

## HALF-HEARTED ORGANIZATIONAL DECENTRALIZATION: THE SMALL STATE ENTERPRISE

T. LAKY

As part of the decentralization process in Hungarian economy a new organizational form: the small state firm, was established in 1982. The idea was that such organizations, much smaller than traditional firms, with simplified accounting, preferential taxation, autonomous in their dealings, will be more efficient and will have a positive effect on domestic competition.

In 1985 some 196 small state firms were active, most of them in services but the hopes attached to them were not fulfilled: the quality of services did not improve. Instead of competing, the employees of small state firms try to create their own clientele and to work in official hours with the state's tools and material on their own, thus obtaining unfair advantages against both independent craftsmen (who assume all the burdens of independence) and employees in large-scale industry. The paper analyzes some causes of this unsatisfactory state of affairs.

The organizational decentralization and breaking up of large-scale, monopolistic enterprises (which were mostly artificially established with state resolutions and fusions) and the establishment of smaller, independent organizations is an essential condition of the reform process. This process, started a few years ago, has come to a standstill after insignificant results—as the studies analyzing the circumstances of the reorganization conclude unanimously. [1, 2, 3, 4]

It is true that 350 new enterprises were established. However, the reorganization—contrary to all expectations—was in practice limited to the food-processing industry and certain services: other areas of the economy were left virtually untouched. “The reorganizations have not basically changed the onesided structure of the large state enterprises”—this is how Éva *Voszka* sums up the facts [2]. The mentioned studies explain the quick exhaustion of the process of reorganization, due to the counter-interests of the directing administration and their insistence on maintaining their previous functions. Because of this, the studies rightly judge the other steps of the reform—aimed at economic revival—as having an uncertain outcome.

The doubts are strengthened by the experiences of the small state enterprises, established during the process of decentralization and representing new organizational forms. Where decentralization has been successful—at least in the case of the numerical majority of small enterprises—it has become evident, in no more than a few years, that the organizational change has only brought about a ‘half’ solution. Although small-scale organizations have been established through the dissolution of a few large trusts and enterprises, it is only the sizes that have



decreased. The administrative organs directing the reorganization did not want to confront the real causes of the decade-long functional disorders, and they did not make the necessary changes to the framework of activity of state enterprises which had, even at an earlier date, proved to be unsuitable.

This paper attempts to point out these critical points, by analyzing the problems of small enterprises, and showing where we have not succeeded in going beyond the old principles and methods which sometimes stick to the old direct central management of economy. After all, these are the main reasons why the form of small state enterprise has not been able to function as a successful way of decentralization.<sup>1</sup>

The intention of reorganizing the economic organizational system has called into being the small state enterprise, as a new form. In the private sector the partnership forms (economic workteams, business partnerships); in the cooperative sphere the small cooperatives and cooperative specialized groups; in the state sector mainly the small enterprises. The main expectations of the affiliated firms (and the enterprise economic workteams as joint undertakings of enterprises and their associated employees) were centred on the hope that the organizational pyramid of the Hungarian economy—now “inverted”—would return to its normal position.<sup>2</sup> In compliance with this, the Enterprise Law was modified in 1981; the Minister of Finance and the Minister of Industry gave joint directives about the economic criterion of small enterprises.<sup>3</sup>

The prospective small enterprise have received different advantages to facilitate their existence and activity and to promote their versatile adaptation. (A part of these—such as the right to expand spheres of activity without restrictions on lines of production—was later extended to the whole enterprise sphere.) The most important concessions have been:

<sup>1</sup>This article is based on a more comprehensive study, written in the Labour Research Institute [5]. This study analyzes in detail the partial market of the servicing areas touched upon, and the circumstances of the establishment of small enterprises on the basis of the yearly data concerning their activities. I have used here the small enterprises' balance-sheet data, the reports of the Central Statistical Office,—the analyses made continuously at different authorities about the whole servicing sphere and its different areas. I have also used the evaluations regularly made by the Servicing Research Institute. In addition to this—elaborating special questions—Ágnes Oszoli has written an independent study about the situation of car repairs, Klára Czenki on the servicing of household and telecommunication appliances, Lajos Hegedűs about hairdressing and Judit Lakatos on the main characteristics of the industrial small enterprises. In this article, I use numerous conclusions and thoughts emerging from these documents and analyses—sometimes, albeit involuntarily, without referring to the source.

<sup>2</sup>The witty figure of the “inverted pyramid” comes from Iván Schweitzer [6].

<sup>3</sup>Law-decree No. 20 1981 as well as the Decree of the Council of Ministers 42/1981. /IX.28./ which modified the implementation of the act, as well as the joint directives 347/1981. /PK.25/ of the Minister of Finance and the Minister of Industry on the economic criterion of small enterprise.

— The economic regulation, accounting, and statistical data-supply functions were reorganized into a simplified system (imposing less responsibilities than the bigger firms had).<sup>4</sup>

— The taxation of small enterprises became simpler and more favourable than that of the bigger ones and over recent years it has become even more favourable. As distinct from traditional enterprises, which are linked to the budget through a complicated system, the small enterprises only make two kinds of payment into the budget: 18 percent of their gross income (the sum of profit and wages) and 40 percent of their depreciation allowance are withdrawn from them. “In the case of small enterprises, in this way the ratio of budgetary payments to the monetary means staying at the enterprise has been modified to 1:3.”—sums up a report[7].

— The economic regulation makes special concessions to those small enterprises where at least 51 percent of their activities are made up of (personal and communal) services. The small enterprises functioning in the industry have become, with only a few exceptions, so-called “consumption servicing” small enterprises.<sup>5</sup>

— The servicing enterprises—among them also the small enterprises—receive, in addition, a refund from the 40 percent social insurance contribution. This is paid after wages, in proportion to the services rendered to the population.

— While the tax burdens of the big enterprises have increased, the small enterprises and the small cooperatives have receive further allowances: the tax on their gross income has decreased to 15 percent and the total sum of the depreciation allowance remains at the enterprise. Although the refunding of a part of the social insurance contribution has stopped, enterprises performing services for the population are granted a 10 percent tax benefit from the sales returns from the services performed (deducting invoiced material and part values).

