

PUBLIC

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

STRATEGY FOR HUNGARY

**REPORT ON THE INVITATION
TO THE PUBLIC TO COMMENT**

1. INTRODUCTION

The objective of this report is to summarise the key comments received from stakeholders during the consultation period on the Bank's Strategy for Hungary and provide the Bank's management responses.

In accordance with the EBRD Access to Information Policy (AIP), the draft strategy for Hungary was posted on the EBRD website in English and Hungarian for 45 calendar days, starting from 27 November 2020. The public was invited to comment on the draft strategy no later than 11 January 2021. The previous strategy was also made available on the EBRD website at <https://www.ebrd.com/documents/strategy-and-policy-coordination/strategy-for-hungary.pdf>.

Information about the public consultation process was posted on the EBRD's dedicated "Have your say" webpage, which highlights the latest opportunities for the public to comment on the Bank's policies and strategies under review. Targeted notifications of the consultation process were sent to local and international civil society organisations (CSOs) that have expressed interest in the Bank's work in the country.

During the consultation period, one set of written comments was received by the EBRD from two linked civil society organisations: MKIK (the Hungarian Chamber of Commerce and Industry) and KAVOS Zrt.

In line with the Bank's increased efforts to involve civil society at an early stage of country strategy development, the EBRD organised a consultative meeting with civil society organisations on 8 October 2020. The objective of the meeting was to gather civil society's feedback during the preparatory phase for developing the draft strategy. 7 participants from different civil society organisations participated in the consultation.

The EBRD was represented by the Managing Director for Central and South Eastern Europe, the Regional Head for Central Europe, the Head of the Resident Office in Budapest, as well as the Economic, Policy and Governance, the Country Strategy and the Civil Society Engagement teams. The summary of the meeting and the list of CSO participants to the consultation process are provided in the Annex 1 to this report.

2. PUBLIC COMMENTS AND STAFF RESPONSES

Comment	EBRD Response
<i>Priority 1 - Support Productivity Improvements through Innovative Financing and Green Investments</i>	
<i>Key objective 1 – Diversify and deepen financial system products including greening the financial system</i>	
<p>The EBRD Strategy for Hungary in the next 5 years aims at just one priority, the development of green economy and green infrastructure. However, the recent circumstances of the economic recession caused by COVID-19 may necessitate other goals – supported by the previous strategy. The CSOs would welcome the aim of supporting competitiveness and productivity in Hungary.</p>	<p>While the green transition is an important element of the strategy, the Priority (page 13) is also structured around activities that support recovery from the economic recession caused by COVID-19, leading to improved competitiveness and productivity in Hungary. Included in the first Objective is the key statement “Diversify and deepen financial system products.....” In this context, the third bullet point covers debt, equity and risk sharing products focused on competitiveness, resilience and COVID-19 recovery with no limitation on such investment having specifically to be green. Furthermore, the proposed strategy also covers such activities as the development of capital market, digitalisation or skills upgrades, all of which can be consider independently from the Green priority.</p> <p>The section defining EBRD Country Strategy Priorities (page 12) underscores this goal and specifically refers to “assisting the private sector to enhance its competitiveness and productivity levels through targeted debt and equity products.”</p>
<p>The country strategy focuses on green economy, however the sectors which had been most affected by the COVID pandemic must be identified and included as a priority – for example, the automotive industry, shipping and tourism. Supporting the underdeveloped sectors can be another priority.</p>	<p>The Priority on page 13 of the country strategy provides the Bank with the flexibility to respond to the COVID pandemic as needed. Moreover, it specifically states that the Bank will “Deploy equity, debt and risk sharing products focused on competitiveness, resilience and COVID-19 recovery...”</p>

<p>Based on the statement on slide 3 about the high GDP growth rate of recent years, it was also supported by employment growth, the significant decrease of the unemployment rate and considerable rise in wages. The increase of wages was supported by the rise of the governmental minimum and guaranteed minimum wage. In certain sectors, wages rose more considerably due to the lack of professionals, during the COVID-19 pandemic as well. The COVID-19 Action Plan of the Hungarian Government has job protection as a main priority.</p>	<p><i>The strategy document points out the tight labour market later on in the paragraph, but the final version now modifies the sentence in para 4 to say: “which has supported employment and consumption until Covid-19...”.</i></p>
<p>As shown on slide 6, competitiveness and innovation in Hungary are strongly connected with the venture capital funds and FDI. The CSO considers that FDI have a key role for stepping out of the recession after the COVID-19 crisis, besides public and private investments. Therefore, the support of FDI can be a relevant priority in the recent strategy as well.</p>	<p>The Bank agrees with this statement that is fully consistent with the proposed priority activities. EBRD will continue to support FDI investments in bankable projects, subject to the Bank being additional.</p>
<p>Given the global liquidity crisis in 2020, the CSO suggests that capital financing and the expansion of direct and indirect bank financing instruments must be included in the strategy in order to provide a long-term solution to the liquidity crisis. The CSO notes however, that this advice does not mean the decrease of investments, but rather increasing them and creating an enabling environment for other investments in future.</p>	<p>The first objective under the Priority of the next strategy period (page 13) states: Diversify and deepen financial system products, including the introduction of green financial products. In addition there is a clear statement that EBRD will seek to continue to develop capital markets products that contribute to diversification of investments base. It is understood, however, that the perceived liquidity crisis in the real economy is unlikely to be tackled by the EBRD’s direct lending and provision of funding through local financial intermediaries would be more relevant for the overall level of funding for local companies. In this connection, we note that the Hungarian banking sector remains over liquid and has limited appetite for additional borrowing from the EBRD. This situation is common across the banking sector in other central European economies, but the EBRD will remain ready to step up its involvement should this situation change.</p>
<p>The draft country strategy mentions the underdevelopment of capital markets and innovation in investment products (green bonds, green investment), that have considerably been lagging. In</p>	<p>The country strategy shows a very clear focus on the continued development of the Hungarian capital markets. EBRD has however limited capacity for</p>

