pension reform program drew on CIPE's experiences in Chile and Argentina, where partner organizations were instrumental in reforming outmoded pension systems. This positioned CIPE as a resource and facilitator for pension reform in Hungary. In particular, with support from USAID and the World Bank, CIPE was able to provide technical guidance, foreign expertise, and advice on mobilizing public support for such reform. Today, key pension reform laws are in place in Hungary and their implementation is proceeding according to schedule.

Business Development Project (SBDP) concentrated on strengthening the microeconomic environment in that nation.

Hungary's banking system has traditionally catered to low-risk, state-owned enterprises, which put SMEs at a great disadvantage because they could not access badly needed credit and capital. Financial Research, an indigenous non-partisan research institute and CIPE partner organization, played an instrumental role in helping to turn this situation around via a series of projects advocating banking and capital market reforms that would facilitate the private sector's access to capital.

By 1996, some two-thirds of the SMEs working with CIPE and its other partner organizations were able to secure loans.

The Institute for Small Business Development's Market-Based Model for Small Loan Projects, sponsored by CIPE, contributed further in this area by creating in 1998 a practical model for small businesses to access loans on a fully commercial basis. That plan has good prospects for administrative backing.

Through wide-ranging economic policy reforms as well as one-to-one counseling of aspiring entrepreneurs, CIPE's SBDP activities have helped to build a better informed entrepreneurial base and enhanced the ability of SMEs to provide services within the Hungarian economy.

Another success in CIPE's efforts to assist SMEs in Hungary was the establishment of the Carpathian Border Region Economic Development Association. This project, initiated in January 1995, concentrated on uniting entrepreneurs in bordering areas of Hungary, Slovakia, and Ukraine. Public and private sector leaders in the Carpathian region recognized the importance of transborder communications and trade flows, and the Zemplen Regional Development Association represented a major step forward in inter-regional cooperation.

CIPE funds were used to create a database of regional entrepreneurs, provide commercial expertise, hold regional meetings to discuss trade opportunities and impediments, generate exposure for the region through a range of media outlets, and take important steps toward establishing a regional free trade zone. In Hungary, the area has been designated until 2008 as a Special Enterprise Zone, a status that brings critical investment incentives to this economically depressed area.

Phase III: Promoting Public Policy Debate and Institutionalizing Business Associations (1996-99)

In the third phase, CIPE took a broader range of approaches to improving the performance of SMEs. A series of economic policy roundtables were developed to strengthen the sector's clout with policymakers and enhance its position in the Hungarian economy. SMEs were the prime beneficiaries of highly effective management training programs for independent business associations, and several projects devoted to franchising and commercialization of innovations sought to spur the entrepreneurial spirit of smaller companies.

Roundtables. Economic policy roundtables have been the highlight of CIPE's third and final phase of programs in Hungary. During the past three years, 19 roundtables were held as forums for high-level debate among public and private sector leaders. These discussions represent a remarkable contribution to Hungary's economic development and policy reform process. (see the box on the next page for a list). Of these roundtables, 16 were aimed at strengthening the SMEs, thereby reinforcing the focus of the second phase of CIPE's Hungarian projects.

CIPE's approach to its roundtable program became increasingly sophisticated over time. Topics narrowed from large legal and regulatory concerns to targeted aspects of reform implementation and modification. By 1996, a winning events formula had evolved that included keeping the language of the conference in Hungarian (unless foreign experts participated); inviting speakers able to provide alternative viewpoints; establishing a roundtable image by designing a special logo; and issuing press releases in two languages (sometimes the same day). This recipe generated strong interest in the roundtables, widened recognition of their contribution to decision-making, and enhanced CIPE's reputation in Hungary.

The final roundtable conference, held in June 1999, concentrated on

growth and investment. It traced the remarkable journey that CIPE and Hungary have made during the past decade, with particular emphasis on partnerships, transparency, the development of SMEs and business associations, financial markets, and regional development.

Well over 100 people attended the roundtable, including top policymakers, Hungarian government representatives, representatives from international organizations, business leaders, and journalists. Dr. John Sullivan, CIPE's Executive Director, attended the final roundtable, delivering an address on "Investing in Partnerships for Policy." The opening address was delivered by Arpad Goncz, the President of Hungary, and Economics Minister Attila Chikan kicked off the second day of sessions with a speech on "Economic Strategies and Prospects." In his welcoming address, President Goncz stressed that creating an adequate regulatory framework for the economy takes many years and must continuously be fine-tuned. He also acknowledged CIPE's efforts to support Hungary's progress toward a market economy.