— Finally, according to the regulations, the founding organ cannot deprive the small enterprise of its assets. On the other hand, financial rehabilitation proceedings cannot be taken for the enterprise either. If the enterprise's balance-sheet shows a deficit or, because of its management, there is a shortage of funds and it is not able to stop this on its own, the founding organ can liquidate the enterprise.

The legislators have helped small enterprises with many kinds of favours. The idea was that they would complement the activities of the large factories, carry out “background” industrial activities, be the prime producers (in smaller batches) of special final products, and meet the demands of the population—above all, the demand of the population for services. The directives of the Minister of Finance and the Minister of Industry especially emphasize that “the establishment

<sup>4</sup>This principle was extended by the regulations to the establishment of affiliated firms from the 1st of January 1982, and then to small cooperatives also.

<sup>5</sup>The small cooperatives and affiliated firms functioning in the form of small enterprises, could choose this form.



of small enterprise can be justified in every branch of the economy" and they list many dozens of activities in the manufacturing industry, the building industry, and home trade and transport which would be deemed especially suitable for this organizational form.

Only three small enterprises were established in 1982, but in 1983 132, in 1984 148 and by 1985 196 were functioning—of which 160 were in specialized branches of the repair-servicing industry. In the rest of the branches of the national economy their number is insignificant: 13 in the building industry, in transport and telecommunications only two, in commerce one, and in other "material" branches, 18 (of this 10 in hairdressing); there are two in the health, welfare and cultural services. In 1985 21,300 people worked in the small enterprises, out of which about 17,000 people were in the industrial services, 1800 in the building industry, 2400 in other branches of "material" activities (within this 1700 in hairdressing) and about 100 people in the rest of the branches of the national economy (health, commerce, intellectual services).<sup>6</sup> Out of the 196 enterprises functioning in 1985, only one was established for productive activity (a paper processing enterprise employing handicapped people). The rest—instead of the many kinds of suggested production activities—were established in different areas of the service sector.

Each of the established small enterprises existed at an earlier date, although under a different name and in a subordinate relationship. The majority of them were established by granting independence to the local units of two trusts which had a nation-wide network (AFIT, dealing with car repairs, and GELKA, dealing with the repair of electronic household and telecommunication appliances).

At the end of the 1970's, AFIT was made up of 13 enterprises, having several sites which operated 68 service-shops in every part of the country, and employing about 10-12 thousand workers. However, of the service shops only one dealt exclusively with passenger car repair and servicing. The rest, beside the repair of trucks, also repaired passenger cars—in smaller or bigger proportions. (In 20 service shops more than 80 percent of the workers, in 5 services less than 20 percent carried out passenger car repair.) The service shops which became small state enterprises were those in which the share of passenger car repair was determinant.

The state enterprises had a share of about 50 percent in the total yearly value of car repair and servicing—performed for the population—until 1974 (within this AFIT accounted for 4 percent); the cooperatives employing about 6-7000 people accounted for nearly 20 percent of this figure, and private small-scale industry, employing 3-4000 people, accounted for nearly 30 percent.

By the end of the 1970's—with roughly the same number of people—the share of the state industry in the increasing demand slackened to about 40 percent; the

<sup>6</sup> At the time of writing this article, I did not have access to the data of 1986. The source of the data mentioned in the article is the publication of the Financial Research Institute. [8]

share of the cooperatives decreased a little; that of the private small-scale industry increased to 43 percent.

At the end of the 1970's GELKA maintained about 320 service workshops—usually employing less than 15 people and scattered around the country—for the servicing of telecommunication and electric household appliances. In the service workshops of GELKA, in 1979 altogether about 4900 people were working; (in the cooperatives about 1700, in the service workshops of the manufacturing firms, 350). In these two repair trades about 1600 artisans were working in 1980: 50 percent of them full-time, 40 percent of them part-time and 10 percent as retired people but still active.

The determinant part of the value of repairs (expressed in terms of sales returns) made for the population was performed by the state enterprises until the middle of the 1970's (telecommunication 67 percent, household appliance services 40 percent; the share of the cooperatives was 16 and 20-24 percent; the rest was performed by private small-scale industry /artisans/). By the end of the decade the share of the private small-scale industry in the increasing demand had gradually increased (telecommunication equipment 25 percent, household appliances about 50 percent).

This is also how 10 individual small enterprises were established out of the Budapest State Hairdressing Saloon. The Budapest State Hairdressing Saloon operated with 111 shops and 1800 workers. The proportion of the state sector in hairdressing and cosmetic services was never high: over the decades it gave about one-tenth of the total of the value performed. The dominant form was the cooperative, with two-thirds of the value performed. The private sector operated mainly in the countryside. In 1982, 4900 (in Budapest 760) barbers and hairdressers, cosmeticians, manicure-pedicure artisans and employees, and helping family members were registered in this trade. In this servicing branch the performance ratios by sectors, on the basis of ownership, did not change considerably until 1981.

One of the reasons for the administrative decisions on the breaking up of these large servicing organizations—made after troublesome delays—was the constant poor economic results of these organizations: comparing the main indicators showing the efficiency of management they fell well behind cooperatives and artisans. It was hoped that the possibility of greater independence and flexible functioning would improve results. In the bargaining between the central authorities affected by the decentralizations envisaged in the central programme for the modernization of organization it was also suggested that sooner or later it "would be better to take a few organizational decentralization measures, and to show willingness to accept a reorganization qualified as well-founded by them, in order that they could act more efficiently in preserving the organizational framework in other cases". [4] In the case of a few of the former local enterprises (repair mechanics, building industry designers), a change of form simply proved more favourable (although with the independence of the units of the provincial Laundry Enterprise they expected



the easing of their problems, as in the case of the state-run repair services). The predecessor of most small enterprises performing intellectual—designer, organizing, advisory—services, was the sectoral organizing institute or educational centre. With the abolition of the 3 industrial ministries, only one possible form was given for maintaining their activities: transformation into small enterprises. Therefore, the past of most two-year old small enterprises generally reaches back, in general, ten to twenty years. The transformation did not bring great improvements in their economic results. In fact, their efficiency indicators lag behind those of other small organizations (affiliated firms, small cooperatives, and affiliated cooperative firms) using similar simplified accounting.<sup>7</sup>

— The share of the small enterprises in the sales returns is smaller in every branch of the national economy than their importance measured by employment. In other words, the staff-proportionate sales returns are the lowest in the small enterprises (321 thousand Forints, as opposed to the affiliated firms' 767 thousand Forints). In the small enterprises the wage cost per 100 Forint sales return is the highest (21 Forints). It is 15 Forints on average; in the affiliated firms 11 Forints. The input per 100 Forint sales return is also the highest (86) at these enterprises. (The appropriate data of the small cooperatives is 65 Forints.)

