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MEMORANDUM AND RECOMMENDATION  
OF THE  
PRESIDENT OF THE  
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
TO THE  
EXECUTIVE DIRECTORS  
ON A  
PROPOSED LOAN  
IN AN AMOUNT EQUIVALENT TO US\$150 MILLION  
TO THE  
REPUBLIC OF HUNGARY  
FOR A  
HUMAN RESOURCES PROJECT

MARCH 11, 1991

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### CURRENCY EQUIVALENTS

Currency Unit - Forint (Ft)

### AVERAGE EXCHANGE RATES

(Forints per US\$)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>
US\$1.00 =FT	50.1	45.8	47.0	50.4	60.8	62.0	71.0

### WEIGHTS AND MEASURES

#### Metric System

#### US System

1 meter (m)	=	3.2808 Feet (ft)
1 kilometer (km)	=	0.6214 mile (mi)
1 square kilometer (km)	=	0.3861 square mile (mi)
1 metric ton (m ton)	=	0.9842 long ton (lg ton)
1 kilogram (kg)	=	2.2046 pounds (lbs)

### ABBREVIATIONS AND ACRONYMS

CEF	-	Catching-up-with-Higher-Education-in-Europe Fund
HAS	-	Hungarian Academy of Sciences
HE	-	Higher Education
IIF	-	R&D Computer Network
MOE	-	Ministry of Culture and Education
MOF	-	Ministry of Finance
MOL	-	Ministry of Labor
NTC	-	National Training Council
OTKA	-	National Scientific Research Fund
RTB	-	Regional Training Board
SAR	-	Staff Appraisal Report
STR	-	Science and Technology Research

### HUNGARY FISCAL YEAR

January 1 - December 31

HUNGARY  
HUMAN RESOURCES PROJECT  
Loan and Project Summary

Borrower: Republic of Hungary

Beneficiaries: Ministry of Labor, National Training Council, the Catching-up-with-Higher-Education-in-Europe Fund (CEF) and the National Scientific Research Fund.

Amount: US\$150 Million

Terms: Fifteen years, including a five year grace period, at the IBRD standard variable interest rate.

Project

Description: The project includes an Employment and Training Program and a Higher Education and Research Program. The Employment and Training Program would: (a) develop employment information and services to promote labor mobility; (b) improve occupational training for adults by providing support for a labor market based training system with strong links to private and public employers; and (c) initiate reform of vocational secondary schooling by developing new curricula with more general education and broader training to replace the out-dated and narrow curricula currently used in vocational schools. The Higher Education and Research Program would: (a) support the introduction of competition-based grant funding for higher education programs according to criteria which emphasize greater collaboration and resource sharing among institutions of higher education and research and new interdisciplinary programs; (b) develop a program of practically oriented foreign language training; and (c) support development of human resources for Science and Technology (STR) by earmarking a portion of the competition-based National Scientific Research Fund (OTKA) for younger researchers, refurbishing the stock of and improving the management of the centers of scientific instrumentation financed by OTKA, and upgrading the national R&D computer network (IIF) used by academic and industrial researchers.

Financing Plan:

	<u>Local</u>	<u>Foreign</u>	<u>Total</u>
	-----US\$ millions-----		
IBRD	-	150.0	150.0
Government	189.8	-	189.8
	-----	-----	-----
TOTAL	189.8	150.0	339.8

Economic Rate of Return: Not Applicable

Staff Appraisal Report: 9183-HU

MEMORANDUM AND RECOMMENDATION OF THE PRESIDENT  
OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
TO THE EXECUTIVE DIRECTORS  
ON A PROPOSED LOAN  
TO THE REPUBLIC OF HUNGARY FOR  
A HUMAN RESOURCES PROJECT

1. The following memorandum and recommendation on a proposed loan to the Republic of Hungary for US\$150 million is submitted for approval. The proposed loan would assist the Government in its program to alleviate the unemployment impact of economic restructuring and to invest in human resources so as to promote Hungary's economic and technological competitiveness. The loan would have a maturity of 15 years, including a five years grace period, at the standard variable interest rate.

2. Background. Rigid labor markets, an unresponsive training system, and fragmented and outdated higher education inappropriately linked to industry and scientific R&D, will severely constrain the success of the economic reforms and the move to a market economy. New institutions and major structural reforms are needed to address human resources issues, which include emerging unemployment, obsolescence of much of the training system, lack of management and foreign language skills, and the scientific and technological gap between Hungary and its competitors. Manpower planning for the command economy has resulted in complex and rigid management of narrow vocational training by the Ministry of Culture and Education (MOE) along with many other line ministries which supervised productive sector enterprises. A more flexible approach capable of quick adaptation to shifting market conditions is urgently needed.

