

REGULATING MARKET ACTIVITIES BY PUBLIC SECTOR
HUNGARY
04-Jun-2004

1. The role and weight of the government in the economy of Hungary

1. In 2003 the average **number of people employed in the budgetary sphere** was 819 thousand, about 30 % of all employees. In the sub-sectors of public administration, defence and compulsory social security a total of 321 thousand, in education a total of 236 thousand and in health and social/welfare services some 201 thousand people were employed.

2. The **government and its institutions contribute** some 17-20 % of **GDP** (with households, businesses, financial institutions and non-profit institutions assisting households contributing 20 %, 50 %, 3 % and less than 1 %, respectively).

3. The various **groups of owners** (public/state and Hungarian/foreign private owners) **contributed to the generation of GDP** within the various sub-sectors, as follows:

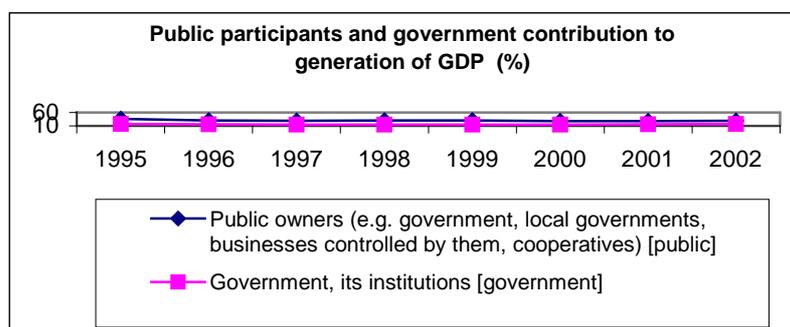
Share of sub-sector from the GDP in 2002 (%)	Sector code	Sector of the national economy	Sector of the national economy (%)					
			2001			2002		
			public	foreign	national	public	foreign	national
			controlled	private		controlled	private	
3,7	A-B	Agriculture, hunting, forestry and fishing	9,6	3,8	86,6	10,2	4,7	85,1
26,1	C-E	Mining; manufacturing; electricity	15,4	49,3	35,3	16,9	49,1	34,0
5,1	F	Construction	1,1	8,9	90,0	1,2	5,6	93,2
11,4	G	Wholesale and retail trade; repair of vehicles	0,6	29,9	69,5	0,6	32,3	67,1
1,8	H	Hotels and restaurants	8,4	14,2	77,4	8,6	14,9	76,5
8,4	I	Transport, storage, post and communications	48,7	12,1	39,2	46,4	14,7	38,9
3,5	J	Financial activities	21,0	42,8	36,2	24,3	40,8	34,9
17,8	K	Real estate, business services	5,1	12,9	82,0	5,1	12,2	82,7
8,6	L	Public administration, defence, compulsory social security	100,0	x	x	100,0	x	x
4,9	M	Education	83,9	0,2	15,9	83,9	0,2	15,9

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4,6	N	Health and social carek	67,8	1,0	31,2	70,7	0,9	28,4
3,4	O	Other community, personal service activities	28,3	4,1	67,6	31,7	6,1	62,2
100	A-O	GDP	27,4	22,1	50,5	29,1	21,9	49,0

Source: CSO

* assignment to groups of ownership according to majority ownership principle

Development of state contribution to GDP between 1995 and 2002

Source: CSO

Remark: 1995-1997: financial services sector not taken into account

4. The trend of the decline of the share of the public sector in GDP broke in 1998 as a result of the diminishing of the assets available for privatisation and the different policy adopted by the government which took office in 1998, in comparison to the policy pursued by the preceding government. The slight growth of the weight of the public sector was also a result of the growth of wages in the public sector in excess of the growth observed in the private sector: i.e. the reason does not lie in any growth of the business operations of the state.

5. Partly in line with the problems of the budget which has been short of funds - in contrast to the anti-privatisation attitude of the government in office between 1998 and 2002 - the sale of state-held assets has accelerated since 2002 (sale of minority shareholdings: the consolidated Postabank, Konzumbank, Dunaferr; sale of minority shareholding in MOL).

6. In 2004 the **expenditures of general government** (central budget, social security, extra budgetary funds) amount to approximately 48 % of the GDP HUF 20.5 thousand billion (about 80 billion Euros). This level of income redistribution places Hungary among the continent's welfare states.