— According to the calculated profitability indexes (results compared to assets, sales returns, income and resources), the management of the small enterprises proved to be the least profitable, that of the small cooperatives the most profitable.

— One third of the small economic organizations showing a deficit were small enterprises. (Another one third came from the small cooperatives, but it is true that one third of the total loss of 243 million Forints occurred in three affiliated firms of the building industry.)

— The poor results have come into being in spite of the fact that, out of the small organizations, the small enterprises (and the affiliated firms) make the smallest payments to the state budget: 11 (the affiliated firms 10) Forints out of 100 Forint returns from sales, as against the average 17 Forints of the small cooperatives and 13 Forints of the affiliated cooperative firms. In addition, the taxes per unit of sales returns have decreased exclusively in the small enterprises (by 19 percent); with the rest, they have increased (with the affiliated firms by 4 percent and the small cooperatives by 6 percent).

The Hungarian public rarely reads about these figures, but they every day experience the poor supply of most small servicing enterprises, the increase of prices, the non-improvement of services offered to individuals and households, and the long waiting periods. The discontent and the complaints are permanent topics in the press, television and broadcasting. It is well-known, but gets less publicity, that in the organizations offering industrial and personal services—comprising the majority of small enterprises—many people work on their own with the machinery

<sup>7</sup> Source of data [8] pp. 29-37.

and materials of the enterprise. This creates unfair competition for the enterprise itself, and also for the artisans who bear a major share of the taxes and operating expenses.

The obvious economic and social problems related to the operation of small enterprises are rooted in several determining circumstances. In my opinion, and in the first place, they are rooted in the fact that the administration only wanted to establish small enterprises by routing, by simply breaking up the big organizations. It did not undertake the truly complicated task of looking for the appropriate form of the numerous service activities. This was principally prevented by the mentality which insists on the superiority of state property. On the other hand, the government—in spite of its intentions—could not find a way to handle the small-scale enterprises in any different manner from the big ones. The necessary standardization of central management and the pursuit of a generally valid regulation have quickly integrated the small firms into the existing order of state enterprises. In addition, the obvious contradictions between the given organizational frameworks and the activities have made numerous small enterprises operate at an economically low efficiency; at the same time, they became state-privileged organizations for unfair individual profitmaking.

#### Activity, organizational form, property

As regards size and *organization*, the legal rules concerning the establishment of small enterprises only state that "the small enterprises have a much smaller staff and less fixed assets than the other enterprises functioning in the given sphere of activity". The staff—especially as compared to the usual size of enterprises—is really small (see *Table 1*) and this perfectly coincides with the structural modernization conceptions. Yet the question arises: is there really a need for such small-scale state enterprises, and if the answer is yes, are they needed where they have actually been established?

The measures related to structural modernization have, in recent years, just like the relevant national literature, only kept in view the necessity of modifying the size-structure of enterprises. They have not examined which form of ownership and organization would be the most appropriate framework for the given activity. The approach which concentrates only on size has remained; this is in spite of the fact that in numerous servicing branches affected by the measures of structural modernization—car repair, hairdressing, servicing of household appliances and telecommunication equipment, textile cleaning—many years of experience have shown, that the (mostly diversified) cooperatives and artisans have produced far better results than the specialized state enterprises.



Table 1

*Distribution by size of enterprises (according to number of employees) in 1985*

Number of employees	Number of small enterprises	Manu- facturing	Building industry branches	Other material classified	Other branches (not elsewhere)
2-10	10	7	—	2	1
11-30	45	43	—	1	1
31-50	8	7	—	—	1
51-100	43	38	3	1	1
101-150	48	34	6	8	—
151-300	39	28	4	6	1
301-	3	3	—	—	—
Total	196	160	13	18	5

Source: [8]

The organizational form in which a given activity can be carried out most successfully depends primarily—according to experience—on the following characteristics of the activity:

— The need for division of labour: this depends on whether we are talking about one competent person or a work organization made up of several people, such as the cooperation of helping family members; also occasional or regular labour is sufficient for carrying out the work; perhaps there is also a need for the cooperation of people having different professions.

— Technological equipment: are hand tools sufficient or is there a need for more complex equipment, machinery, and factory-like circumstances?

— The scene of performing work: is the work done at the customer's home or at the servicing firm?

The fact that numerous services—mainly the less capital-intensive ones—have remained everywhere in the world in great part in individual or family establishments, and that big industry has not invaded the many areas of services (even at the time of its rapid expansion) can be traced back to these factors. In contrast to this, the big servicing organizations have become dominant in Hungary. Added to the above mentioned complexes, the textile cleaning “factories” were founded to serve big districts, the staff of the big building and designing enterprises could be about 100-200 etc. At the time of their establishment the obvious principles of organizational rationality were not taken into account. They were replaced—said or unsaid—by the demand for the existence of big state-owned organizations and their easy manageability. At the time of decentralization of the big organizations, the “protection of the already invested state property” and “its keeping together” had become more important than the organizational forms adequate for the particular professional characteristics or the real capital intensity of the different activities.

It is, therefore, worth examining more closely what property the small enter-

prises have inherited; furthermore, it is necessary to see what chances there are for the realization of state property by mechanically giving independence to the units.