3. The economic stagnation over the past 15 years has resulted in under-investment in human resources. Some 70% of the secondary school age population is enrolled in secondary school, but nearly half of this is in narrow apprentice training with very little general secondary education beyond the primary school level. Only 15% of the university age population attends college or university, compared with at least 30% in OECD countries. Government strategy is to expand secondary and tertiary enrollments, and to initiate institutional and policy reforms, while refurbishing outmoded equipment and infrastructure at these levels.

4. Rationale for Bank Involvement. As a part of the Bank's assistance in helping Hungary move towards a market economy, the Government requested Bank assistance in a broad spectrum of human resources issues including labor markets, training, higher education and science and technology research (STR). Following extensive sector work in FY90, the Bank is now well positioned to support a broad project which provides the initial support for a larger human resources investment program. The Government sees the framework adopted in this project as useful for attracting external assistance from other donors.

5. Project Objectives. The project would address certain priority human resources issues which constrain a successful transition to a market economy. Specific objectives are to: (a) assist unemployed workers to find jobs and enterprises to find suitable workers; (b) provide relevant training for youth and adults, especially in relation to item (a); (c) improve the responsiveness of higher education to the new technical and managerial demands of a market economy, with special emphasis on improving access, relevance, quality, efficiency and financing; (d) assist in narrowing the technological gap between Hungary and its competitors by expanding and reorienting the training of science and technology researchers, improving management of research and improving the linkages between the academic community and enterprises; and (e) develop foreign language competence so as to promote international economic and technological ties.

#### Project Description

6. The Employment and Training Program would provide equipment and technical assistance needed to: (a) develop employment information and services to promote labor mobility by incorporating lessons from pilot employment programs in the Third Industrial Restructuring Project (implementing agency: Ministry of Labor (MOL)); (b) improve the responsiveness of adult vocational training, by providing specialized occupational training with strong links to private and public employers and the labor market (implementing agency: the National Training Council (NTC), a new body with business, government and worker representation, whose mandate is to organize the development and delivery of training in response to market signals); and (c) improve vocational curricula for 14 - 16 year olds by converting excessively narrow vocational programs into broad based general education programs (science, mathematics, languages, etc.), coupled with training in broad clusters of occupational skills as a base for further specialized training (implementing agency: MOL).

7. The Higher Education and Research Program would assist: (a) the recently established Catching-up-with-Higher-Education-in-Europe Fund (CEF) to implement its mandate to review and select the winners of competitions for innovative and relevant higher education programs according to agreed upon criteria and procedures, and (b) the development of human resources for Science and Technology Research (STR) by supporting research grants for young scientists, improvement of scientific instrumentation centers shared by the scientific community and the development of the national R&D computer network. The criteria for selecting proposals submitted to the CEF would encourage greater collaboration and resource sharing among specialized universities and the research institutes of the Hungarian Academy of Sciences (HAS) and new inter-disciplinary programs (e.g., economics and management for engineers and scientists). This would also include support for practically oriented foreign language training programs. The STR programs would be implemented by the newly restructured National Scientific Research Fund (OTKA).

8. The total cost of the project is estimated at \$US 339.8 million, with a foreign exchange component of \$US 150.0 million (44%). A breakdown of costs and the financing plan are shown in Schedule A. Amounts and methods of procurement and of disbursements are shown in Schedule B. A timetable of key project processing events and the status of Bank Group operations in Hungary are given in Schedules C and D, respectively. The Staff Appraisal Report (SAR), No. 9183-HU, dated March 1991 is being distributed separately.

9. Actions Agreed. During negotiations the Government gave assurances that: (a) the system of unemployment monitoring implemented in January 1991 would be continued on at least a quarterly basis; (b) it would review with the Bank not later than November 30 of each year the proposed NTC and RTBs budget and programs for the following fiscal year of the Borrower; (c) it would staff adequately and provide other resources to the relevant professional departments of MOL to ensure successful implementation of: (i) industrial adjustment services, occupational and educational information; (ii) aptitude and interest assessment, career information systems development and user training; and (iii) job search and development; and (d) it would staff adequately and provide other resources to the relevant professional departments of the MOL to implement the new vocational secondary school curriculum. These staff (to be appointed by Minister of Labor through internal redeployment) would act as facilitators and liaison officers across existing departments and with the staff of the MOE. They would develop terms of reference for technical assistance contracts and equipment, coordinate procurement activities among MOE, Government and Bank officials, monitor expenditures and provide reports to the Government and the Bank.

10. During negotiations the Government also gave assurances that it would: (a) submit to Parliament by December 31, 1991 draft laws providing for (i) the autonomy of universities and colleges and a mechanism for their normative financing, (ii) the autonomy of the HAS, and (iii) the reform of the system of advanced training for scientists and the awarding of scientific degrees; (b) carry out and review with the Bank by June 30, 1992 a feasibility study on revenue generation and cost recovery in higher education and take all measures required on its part to ensure the improvement of cost recovery on the basis of the study's recommendations, taking into consideration the comments of the Bank; and (c) use the agreed criteria, guidelines and procedures for awards of grants/allocations under the CEF, the Scientific Instrument Centers and the Young Scientists Support Program and review any future changes to these criteria, guidelines and procedures with the Bank before they are introduced.