Institutionalizing Business Associations. Business association management training has become a hallmark of CIPE's programs around the world, and few have been more successful than the four sessions held in Hungary in 1996 and 1998. The objectives of the training programs included:

- ▶ developing a broader awareness throughout Hungary of the potential that independent, voluntary business organizations have in promoting democratic practices and open-market economic principles;
- ▶ strengthening the capability of these business groups to play a more active role in policymaking through the development of effective public policy programs and member services;

HUNGARY OFFICE HOSTS ECONOMIC ROUNDTABLES

An important component of CIPE's work in Hungary included the Economic Policy Roundtables. Each session consisted of a background paper presented by one expert, a presentation of an alternative viewpoint, and then a moderated discussion. Held throughout the year, these meetings gave experts, policymakers and the business community a chance to discuss, debate and find consensus on a myriad of complex economic issues.

For a report on each of these roundtable sessions, see CIPE's Web page at www.cipe.org/pub/cee/epr.html

Legal Security in the Economy of Hungary

Gábor Papanek

GKI Economic Research Company

Alternative Methods in Micro-Financing

László Kállay

Institute for Small Business

Development

Public Procurement: Lessons from Three Years' Experience

György Várday

Technical University of Budapest

Venture Capital Legislation and Economic Development

Péter Osman

Financial and Investment Services in a Changing Environment

Éva Várhegyi

Financial Research Ltd.

Hungarian Corporate Law

Gábor Gadó

How Heading to the European Union is Expected to Affect Small and Medium Sized Enterprises (SMEs) in Hungary: The Role of Such Enterprises in the Division of Labor

Adám Török

Hungarian Academy of Science

The Concept and the Scope of the Act on Small Businesses

Endre Ferenczy

Hungarian Academy of Science

Local Government and Enterprises: Intensifying Regional Development

Ferenc Csefkó

The Role of Mortgage Finance in Stimulating the Real Estate Market

Eva Várhegyi

Financial Research Ltd.

The Role of Transparency in Political Decision Making and Its Effect on the Economy

Tibor Vidos

GJW Politconsult

Some Major Issues in the Transformation of the Tax System

Pál Gáspár

Financial Research Ltd.

The Hidden Economy in Hungary

András Vértes

GKI Economic Research Co.

Policy Issues of the New Acts on Credit Institutions and Securities

Éva Várhegyi

Financial Research Limited

The Role of the Non-Profit Oriented Sector in the Reform of the Public Finance System and in the

Development of Public Services

László Harsányi

- ▶ developing skills and expertise necessary for the effective management, administration, and operation of membership services for local business associations; and

- ▶ facilitating a national network of business associations for the exchange of information, expertise, and experiences.

One participant enumerated the many useful skills he acquired in managing associations effectively: "recognizing the importance of maintaining continuous communications with our members; forming committees and organizing their activities; using mechanisms for interest coordination and conflict resolution; and seeking consensus and the techniques to attain it."

In Hungary and around the region, there is growing recognition of the important role played by women in business. At the business association management training program held in Hungary in 1998, more than one-third of the participants were women entrepreneurs and/or association leaders. Another positive outgrowth of CIPE's training program was the initiative shown by the training participants in forming their own "Club of Association Leaders."

An even better example of the growing role that Hungarian women play in business was the June 1999 workshop in Budapest of the Central European Business Women Academy. CEBAW was founded in September 1997 in conjunction with CIPE's "Organizing

for Success: Strengthening Women's Business Organizations" conference in Washington, DC.

The 1999 Hungarian workshop brought together women from six countries: Hungary, Poland, Slovakia, Czech Republic, Croatia, and Ukraine. Each nation was represented by a non-governmental organization (NGO) leader, a trade expert, a media representative, and at least one businesswoman.

The gathering, coordinated by the Business Basics Foundation, focused on three core activities: establishing linkages for market expansion, exchanging commercial data on each nation, and networking. The workshop was highly successful, prompting one participant to note, "This has been a wonderful experience and an im-

portant step for bringing Central European businesswomen into ongoing contact with one another. CIPE has helped us to plant the seeds. Now it's up to us to make this institution grow."

Toward the end of its Hungary program, CIPE moved into largely uncharted territory with projects to directly support the private sector by encouraging commercial innovation and protection of technology and property rights. Two studies in the franchise area led directly to legislative action. The first, "Improving Conditions for Franchisees," mapped out the state of franchising in Hungary and conducted public education and advocacy campaigns targeted at policymakers. A 1996 study by the Hungarian Franchise Association built on this framework by promoting the introduction of franchise laws appropriate for Hungary and by expanding the range of useful publications and services it provides to its growing membership.

In 1996, the Technical University of Budapest's Commercializing Innovations project created a model for how academic institutions can bring their innovations to the marketplace by cementing working relationships with the business community, including foreign multinationals operating in Hungary.

Along these same lines, GKI Economic Research Company, one of Hungary's leading business research firms, identified obstacles to improving the enforcement of property rights and contractual obligations—one of Hungary's most important and least tractable economic problems. A roundtable presentation of the results recommended remedies for the legal and institutional constraints that block fair competition in Hungary.