Since, in the course of reorganization, the procedure usually followed was that the building and equipment used until that time came to constitute the property of independent small enterprises, the established small enterprises did, in some cases, not even dispose of the necessary means. In other cases, just the contrary happened: they inherited a much too large manufacturing capacity, which they had not been able to utilize satisfactorily even at an earlier date. This is the situation, for example, in textile cleaning, where the constant problem of the small “Patyolat” enterprises is the unutilized capacities established for the centralized supply of the wide districts.<sup>8</sup>

Many enterprises originating from the division of AFIT have also inherited large unutilized servicing capacities. “A big car repair enterprise has been established, for example, in the capital. It has been advertised as being the biggest service workshop in Central Europe. Not one word was said about what types of cars would be repaired here and how they would try to win customers” [10]. The result was that, even in 1985, there were many complaints about the unutilized capacities [11]. In addition, the technical instruments—bought mainly from state development subsidies—piled up at the big service stations. These provided evidence of the whimsical nature of the earlier acquisition of these instruments [23]. In the case of hairdressing, a relatively less instrument-intensive activity, the immovable property of the small enterprises was also causing trouble. Some of the shops were established between 1980 and 1982, in the framework of a 128 million Forint development project (half received as state grant), and renewals implemented earlier and paid for by state subsidy. The new oversized shops—especially designed for the expected residents in the servicing houses of the new housing estates—(just like the entertainment units, established in the same mentality) did not win many customers. With time, almost all of these shops have suffered financial losses. (The losses were covered—as with GELKA and AFIT—by the predecessor of the enterprises, that is, from the “common hat”.)

The majority of the assets of the successor enterprises of GELKA are immovables. The value of their machinery and equipment does not even make up half

<sup>8</sup>Two years ago one of our daily papers reported: “... the network has been established for thousands of million of Ft, it cannot be changed. It is certain, that more small-scale shops are needed instead of the monstrous ones...” [9] The manager of the first established small “Patyolat” enterprise said in a broadcast last year: “The different needs and constraints forced the enterprises to take up different actions.” Grasping the opportunity which enables small enterprises to autonomously widen their sphere of activity, with the steam generated during washing they are growing asparagus in foil tents on 400 m of the factory hall. They have made Ft 100.000 in one year. Another Ft 400.000 was earned by their undertaking to burn environmentally harmful materials. Their greatest profit, Ft 1 million came from commercial activity; they sold shoes, dresses and left-over textiles. This way they could stand on their own feet, but the central establishment has little work. (Radio Petőfi, January 1986)



the value of their immovables—i.e. their workshops and the buildings including the workshops. According to a survey conducted by the Ministry of Industry in 1985 (in which they received processable answers from 63 enterprises of GELKA) operational conditions were satisfactory in only 14 enterprises. The rest complained about settlement, the conditions of the premises, and— 62 percent—about the inappropriate technological equipment and the supply of instruments.

The out-dated technological equipment and the lack of needed equipment are old and constantly reappearing problems. The former shops of GELKA received equipment more or less depending on whether they functioned in small or large settlements. However, they could not utilize the capacities—in spite of the general discontent— even before the reorganization.

The assets of other small enterprises not mentioned here are insignificant—they do not even make up 10 percent of the small enterprises' total assets. A significant part of them are also in the form of buildings, offices and premises. The inherited immovables are in part really necessary, but they would like to get rid of some of them if they could (incorrectly built buildings which are very large and consume big heating, lighting and maintenance costs).

Protection of assets at the majority of the small enterprises means primarily the protection of the state property. Yet there are other possibilities for this. For instance the buildings might be handed over to the local councils and the small enterprises could rent them. This solution would ease the liquidation of the units which continuously show deficits; only the tenant would change, so the state property would not suffer any damage.

A more moderate proportion of the property of the small enterprises is tied up in machinery and equipment. (In the small enterprises repairing telecommunications and household appliances this value was only 50.000 Forints per employee, and much less in hairdressing.) There is relatively less capital engaged in the means of production in the activity of workers in small enterprises— probably less than each artisan would invest in this profession.

The decentralization, introduced with the slogan of protecting state property, actually disregarded the protection and utilization of productive property. As a matter of fact, even the analysis of the degree and composition of the productive property itself makes it questionable whether "keeping together the state property" is necessary and correct in all services.<sup>9</sup> If it has to be kept together—as it is believed—(because the high-value, built-in equipment is localized), is the enterprise form the exclusive framework, or can other utilization possibilities be brought up (lease, franchising, inner venture, etc.)?

Naturally, a contributory fact to the neglect of these questions was that the

<sup>9</sup>It is obvious that "The scissors, the razor and the hair-drier will not really be public property in hairdressing saloons employing one or two people, no matter how big the state-owned hairdressing saloons we organize actually are"— wrote Balázs Hámori and Katalin Szabó in an article [13].

central management urged the quickest possible termination of the rather clumsy decentralization process.

I for one, find the main cause in the fact that, in the course of decentralization, the government did not intend to face either the contradictions of development conceptions already involving determining circumstances, or the possibly uncomfortable consequences of progress.

Every concept which prepared for the modernization of organization and offered various possible solutions, started from the fact that existing state organizations and national networks are, under the present circumstances, not flexible and efficient enough. That is why they should be divided into small units, which are able to adapt to the requirements or the buyers. The idea that the establishment of the inflexible structure of big, state service enterprises is the product of an economic policy endeavour which may be qualified as mistaken from the outset, has not come up. In fact, just the opposite has occurred: instead of a critical review, insistence upon the correctness of earlier decisions has been a characteristic feature. "We have to recognize that the network could only be established by the concentration of forces. It would be a pity to deny in retrospect those things which were correct." [11] Every centralized development programme has also been justified: "In the period of extensive development until 1980 a modern, well-equipped service-network was built. Thus, laundries and services were built all over the country. The opening of these businesses was needed, because the growing demands of the population could only be satisfied in this way." [14]

Is our service network really so good, that "it would be a pity do deny the way of its establishment, the conception of its development in retrospect"? The constant shortage of services, the lasting dissatisfaction of the population, the poor efficiency of the servicing units in monopolistic situations which are indifferent to the customers' demands, and the spreading of illegal activities have shown, for a long time now, the radical error of this development conception. The mentioned opinions—which exist in a wide circle—protect the very practice which prevented natural organic development in the servicing sphere for decades. Instead, organic development was replaced by artificial expansion.