11. During negotiations the Government confirmed that: (a) progress reports would be submitted semi-annually; (b) annual audits of acceptable scope and quality would be carried out by independent auditors satisfactory to the Bank; (c) annual audit reports for the preceding fiscal year would be made available to the Bank no later than by June 30th each year; and (d) a mid-term review of the project's progress would be carried out by the Bank and the Borrower by November 30, 1993.

12. Conditions of Disbursement. Disbursements for goods under the adult training component of the project would be conditional upon: (a) the NTC

budget having been adopted for the borrower's fiscal year ending December 31, 1991; (b) operational guidelines for regional training boards having been adopted and at least four of these boards having been established and staffed; and (c) the proposed programs and budgets of these regional training boards having been adopted for the borrower's fiscal year ending December 31, 1991.

13. Benefits. The major benefit would be the contribution this project would make to promoting a quick and flexible supply response to the transformation of the Hungarian economy. Employment services developed by the project would assist in the alleviation of unemployment and the productive redeployment of labor. Hungary's base of skilled workers and professionals would be expanded and improved to assist the country to compete successfully in a European framework. The national capacity for research and technological development, with an enhanced capability to respond to changing market needs, would be increased through the HE and STR components of the project.

14. Risks. The major risks are: (a) that the past fragmentation in the education and training system has resulted in bureaucratic vested interests which may try to preserve their spheres of control and delay implementation; and (b) newly created agencies would have inadequate experience to implement major components. The first risk is being addressed by providing a sufficient amount of financing to motivate effective cooperation and sharing of resources, thereby helping to overcome the fragmentation in the education and training system; the second risk is being addressed by incorporating technical assistance to strengthen institutional performance.

15. Recommendation. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Bank and recommend that the Executive Directors approve the proposed loan.

Barber B. Conable  
President

Attachments  
Washington, D.C.  
March 11, 1991

SCHEDULE AHUNGARYHUMAN RESOURCES PROJECTEstimated Costs and Financing Plan

	<u>Local</u>	<u>Foreign</u>	<u>Total</u>
	----- US\$ Million -----		
<u>Estimated Cost:</u>			
-----			
Improved Labor Programs	5.5	2.6	8.1
Adult Training Programs	48.0	19.8	67.8
Improved Youth Training	30.1	29.9	60.0
Higher Education and Research	45.7	58.9	104.7
Science and Technology	30.2	17.8	48.0
	-----	-----	-----
Total Base Costs	159.5	129.1	288.6
Physical Contingencies	9.6	7.8	17.4
Price Contingencies	20.7	13.1	33.8
	-----	-----	-----
Total Costs	<u>189.8</u>	<u>150.0</u>	<u>339.8</u>
 <u>Financing Plan</u>			
-----			
	<u>Local</u>	<u>Foreign</u>	<u>Total</u>
	----- US\$ Million -----		
Government of Hungary	189.8	0.0	189.8
International Bank for Rec. & Dev.	0.0	150.0	150.0
Co-financier			
	-----	-----	-----
Total Financing Requirements	<u>189.8</u>	<u>150.0</u>	<u>339.8</u>

SCHEDULE BHUNGARY  
HUMAN RESOURCES PROJECTProcurement Method and Disbursement  
(US\$ million)Procurement Arrangements a/  
US\$ Million

28-Feb-91 09:59	ICB	LIB	OTHER	N/A	TOTAL
<u>Foreign Investment:</u>					
Technical Assistance			38.4 (32.3)		38.4 (32.3)
Equipment	83.3 (83.3)	20.8 (20.8)	39.6 (0.0)		143.8 (104.2)
Software (Including Books)			15.9 (11.4)		15.9 (11.4)
<u>Research Support:</u>					
Young Scientists Supp. Program			3.9 (2.1)		3.9 (2.1)
<u>Local Costs:</u>					
Construction			92.3 (0.0)		92.3 (0.0)
Staff, Operat. and Maintenance				45.5 (0.0)	45.5 (0.0)
Total Financing Requirements	83.3 (83.3)	20.8 (20.8)	190.1 (45.8)	45.5 (0.0)	339.8 (150.0)
Total Bank Financing					

a/ Figures in brackets are the respective amounts financed by the Bank Loan

IBRD Disbursement  
(US million)