7. The percentage of the business assets of the state is relatively low - the **state business property managed by the State Privatisation and Holding Company (ÁPV Rt.)** in relation to the central budget amounted on 31 December 2003 to HUF 648 billion (equalling about 3.3 % of GDP) and without the property to be kept in state ownership on a permanent basis it amounted to HUF 405 billion. At the same time there is no precise information on the other key component of the public assets, the assets held by local governments.

2. Designation of the range of state and local governmental assets

8. For the specification of the range of **permanent state property** Act XXXIX of 1995 on the Disposal of Business Assets in State Ownership **specifies four criteria**:

1. provision of national public utility services (for example):

- Magyar Villamosművek Rt. (central power trust)
- Magyar Posta Rt. (the Hungarian post)
- Magyar Államvasutak Rt. (state railways)

2. **strategic importance from the aspect of the national economy** (for example):

- Regional waterworks
- Power generators
- Gas supplying companies

3. **defence objective** (for example)

- HM ARCOM Kommunikációtechnikai Rt. (communication technology company)
- HM ARZENÁL Elektromechanikai Rt. (electro-mechanical company)
- HM CURRUS Gödöllői Harcjármű technika Rt. (military vehicle technology)

4. **servicing other special objectives** (for example):

- Forest and game wardening,
- Research institutes involved in the production of fruits, ornamental plants, medicinal herbs,
- six smaller enterprises employing employees with disabilities
- some industrial ventures engaged in the production of Hungarian specialities.

9. The **business share of the state** varies widely in the above groups of assets, extending between 100 % and a single voting preferential share. The basic role is that the state ownership may not be below a share carrying 50 % of all votes plus one vote.

10. Ownership rights are exercised by the State Privatisation and Holding Company or the line minister concerned.

11. Another large category of public business assets comprises **companies operated by local governments**. The range of business operations of local governments is specified by the Act on Local Governments by setting the compulsory and voluntary tasks that may be carried out by municipal governments.

12. **The mandatory tasks include** the provision for healthy drinking water supplies, of street lighting, maintenance of local public roads and public cemeteries, kindergarten and primary school services, basic health and social/welfare services.

13. Depending on the demands of the local population and the available funding sources local governments **may provide for** - as local public services - municipal development and zoning tasks, the protection of manmade and natural environment, management of council flats, water management/drainage, local public transport services, sanitation services, local fire protection and local public safety. A municipal government may participate in local energy supplies, employment policy, child protection, public education, it may support artistic and sport activities and the development of a healthy mode of life.

14. Local governmental councils may set up local governmental institutions, business organisations or cooperatives for the performance of the above public services. In the areas of the operation of municipalities and the ongoing supply of public utility and communal services local governments are operating business organisations as a typical arrangement.

15. As a consequence of the above considerations state and local governmental functions involve a number of areas where the public sector competes with private entities in the market. There are lots of examples of their presence limiting or distorting competition.

16. The plan of the state subsidy of Antenna Hungária Rt. under the pretence of shifting to *terrestrial* digital television operation is, for instance, a sign of the lack of a fully thought-out policy aiming at competition-neutral operation of state business property which is considered by cable service providers - with reference to the technology-neutrality of regulation - as a serious violation of equal conditions and opportunities in competition for digital television service provision may be operated via cable and satellite systems alike. Some cable operators have announced that in view of the 50-60 % of households supplied with cable services their involvement would enable faster and cheaper introduction of digital television operations. The debate between the government and market participants has not yet been close and the communication ministry has promised further consultations.

3. Competitively neutral regulation of enterprises under state and local governmental control

17. The government has recognised the importance of competitive neutrality in the regulation of state owned or state controlled enterprises however, for the time being there is no **governmental policy based on consistent principles** that would impose an obligation on state enterprises to adopt competitive behaviour as adopted by private businesses. The principles of competitive neutrality are impaired from time to time despite some statutory regulations already in effect. Initial steps have however been taken to ensure competitively neutral regulation of state/local government controlled enterprises.

18. One important and controllable requisite of competitively neutral behaviour is the separation of **costs and revenues** relating to the market and non-market activities of businesses operating under state control and the prevention of cross financing which is a practice distorting competition. This essential target is intended to be implemented by the Government Decree - No. 105/2003. (VII. 18.) - on the 'Transparency of the financial relationships between general government organs and public enterprises and the financial transparency within enterprises' which entered into force on 1 May 2004 - the day of Hungary's EU accession - as one of the implementing decrees of the Act on State Budget.