The conceptions developed in the 60's were really organic continuations of those of the 50's: instead of letting the characteristics of the servicing activity determine the organizational form, the fundamental principle of state property and the tight central manageability of the organizations and processes remained dominant. Yet organizational form like the individual enterprise, the family work organization or a workshop employing a couple of people did not conform to this.<sup>10</sup>

<sup>10</sup>Katalin Szabó writes about the fetishism of state property: "We treated state property as a form in which the other property solutions could finally be resolved, which could then be suitable for "homogenizing" the property system . . . We gave preference to state property in every aspect, against other property forms. We discriminated against the cooperative and individual enterprises



For example, the natural product of the demand for this type of management was the decision that the state had to organize the servicing network for the quickly expanding durable consumer goods. The decision (and what goes with it: restriction of the vital conditions of the small-scale servicing industry, and the decay of the servicing network of small-scale industry) has delayed the natural and organic development of numerous servicing branches for a long time.

The further development of the sphere of servicing continued according to the old principles in the 1970's. Furthermore, in the years of recentralization the old preferences cropped up again and this sphere was naturally included in the demand for wide-ranging central management. The existence of the big state servicing enterprises provided possibilities for this. Allocation of the central development funds to a few big firms and keeping track of their managements are routine administrative tasks. In this way, the investments could not be qualified as rational according to the real, differing needs of various spheres or the weighing of the profitability differences; rather, it appeared rational to the central developmental intentions which conformed to the interests of the large enterprises: that is, services should be expanded by the location of big units and capacities ("planned network development") in the areas considered as being unprovided for.

It was, of course, rational for the state to take over the establishment of units which satisfied actual needs and which required greater capital investment. For others—beside cooperations—there was no possibility to do that. However, the development conceptions focused exclusively on centrally manageable big expansions and disregarded the small servicing units. Yet the majority of the population's needs was actually satisfied by these units. The servicing-development conceptions thus did not serve the general expansions of these services, but the unilateral development of the socialist sector.

This was supported by many ideological arguments, starting with an insistence on the principle of responsibility for supply (taken as a state responsibility), all the way to that thesis according to which the concentrated utilization of the central sources is the main pledge of rationality. Moreover, the principle of the central development and management of the servicing sphere necessarily strengthened one side of the arguments concerning an issue which is still handled today in an ambivalent manner: the unsolved question of the place and role of the private sector.

This is why the question of why thousands of millions intended for the development of services were not utilized in another way, never came up: for example, should the people working in services receive it as tax relief or in other forms of advantages or, parallel to the establishment of units with greater capital investment,

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in taxation, as well as in the distribution of social resources. This kind of favouritism does not cause the greatest damage with the social tensions it provokes, but with the fact that it does not leave enough room for the "natural selection" of the forms. [15]

should the competent state organizations work out stimulating programmes for the development of small-scale industry workshops?

It is mainly the "traditional socialist" values of a significant part of the managing administration that explain why the earlier years' organizational development conceptions were not revised on their merits, thus such values affected the practice even in the 1980's. They stressed the superiority of state property, against the "class-alien" nature of the small private property of the means of production; there was verbal acknowledgement of the economic necessity of the private sector, but it was judged carefully and with distrust.

The organizational development programmes of the 1980's did not openly break away from the old principles and this is why the course for future development was characterised in an ambiguous way. Instead of a radical revision of the whole system of services—within this the role of the state enterprises—only the small enterprise model was established. This compromise proved to be feasible in practice.

The previous experiences with the functioning of small enterprises did not generate the need for a revision of the organizational forms in the mentioned servicing branches. In the eyes of the government administration the small enterprise is the product of, on the one hand, a successfully executed administrative action (of organizational modernization) and its mere existence is qualified as an achievement: small organizations have replaced large organizations. On the other hand, the organizational development conceptions have chartered the course for further development; thus the administrative organs consider the execution of such conceptions as their task—not the revision of the actual situation and functioning of small enterprises. According to the conceptions, there should be even smaller, independent units established under the auspices of the small enterprises. This should be in such a way that the smallest, separately located units and shops would operate under contract across a wider range. (The cooperatives also strive for this, with the establishment of the 'lump-sum' accounting units.) Yet this contractual operation has not gained ground in the past few years. At the same time, the proposal—which still appeared in the original conception of organizational development—that the smallest workshops should be leased to artisans or to work collectives of artisans has been removed from the agenda. The proposal has been unpopular from the beginning since, in the eyes of many, small-scale industry is invariably the real rival threatening the "truly socialist" state sector. This is why many people in the economic management and political bodies are afraid of the expansion of private property (although many analysts have pointed out that the flexibility of small-scale industry results from its organizational characteristics and from the fact that the artisan usually works alone, in a self-governing organization with little administration). The guard of the old principles wants to ignore the advantages inherent in the work organizations of small-scale industry.

For the time being, the organizational development conceptions do not even plan to introduce other modes of utilization of state property. (One way would be,



for example, the utilization of a part of the high-value equipment in a technical station. This could be leased to cooperatives or to individuals—or even sold to them.)

### The central management of small enterprises—intentions and reality

#### *Regulation of the functioning of small enterprises*

In the beginning it seemed that the small enterprises, which functioned in the simplified system of economic regulation, accounts, accounting and statistical data supply, would have the benefit of greater independence. However, it soon became evident that the small enterprises were not going to receive any greater autonomy than the big ones. This was partly because—as mentioned earlier—many kinds of conditions of independent operation were missing from the small enterprises. (And this was caused by the mechanical way of their foundation.) They inevitably needed the help of their new manager, the local council; the difficulties which occurred later made these relations even tighter. On the other hand, it also became evident that although the economic management strived to take into consideration the characteristics resulting from the small proportions and the form of small enterprises, later on they could not handle the small ones in a manner different from the big ones.