<p>recent years, the companies are more open to classic capital financing (as investment on stock exchange or issuance of bonds). The new, SME-specific institutional and market framework is part of the Hungarian Government's strategy, as Hungarian companies must develop the capital market financing strategy and opportunities to support and strengthen their competitiveness. These financing channels can be important tools for organisation building, the separation of management and owner roles, the realisation of investments, as well as expanding for export markets and acquisition strategies.</p>	<p>direct investment in SME's due to size constraints on individual direct loans and equity investments.</p> <p>The capital markets can indeed be a mechanism through which higher standards of corporate governance are introduced and which in turn can open a wide range of new opportunities – including export markets and acquisition strategies.</p>
<p>The CSOs consider that - as SMEs are the most affected group by the pandemic - measures are needed to strengthen them, as they represent the foundation for sustainable economic development.</p>	<p>SME's are indeed likely to be one of the most severely impacted groups and there are already a number of soft loans and support mechanisms being channelled towards this sector.</p> <p>The EBRD can consider directing finance to SME's through local financial intermediaries. However, local banks remain highly liquid and, as a result, have indicated little appetite for additional borrowing from the EBRD.</p>
<p>EBRD financing can be expanded for providing basic food supply, supporting agricultural improvements and improving the health industry.</p>	<p>The Priority provides the Bank with a wide scope to support COVID-19 recovery. As such, EBRD will continue to actively seek out bankable projects with the private sector that supports COVID-19 recovery whether these be in healthcare, sustainable agriculture or another sector.</p>
<p>The draft country strategy mentions the lack of simplicity of taxation system. The Hungarian Government prioritises the fine tuning and simplifying the tax system in order to promote the competitiveness of the national economy. The work of the National Operational staff for Economic Protection shows that, in</p>	<p>The document refers to the tax system in context of the EBRD's Business Environment and Enterprise Performance Survey (BEEPS), which identified paying taxes as the biggest obstacle facing businesses despite a low CIT rate.</p>

<p>2020, the Ministry of Finance made efforts to put the Hungarian economy on a growth path, through identification and eradication of bureaucratic rules and burdens, as well as the development, rationalisation and adaptation of tax system to the current economic challenges.</p>	
<p><i>Key objective 2 – Resource and energy efficiency / Decarbonisation; Renewables</i></p>	
<p>As shown on slide 6, in the previous strategy period, the increase of energy efficiency was a prior goal. The use of green energy, green transportation and circular economy can be a supported priority in the current strategy period as well.</p>	<p>The Bank agrees that this is a key focus of the new country strategy as well as the overall strategy of the EBRD to increase its share of investments aimed at support for green economy transition.</p>
<p><i>Government Priorities and Stakeholder Engagement</i></p>	
<p><i>Key Messages from Civil Society to EBRD</i></p>	
<p>We do not agree with the civil society key message stating, “Breaches of human rights, transparency and anti-corruption are increasing”.</p>	<p>Civil society organisations (CSOs) are integral audiences and partners of the EBRD. They provide valuable contributions to the development of the Bank’s policies, strategies and the implementation of investment projects. Holding governments and policy makers publicly accountable is another important role they play. Therefore, we listen to them, consider and convey their messages across the Bank, where applicable.</p> <p>The quoted statement is one of the main messages received from the civil society organisations consulted by the EBRD in regards to good governance in Hungary. Accordingly, as standard practice, the Bank incorporated the civil society’s expressed views in the “Key Messages from Civil Society to EBRD” section of the draft country strategy.</p>