<u>Category</u>	<u>Amount of the Loan Allocated (Expressed in Dollar Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(1) Goods:		
(a) for Adult Training	18.5	100% of foreign expenditures (C.I.F.);
(b) for the other Parts of the Project	79.3	100% of local expenditures (ex-factory).
(2) Consultants' Services	12.5	100% of foreign costs of foreign consultancy services and of overseas fellowships.
(3) Fellowships and Research Grants	21.0	100% of foreign expenditures of research grants.
(4) Unallocated	18.7	

## Estimated IBRD Disbursement

<u>IBRD FY (US\$million)</u>	<u>FY92</u>	<u>FY93</u>	<u>FY94</u>	<u>FY95</u>	<u>FY96</u>
Annual	20.0	35.0	50.0	40.0	5.0
Cumulative	20.0	55.0	105.0	145.0	150.0

HUNGARYHUMAN RESOURCES PROJECTTimetable of Key Project Processing Events

- |                                      |                                 |
|--------------------------------------|---------------------------------|
| (a) Time taken to prepare:           | 18 months                       |
| (b) Prepared by:                     | Government with Bank Assistance |
| (c) Appraisal mission departed:      | October 1990                    |
| (e) Negotiations:                    | February 1991                   |
| (f) Planned date of effectiveness:   | June 1991                       |
| (g) List of relevant PCRs and PPARS: | None                            |

THE STATUS OF BANK GROUP OPERATIONS IN HUNGARYA. STATEMENT OF BANK LOANS <sup>a</sup>  
(As of Dec. 31, 1990)

Loan No.	Fiscal Year	Borrower	Project	US\$ Million	
				Loan	(Less Cancellations) Undisbursed
Four loans and six B-loans fully disbursed				665.92	-
Of which: SECALs, SALs and Program Loans <sup>b</sup>					
2965	1988	NBH <sup>c</sup>	Industrial Sector Adjustment	200.00	-
2317	1983	ROH <sup>d</sup>	Industrial Energy Conservation	109.00	0.20
2510	1985	NBH	Integrated Livestock	80.00	19.20
2511	1985	NBH	Fine Chemicals	73.00	-0.10
2557	1985	ROH	Transport (Rail/Road)	75.00	5.20
2697	1986	ROH	Power	64.00	26.90
2700	1986	NBH	Industrial Restructuring I	100.00	15.70
2709	1986	NBH	Industrial Energy Conserv. II	25.00	4.40
2738	1987	NBH	Crop Production	100.00	12.00
2834	1987	NBH	Industrial Restructuring II	150.00	53.60
2847	1987	NBH	Telecommunications	70.00	23.20
2936	1988	NBH	Agroprocessing Modernization	70.00	58.30
2966	1988	NBH	Technology Development	50.00	31.10
3020	1989	NBH	Industrial Restructuring III	140.00	123.10
3032	1989	ROH	Transport II	95.00	79.10
3055	1989	NBH	Energy Development-Conservation	10.00	8.00
3056	1989	OKGT <sup>e/</sup>	Energy Development-Oil and Gas	100.00	92.40
3191	1990	NBH	Financial System Moderniz.	66.00	61.00
3228	1990	NBH	SAL	200.00	100.00
3229	1990	NBH	Integrated Agric. Exports	100.00	92.00
B1010	1991	ROH	ECO	200.00	200.00
3264	1991	HTC	Telecommunications II	150.00	150.00
Total				2,692.92	
Of which: Repaid				<u>221.59</u>	
Total now held by the Bank				<u>2,471.94</u>	
Total undisbursed					<u>1,155.48</u>

a/ The status of these projects is described in a separate report on all Bank/IDA financed projects in execution, which is updated twice yearly and circulated to the Executive Directors on April 30 and October 31.

b/ Approved during or after FY80.

c/ National Bank of Hungary.

d/ Republic of Hungary.

e/ National Oil and Gas Trust.

B. STATEMENT OF IFC INVESTMENTS  
(As of Dec. 31, 1990)

Fiscal Year	Obligor	Type of Business	Gross Commitments		
			US\$ Million		
			Loan	Equity	Total
1987	Lysine	Lysine Mfg.	8.55	2.70	11.25
1987	UNIC Bank	Banking	-	3.23	3.23
1989	Glass Wool	General Mfg.	3.44	1.53	4.97
1989	Dunamont	General Mfg.	28.84	3.76	32.60
1990	Tetra Pak	Pulp and Paper	7.87	3.21	11.08
1990	Dexter Mold	General Mfg.	2.97	0.93	3.90
1990	First Hungary Fund	Capital Markets	-	7.50	7.50
1990	FAIAC	Capital Markets	-	0.04	0.04
Total Gross Commitments			51.67	22.90	74.57
Less: Cancellations, terminations, exchange adjustments, repayments, write-offs and sales			12.12	-	12.12
Total Commitments now held by IFC			39.55	22.90	62.45
Total Undisbursed			12.13	2.97	15.10
Total Disbursed			27.42	19.93	47.35

March 11, 1991