The most important of the few remaining distinctions is the taxation of the gross income. This undoubtedly simplified the generally valid, multi-channel withdrawal system of the state enterprises. With this, the regulation made the financial accounting of small enterprises easier and, together with other financial advantages, made a significant increase possible in the results, even in the case of organizations working with a high wage cost ratio. [7] After the payment of taxes, the small enterprises can freely use their profit, decide what proportion to keep in reserve, or they can use the money for development or the increase of wages. Yet the small enterprises—just like the big ones—put wage increases in the first place.

The free widening of the sphere of activities—which at the beginning was an advantage only offered to the small enterprises—was also a great help. The profit resulting from the widening of the scope of activities, from the utilization of the premises and from commercial business enabled them to function and provided the possibility of good results.

However, the facilitating measures were accompanied by more and more detailed, all-embracing regulations and, in the end, “as a consequence of the combined effect of the different regulations, instead of the expected improvement, the profitability of the small service enterprises in fact decreased.”

[16] Yet in the system of the regulations, as usual, the “gaps”, and conflicting reg-

ulations have appeared. The managing organs conscientiously worked hard on the modification and regulation. With this they tried to indicate that they do in fact pay attention to every problem of the small enterprises and are ready to take even newer measures. (Within the regulation of wages, for example, they regulated with meticulous care—and with several modifications—the premium of the managers and their deputies, the so-called “higher executives”; they encouraged the training of apprentices, reduced the tax on wages paid for economizing materials and granted credit with favourable terms for development, etc.)

The very detailed regulations extended to small firms and the solicitude of the central directing bodies have made the relations of dependence unequivocal for the small enterprises. Thus, instead of the expected market behaviour (competition for the buyers), they adjusted their operations more and more to the requirements of regulation. In fact, they did not have a genuinely different choice: prices and wages depend on regulations and not on the market situation. Instead of the price-forming effect of demand and supply, the price authority regulated their price and first the successor companies of GELKA and AFIT; then small hairdressing enterprises applied for the possibility of raising their prices,—and they did.

In such a regulative environment, the intended simplification of the administration of small enterprises could not succeed either. Immediately after their establishment, and by the time their rules of operation had been elaborated, serious administrative burdens began to fall on these organization and their small staff: “the authorities set the same requirements for them as for traditional enterprises. They are controlled by the fire department, labour safety authorities, social security authorities, the state prosecution and—for tax, price, personnel and other reasons—by various offices. Their rules of organization and operation have been elaborated according to the viewpoints of these organizations. One of these rules actually runs into more than 500 pages, and its implementation requires considerable expense and time”. [17] “Small enterprises have to prepare more than 23 rules (according to certain opinions, even more)”. [18]

The burdens of small state enterprises have continued to grow because the regulations of the directing bodies—concerning economy—put ever newer administrative obligations on them—as is the case with the big companies.

#### *The supervision of small enterprises*

The direct supervision of the functioning of small state enterprises—and thus the responsibility—was delegated to the local councils. (Sectorial direction has remained the task of the competent ministry.) In the beginning, the councils were a little bit hesitant about what should be the substance, methods and means of



supervisory activity, especially if the declared independence of small enterprises was to be respected.

According to the law, they could practice a legal supervision. Yet it was evident from the beginning that most small enterprises required concrete help. The supervising bodies could not and did not want to deny help. This was formulated for them by the Council Office of the Council of Ministers: "local councils should not interfere with the functioning of the enterprise, but should help where they find problems; if bankruptcy threatens, the councils should help them to avoid it—within the possibilities of their manoeuvring." [19]

Thus, in times of need, the supervisory organ of the council—sometimes at the request of the small enterprise, sometimes on its own initiative—had recourse to the usually applied means: if needed, it gave financial support (in the form of transferred or repayable circulating-capital provisions, supplementation of development funds, elimination of liquidity problems, granting of sites, cession of assets etc.), took part in the changing of managers, in the solution of staff problems, and "not least they helped the development of enterprises by paying continuous attention to their activity, by making the managers report, and through different resolutions". [20] The councils are ready for this because the general principle is that they are responsible for the quality of services in their own area. The responsibility for supply in itself justifies the fact that elimination of the economic problems of small enterprises should be helped by all means at the disposal of the councils. This is all the more in their interest because, in cases of bankruptcy among the bigger units, the sale of assets seems to be an insoluble task for the time being.

Under the present circumstances it is also understandable that small enterprises do not demand greater independence. Employees were thoroughly discontented in certain enterprises when some councils appointed their "own" people to the higher posts of the enterprise, instead of selecting the adequate leaders from among the employees of the small enterprise. In the course of the election of the director, in certain places this led to a situation where the director appointed by the council was not re-elected.

In fact, the small enterprises do not want to become independent of the councils which comprehensively help them in their operations. The practice of the councils so far has been reaffirmed by the position of the Council Office of the Council of Ministers: "It is a just requirement that—even after the introduction of new enterprise management forms—the presidents of the Budapest and county councils should pay closer attention to, and help the activity and increase the supplying ability of, small enterprises." [19]

Thus, instead of developing the conditions of autonomous management, the unequivocal dependency relations, the all-comprehensive regulations and the ever widening data supply obligation (which all give an opportunity for intervention) made small enterprises an integral part of the hierarchy of economic organizations. The adaptation was helped by the unchanged automatism of central management

practice and the invariably prevailing ideas about the superiority of state property and the necessity of its being held together.

The stability of ideological values has an interest-asserting function in this case, too: these can justify the necessity of existence of central managing organs; they are indispensable even in this small sphere, since they manage, guard, develop, and supervise the property of the state.