<i>EBRD Reform Areas Broadly Agreed with Authorities</i>	
<p>The aim of EBRD strategy should include goals that are in line with the EU package for containing the recession caused by COVID-19 pandemic. For example, the support of foreign investment.</p> <p>Overcoming the recession can be supported by bolstering the SME sector and better integrating SMEs into international supply chains. For SMEs, green and digital innovation can be promoted by funding, leading to a significant competitiveness increase for companies and Hungary as a whole.</p> <p>The support and development of the green economy – and circular economy – in Hungary is one of the main aims of Hungarian Ministry of Innovation and Technology (ITM). The CSOs find it important to provide opportunities and funding for SMEs to make green investments, including through ITM projects.</p>	<p>As stated above, EBRD’s strategy for the coming period clearly states that it will support COVID-19 recovery. The strategy does not aim to highlight every conceivable beneficiary but certainly the Priority enables FDI investment to be supported during the next strategy period.</p> <p>Regarding the SME sector, due to loan size constraints, EBRD does not have a mechanism through which it can invest debt directly into such companies (which already receive considerable support in the form of soft loans). EBRD can however provide funding to both SME’s and individuals to support green investments indirectly through loans to partner banks providing the such programmes receive the necessary government support in the form of enabling legislative changes, and potential grant co-financing to further incentivise the beneficiary. In addition, EBRD shall continue to supply equity to Hungarian SMEs through local and regional equity funds.</p>
<p>In line with the development of EU Capital Union, it would be important to take steps in the development of Hungarian Capital Market, promoting the diversification of corporate financial resources supporting the issue and use of green bonds and other green financial instruments for small investors or retail investors.</p>	<p>It is a clearly stated goal that the EBRD will continue to support the development of the capital markets products to contribute to diversifying the investment base. The success is dependent on developing a wider investor base and working with the government to ensure that the legislative environment is conducive and both the required investor protection regulation and the necessary financial incentives are in place.</p>

EBRD Strategy for Hungary

Consultation with civil society, 8 October 2020

Summary of key messages from CSOs:

- CSOs endorsed the Bank's priority for supporting green investments and green financial products in Hungary, but also highlighted that considering Hungary as an 'advanced transition economy' may cause misunderstanding as further reforms of the business environment and governance are needed.
- The EBRD management emphasised the Bank's focus on the private sector and limited collaboration with the Hungarian Government focused on policy engagement rather than direct public sector financing, and Hungary's comparatively advanced position according to economic indicators, despite the challenges in transparency and good governance highlighted by the civil society.

Good Governance

- Apart from green investments, CSOs also noted other areas where support is needed in Hungary, such as human rights and gender issues. CSOs questioned the EBRD's flexibility in supporting these areas.
- Civil society organisations consider that good governance, transparency and anti-corruption policies are crucial for a well-functioning market economy, and that in Hungary the situation is getting more challenging, impacting the economic transition as well.
- CSOs recommended that the EBRD should continue supporting private sector investments and focus on market-based solutions when cooperating with the Hungarian Government.
- Civil society organisations advised the Bank to consider strengthening large institutions that work for improving rule of law and engaging with CSOs in the country. Even though the EBRD's mandate is limited to addressing gaps in economy, the challenges in democratic transition negatively affect the economy in the long term, according to the CSOs.
- The EBRD management pointed to the Bank's standards and commitment to transparency, business integrity and anti-corruption, which were not detailed in the draft country strategy as they are the 'modus operandi' of the EBRD.

Green Economy

- CSOs expressed concern about the current condition of green economy in the country, stating that they perceive the current lack of sufficient funds for green financing to be

an important issue. As such, they highlighted the need for providing more financing for green investments during the next strategy period.

- According to IMF's recent publication, improving energy efficiency in residential buildings is the most needed and effective way to reach climate goals - as in most other EU countries. For this end, CSOs highlighted the need for investment in the residential sector, contending that the obligation system would not be enough to reach the needed level of refurbishment in this sector.
- CSOs underlined the need for a cheaper and more accessible renewable energy supply, pointing out that the renewable energy and energy efficiency market in Hungary can improve with the EBRD's support.
- Fossil fuel companies are getting more financial support as part of COVID-19 recovery packages according to the CSOs. Although the Bank is committed to halt all direct financing for coal projects, CSOs are concerned about deviating from this principle within the scope of Solidarity Package.
- CSOs consider that an urban road pricing system needs to be introduced in Budapest for less congestion and better air quality. Congestion charges should have been implemented according to the agreement between the European Commission and the Hungarian Government in 2014, but they have not been respected to date.
- Acknowledging the challenges related to the green economy in Hungary, the EBRD management gave priority to market-based solutions for energy efficiency, supporting legislation for green financing and engaging in policy dialogue to improve energy efficiency in private and public sector instead of residential improvements.
- The CSOs have been reassured that the EBRD Solidarity Package covers only the existing clients and aims to strengthen the established frameworks of the Bank. Therefore, there are no fossil fuels components in the foreseeable projects.

List of CSOs participating to the consultation process

1. CEE Bankwatch Network
2. Budapest Chamber of Commerce and Industry (BKIK)
3. Transparency International Hungary
4. Political Capital
5. Clean Air Action Group, Levego
6. Hungarian Helsinki Committee
7. Energiaklub – Climate Policy and Applied Science