19. According to the provisions of the above decree an enterprise enjoying special or exclusive rights granted by the state or one that is providing services of general economic interests for which it receives state subsidy - providing it is performing other activities as well in addition to such services - is obliged to keep separated accounts. The obligation to keep separate accounts of costs is, of course, in effect only above a threshold figure specified in the decree. Accordingly, the scope of the Decree does not cover enterprises whose net sales revenues during the two business years preceding the year under review did not reach EUR 40 million. Nor do businesses that have been commissioned to provide services of general economic interests through a competitive bidding procedures for a specific period of time, need to observe the rules on the separation of the accounting of costs and revenues..

20. According to the Decree a **public enterprise** is obliged to separate in its internal accounts the subsidies originating from any organisation of the general government system (e.g. compensation for operational losses, capital injections, non-refundable subsidies, preferential loans and the refunding of certain financial burdens).

21. Public businesses keep separate accounts of *dividends* and financial advantages received in return for relinquishing such and on the relinquishing of the *expected returns* on state funds used.

22. Public enterprises stating annual net sales revenue figures equalling at least EUR 250 million in the manufacturing industry have to submit their annual accounts to the Minister of Finance.

23. Such reports have to cover the following:

- provision of own shares, own stakes, bonds providing subscription rights, with detailed conditions,
- non-repayable and repayable grants and financial assistance,
- loans extended to the reporting enterprise including technical loans concerning capital injections, specifying interest rates and any guarantees provided by the lender,
- dividends paid and retained profit,
- remission of the repayment any debt, loan, subsidy or of payment of taxes.

24. According to the Act on the Disposal of Business Assets held by the State where a sale transaction fails to be completed or if the conditions of sale are not favourable for a period ÁPV Rt. may conclude **asset management contracts** to ensure the utilisation of assets. The **goal** of asset management is to **retain the value of the assets** as specified in the contract and to **attain growth of the value of the assets through returns** (dividends, profit sharing). An asset management contract may also provide that the asset manager receives compensation only upon delivering the profit specified in the contract.

25. The lack of separation of regulation and service provision leads to the restriction of competition primarily in the case of territorial governments.

26. An investigation was launched against the council of a town's local government based on a report submitted to the Office of Economic Competition because the municipal government as the owner of public places did not grant permit to an enterprise intending to construct a cable television network whereby it hindered a new service provider in entering the market. The act - seemingly a decision by the authority - was motivated by the fact that a traditional serial system cable television network operator had been functioning in the town already and it happened to be a fully owned enterprise of the local government. The subscription fee charged by the operator limited liability company (Kft.) was set by the council and according to its decision the fees could not contain profits and in order to keep costs low the Kft. was not paying a charge for the use of public places.

27. In view of the circumstances the Competition Council declared in its decision that the presence of another enterprise in the given geographically defined market would be beneficial for the consumers for this would force market actors to participate in quality and price competition. The Competition Council pointed out that a price containing profit as well, set by a profit oriented enterprise, is not necessarily higher than a price covering costs only applied by a non-cost sensitive monopoly.

28. The decision against the council of the local government is all the more noteworthy for it stated that the ownership activities of the local government and its official administrative tasks must not be combined for they involve different legal relationships. The Competition Council did not impose a fee in this case but it obliged the local government in question to give a written response to the contract proposal submitted by the cable television service provider intending to enter the market, within a maximum of 30 days.

4. The most typical example of a case closed with a decision against a state enterprise in the practice of the application of the law by the Office of Economic Competition:

29. The Competition Council made a decision against **Magyar Posta Rt.** - the Hungarian Post Office - and imposed a fine of HUF 20 million on the national postal service provider. The Post Office abused its exclusive right in the delivery of mail consignments as a bidder in a public procurement tender, for owing to its monopoly position in this segment of the market the Post Office is the only entity that is capable of providing complex vertically integrated services in the market of the generation and delivery of consignments. Concluding a contract with a single partner is definitely advantageous for clients issuing large numbers of bills for consumers therefore the invitations for proposals in public procurement tenders call for complex services, i.e. they do not even permit the submission of bids for part services. This is why the behaviour of the Hungarian Post Office is crucial in relation to its competitors in the market of the generation of consignments for the chances of their entering the market depends largely on the offers submitted by the Post Office concerning delivery. In the case in question it was proven that the Post Office offered a discount on delivery - not justified by the saving of costs - to the client which was suitable for placing its competitors in the market of the generation of consignments in a competitively disadvantageous position and thereby for their forcing off the market since it failed to provide such discounts in its role as a sub-contractor. The Competition Council expressed the expectation to be met by a universal service provider enjoying exclusive rights that it has to provide access to the postal network constituting a basic requirement of the operation of other markets as well, for other enterprises operating in the competitive market, under equal conditions, as a matter of principle.