Yet in the meantime, it is precisely the state administration which has left unsolved numerous problems which basically determine the existence of small enterprises. The most serious failure, affecting almost every industrial service, is that in the course of establishing small state enterprises the earlier central provision of spare parts was eliminated without reorganizing the nature of its trade. In its absence, the spare part market disintegrated, supply became disorganized, and shortages became overwhelming. In the interest of preventing disturbances, only those steps were taken which cooperating smaller or bigger organizations could solve on their own; in fact, a really comprehensive, resolute state conception, and a general settlement was what were really needed.

### Illegal services

The 160 small enterprises functioning in 1985 are mainly the successors of AFIT and GELKA. In the circle of their mechanics it became a general endeavour—exceptions are worthy of respect—to try to increase (illegal) income with a greater part of the countervalue of their services—instead of the sales returns of the enterprise. In consequence of their working conditions, some of the employees are able to influence considerably the scale and proportions between legal enterprise and illegal personal incomes. This aggravates the problems of the functioning of small enterprises within them, adding to the problems that stem from without—from the circumstances related to the establishment and conditions of their activities.

Since 1983 an increasing number of analyses have reported on the expansion of illegal services and the increase of illegally tax-free incomes in the field of car repairs and telecommunication and household appliances repair. (Apart from this, illegal work is estimated to be considerable in the sphere of apartment maintenance.)<sup>11</sup>

According to estimates, the proportion of illegal services is high and has been continuously on the increase since 1983.

At the time of the establishment of small enterprises many hoped that if they succeeded in making mechanics interested in increasing the results of the small enterprises—mainly by raising wages—illegal services would be forced back,

<sup>11</sup> On the basis of a many-sided analysis, a comprehensive estimate was made by Drexler—Belyó [21], on the customs prevailing in the field of car repair by Polgár [22] and Oszoli [23, 24]; on the telecommunication and household appliance repair by Czenki [25].



at least in this circle. After the establishment of small enterprises, wages really began to grow (the officially announced average monthly income in industrial small enterprises was Ft 5515—somewhat lower than the industrial average: Ft 6674).

Beyond the continuous raising of wages, the earlier system of task-wage has been modified. It now strives to increase the share of manual workers in the payments received after their own work. This was aimed at suppressing illegal activities. "By certain incentive elements mechanics are stimulated to do a bigger part of their work within the framework of small enterprises." [26]—in other words, not illegally. The introduction of a more incentive wage system and the increase of payments due to the employees no doubt also made legal work for the enterprise more advantageous—at least in certain professions and within certain limits. In the small enterprises repairing telecommunications and household appliances average earnings have increased, but at the successor firms of AFIT even the more incentive wage system proved to be insufficiently attractive to increase enterprise performance—and thus legal earnings.

Illegal work is not a socio-economic problem affecting only small enterprises, but it directly threatens their viability. I would like to stress just one reason for the spreading of illegal activities: the role of the organizational form which does not suitably adjust to the activity. At the same time it places firm managers in a position of impotence, for they cannot force back illegal incomes attained to the detriment of the enterprise.

Probably the key problem is that in the case of many different activities the buyer and the worker inevitably get into personal contact. An enterprise, no matter how small, cannot handle this relationship. In this contact the buyer can ask for, and the mechanic can offer certain additional services (for example, a deadline shorter than the official one, in general, quicker service and "shortage" parts). In extreme cases, the enterprise can be left out of the whole business. That is why servicing enterprises were always at the mercy of their employees, on whom the fulfillment of the plan and the returns from sales depended.

In the case of small enterprises it is the *labour force* that makes up the real capacity. The volume of performances depends rather on the quantity of living labour than, for example, on the volume of the engaged capital—in some cases materialized in real estate. In other words, incomes are "brought" by skilled workers. The elementary interest of small enterprises is to keep their specialists. (According to one deterrent example from an analysis: after the loss of a television mechanic one small enterprise lost 300 clients.)

The managers of small enterprises try to solve the dilemma of the interest of the enterprise (namely that if they do not take a stand against illegal work, they lose their clients; if they do, they might lose their workers) with a reasonable compromise: they increase the legal framework, introduce supplementary activities—and put up with illegal work. Even so, it is up to the workers in what proportion they want to share the incomes with the enterprise.

In this situation, every kind of demand which is aimed at stimulating managers to take a firmer stand and to "force back the illegal activity of their employees by taking more resolute measures" is *irresponsible*.

Instead, both the managers of small enterprises, and those searching for solutions bring up the most diversified ideas in order to increase the legal performance—and thus the legal income—of the employees of the small state enterprises.

According to one of the characteristic conceptions, for example: "the internal structure of a small organization should be reconstructed as if it were a private one. Mechanics would organize their own work themselves and would appear as entrepreneurs." [18] According to this, the small state servicing enterprise—although it has not proved to be an economically advantageous form—should be further maintained. The ideological background of the conception is invariably the rather non-substantial slogan concerning the "protection of state property". Yet the proposal itself is so pragmatic that it builds the future of small enterprises upon illegal work permitted by the state, during working hours, and performed with state-owned tools and materials. This then legalizes the privileged situation which the employees of small enterprises (and other servicing units) enjoy over the employees of both large factories and artisans.

#### Interests related to the maintenance of the small enterprise form

Strong interests are related today to the maintenance of this form. The proof shows that the viability of the small enterprise is an unambiguous interest for both the state administrative agencies which establish this form, and the managers<sup>12</sup> integrated in the hierarchy of management of state-owned enterprise, and also of the people working there.

I would only like to analyse here the least obvious phenomenon: why do manual workers cling to the small state enterprises?

In the beginning, the small enterprises were afraid of losing experts and skilled workers, but their number quickly became constant. In the mentioned professions very few small independent ventures were established at the beginning of the 1980's. From 1985 on—especially because of the high social security contribution—not only did the process of becoming independent come to a sudden stop, but many people went back to the socialist sector because it offered greater security. (According to the data of the National Association of Artisans, the fluctuation among artisans is 25–30 percent annually, while the number of full-time artisans has stagnated.)

<sup>12</sup>The managers and the deputies who head small enterprises were put into the same 'B' category enterprises rank, as are the managers of state industry.