Boding well for Hungary's private businesses on the government policy side is a 1996-97 study of the Macro-

economic Factors of Competitiveness, which examined a range of issues that put Hungarian firms at a competitive disadvantage vis-à-vis producers in the European Union and offered specific solutions. That project's principle investigator was Attila Chikan, who was then connected with Budapest University of Economics, a CIPE grantee, and was Hungary's Minister of Economics at that time.

Combating corruption became a growing focus for CIPE activities in Hungary. Presentations at its final



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*Attila Chikan,
former Minister
of the Economy*

conference in June 1999 underscored that greater transparency in governmental decision-making and improved business ethics are essential to Hungary's continued economic advancement. Several CIPE projects addressed this sensitive topic in 1999. Financial Research Ltd. conducted a "Survey on Corruption" to examine its extent and nature, and Prolegamena's "Transparency versus Corruption" study looked into specific areas like public procurement, the media and access to information. Financial Research's Istvan Csillag called the growing focus on corruption "a healthy development, reflect-

ing less tolerance for bad practices and more understanding that in a democratic market economy corruption and bargaining with influence is obsolete."

CIPE's partnership with Hungary over the past decade has helped to bring about some remarkable changes. Funding for CIPE's activities in Hungary is drawing to a close, but CIPE's partner organizations will continue to work on behalf of market-oriented economic reforms and enduring democracy.

The June 1999 conference wrapping up CIPE activities in Hungary identified what is still needed to consolidate the transition to a market-based economy. Looming large on the conference's list of "Recommendations for the Future" were measures to ensure open debate among the private sector and policymakers on economic matters. The recommendations also call for more opportunities for public commentary on potential legislation. Among those voices should be the policy thinktanks, business associations, and others in a position to provide sound recommendations and to disseminate intelligible summaries for the media and public.

Continued support for small business also featured strongly as an area that needs additional work. Encouraging flexible, market-based structures for small business financing, for example, would build on the many programs CIPE has funded to ease SME access to capital. Simplifying and increasing the predictability of the government's remaining support programs for business would similarly help small businesses.

Other areas that will present key challenges for Hungary in the coming years include the adoption of sound corporate governance principles, not only within the boardroom but within its capital markets and financial services. While Hungarian business has made great strides in developing a competitive edge, the

key to maintaining that position—and attracting further international and domestic investment—will be investor confidence in the governance of companies, and the ability to easily exercise and transfer ownership rights. As Hungary moves towards EU entry and a more active role in the global economy, a transparent, predictable, and stable corporate governance environment will be key to its ability to remain competitive.

EU entry also remains an economic policy priority. Harmonization with EU trade, labor, environmental, and currency policy will place renewed strains on the Hungarian economy and test the ability of its reform-oriented leadership to navigate the difficult waters of accession. Economic and technical support from the EU for this process will be critical to ensure that Hungary's entry places as little burden as possible on both Hungarian and European resources.

Developments in the business community continue to be of interest, with the prospect of a change in the status of the Chamber of Commerce away from a mandatory membership "public law" model to a "private law" voluntary model of membership. The Hungarian Chamber will face a myriad of issues to insure its relevance to the Hungarian business community and its long-term viability and sustainability. CIPE will track this develop-

ment carefully and strive to offer assistance to the Hungarian Chamber should this transition occur.

CIPE expects the emerging business associations that it has helped to train, the many policy think tanks with which it has worked, and former members of its Advisory Board to lead the charge in creating the new Hungarian economy and making it a potent force in the global marketplace. It placed a special responsibility on the independent business associations to advocate for change, exhorting them to turn to their members for practical advice and input regarding development strategies. Teaching the vital importance of effective political advocacy of policies that strengthen the market mechanism and advance legitimate business interests will be one of CIPE's lasting contributions to democracy building and economic transformation in Hungary.

Perhaps one of the most important legacies of Hungary's transformation is the wealth of reform experience garnered by its policy experts and economic development professionals. Lessons learned in Hungary over the past ten years have direct relevance for other economies still struggling with transition. CIPE is actively using this knowledge to enhance its programs throughout the region, through face to face contacts between Hungarians and their region-

al counterparts, and through Internet exchanges. CIPE's partners throughout Central and Eastern Europe are sure to reap the dividends of the Hungarian experience as they seek their own paths of transition. 🌐

CIPE's Hungary program recently underwent a full, independent evaluation by Paul Marer. The resulting assessment summarized the program as "surprisingly impressive and highly effective" at building democracy and creating an economic transformation in the country. The program was so effective because the groups it supported devised sound legislative and policy recommendations and lobbied hard and effectively to have them implemented. This certainly constitutes a lasting contribution to democracy-building and economic transformation. The full text of this evaluation is available on CIPE's Web site at www.cipe.org.