According to the data of surveys, the people leaving the small ventures prefer the socialist sector because it offers greater security than the private enterprises.<sup>13</sup>

This shows that in the present situation—for many reasons—neither the traditional small-scale industry (artisans) nor the company forms can offer attractive perspectives. The changeover from the state sector to the private sector can only be realized by the taking on of serious financial burdens. The value of the absolutely necessary initial capital differs by trades, but its finding requires financial efforts in any case. The self-managing entrepreneur has to cope with the everyday problems of continuous operation, (for example, the difficulties of purchasing materials). To these are added the tax burdens and extremely high social security expenses which, moreover, entitle the entrepreneur to less services than in the socialist sector. When considering the possibilities of becoming self-employed, this is a very important factor.

However, the employee of a small state enterprise involved in repairing or assembling (at times building or hairdressing) can use every piece of equipment that the firm has, due to his rights as an employee. Thus he can form his illegal activity and clientele (albeit linked to the legal one), and also work on his own. Through the company, he might have access to otherwise constantly lacking service parts or materials, which he utilizes to favour his "own clientele". In this way—if he wishes—his income can come from 2–3 sources: the "official work" for the firm, illegal activities on his own account and tips. (According to the estimates of experts, managers of small enterprises and employees, the income of certain mechanics in car repair services—stemming from tips and from working on their own account—can reach 1000 Ft and that of their assistants 500 Ft *per day*. Among the mechanics of the successor-companies of GELKA, a good telecommunication technician can increase his monthly income by 4000–5000 Ft, and a qualified household appliance mechanic by 3000–4000 Ft just by working on his own account. According to a more modest estimate, mechanics can earn an amount—by working like this and with tips—which, even at its minimum, is equal to their official salary in the small enterprise. Although in the circle of hairdressers illegal activity is not unknown, the principal source of supplementary income is traditionally tips, which amount approximately to 4–5000 Ft per month—according to estimates—of hairdressers with good clientele.

The interests of people working in small enterprises are unambiguously in favour of the preservation of this form of operation. It ensures these unique advantages, and there is the reasonable compromise that a lot of people apply for an artisan's licence beside their official job, which implies modest tax liability.<sup>14</sup>

<sup>13</sup>The labour-turnover was surveyed in 1984 at the small and affiliated successor enterprises of the AFIT and GELKA. About 5500 employees entered or left. In the same year, about 250 became independent in the mentioned occupations; the change of jobs took place within the socialist sector in such a way that employment increased in the small and affiliated firms.

<sup>14</sup>According to the data of the Central Statistical Office, in the above mentioned repairing-

For this reason,—between "reasonable" limits—they are interested in the moderate growth of the small enterprises' results; thus they can maintain the already existing state of affairs and can have untroubled access to their income stemming from other sources, too. This "interest" is not enough for the efficient functioning of an economic organization. In the present state of affairs one can expect the "mechanist to become ever richer while the servicing firm becomes ever poorer," [27] and in the field of services, the small state enterprise is thus proven to be *the least* successful form.

Small-state enterprises, as organizational forms, are already existing realities. The evident deficiencies of this form in several fields of services lead to consequences beyond the questions surrounding small enterprises: i.e. they lead to the essential questions of organizational modernization. We have known for a long time that the restructuring of the economy's organizational set-up, and the establishment of smaller, self-managing economic organizations is an inevitable, necessary process. We already know that new forms and solutions can only be successful if we do not try to build new things on old and shaky bases. If a critical review of the basis is missing and if central managing organizations evade more complicated, non-routine tasks, endeavours at modernization can only lead to half-hearted solutions and thus reproduce the problems.

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assembling trades a mere 36 percent of the employees were engaged full-time in 1986. In car-repair services 1960 employees were full-time and 3300 part-time; in household appliance repair the corresponding figures were 367 and 138; in the telecommunication repair services the figures were 758 and 514. When considering part-timers, naturally not only the employees of small enterprises but people disposing of adequate professional expertise, employed elsewhere, were also taken into account.



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### МЕЛКОЕ ГОСУДАРСТВЕННОЕ ПРЕДПРИЯТИЕ—ПАЛЛИАТИВ ДЕЦЕНТРАЛИЗАЦИИ ОРГАНИЗАЦИОННОЙ СТРУКТУРЫ

T. LAKY

В ходе попытки децентрализации чрезмерно концентрированной организационной системы экономики с 1982 г. возникла новая организационная форма, мелкое государственное предприятие. Предполагалось, что эти гораздо меньше традиционных предприятий организации, с более простым делопроизводством, с льготным налогообложением, самостоятельно работающие, будут способны рентабельно функционировать и оживить конкуренцию.

В 1985 г. работало уже 196 таких мелких предприятий, подавляющее большинство—в сфере услуг (ремонт легковых автомобилей, ремонт бытовых электро-приборов и радиоаппаратуры, парикмахерские, химчистки и т.д.). Однако они не оправдали возлагавшихся на них надежд: качество обслуживания не улучшилось. Вместо конкуренции работники государственных мелких предприятий создали собственную клиентуру и работают в свою пользу, используя государственное оборудование, материал, в рабочее время, пользуясь тем самым нечестными привилегиями как по отношению с рабочими крупных промышленных предприятий, так и самостоятельными мелкими ремесленниками, легально занимающимися таким трудом и платящими соответствующие налоги.



В статье рассматривается несколько причин неудовлетворительного функционирования мелких предприятий. Не удалось создать соответствующую организационную форму: большинство видов подобной деятельности требует не предприятия как организационной формы, а специфическое мастерское с одним или несколькими работниками. Однако и на этот раз не отказались от неоднократно объявленного ошибочным принципа, провозглашавшего превосходство государственной собственности и определявшего на протяжении десятилетий и соответствующую практику. Все это усугубило то, что государственное управление не способно дать даже мелким предприятиям более полную самостоятельность, чем крупным. Пример мелких предприятий—это урок для всех наших попыток реформ: новые формы и решения не могут быть успешными, если базируются на старых, прогнивших основах, успешные мероприятия требуют более глубоких изменений.