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**WHY THE UNEMPLOYED ARE UNINTERESTED IN  
SELF-EMPLOYMENT PROMOTION IN HUNGARY?**

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## **WHY THE UNEMPLOYED ARE UNINTERESTED IN SELF-EMPLOYMENT PROMOTION IN HUNGARY?**

My lecture consists of two parts. The first one is an overview of the two methods of self-employment promotion for the unemployed used so far in Hungary, the first in the early period of transition, from 1988 and 1990, and the second from the time of the approval of the 1991 Employment Act. Neither was a complete success, albeit for different reasons.

The second part of the lecture analyses the role of self-employment in Hungary. I shall survey the facts that may explain why, after the initial wave of massive self-employment, decreasing number of people choose this form.

In my lecture, I shall use the term "self-employed" as a synonym for the small entrepreneur: in Hungary, as in many other countries, apart from casual work, all legal independent earning activity (from window-cleaning to small artisanal, retail or private medical activities) is conditional upon the possession of an entrepreneurial permit.

I shall use the term "self-employed" as defined by ILO, with a single exception: members of industrial and agricultural co-operatives are not included in the relevant statistical data, partly because, as opposed to the European principles of co-operation, in Hungary, prior to 1989, roughly the same regulations had applied to such organisations as to state companies, i.e., their members used to work basically as employees, and partly because the disintegration and restructuring of co-operatives has not been finished and, therefore, the relevant employment relations are not discernible as yet. Moreover, since no previous Hungarian statistics of the self-employed (small entrepreneurs) had included co-operative members, they would have to be disregarded anyway, for the sake of comparability.

### **I. Self-employment Promotion, An Active Labour Market Policy Instrument**

Although, as is well known, the Hungarian private sector used to be the most advanced one in all the former Socialist countries, in 1988, the year before the



change of regime, 7.2 percent only of the active earners had worked as self-employed or the employee or assisting family member thereof.

Their number had risen by one-third at once after the change of regime: by 1989, 332 thousand of the 4.8 million earners had been independent, with 71 thousand employees and 80 thousand assisting family members. The following year, their number increased by another 194 thousand to nearly 14.5 percent of all active earners. The majority of the self-employed had been small artisans (43.7 percent), to be followed by retailers (28.7 percent), free-lance intellectuals (27 percent) and a few thousand independent farmers.

The first self-employment promotion measure, the so-called Re-start Loan, was introduced in this context.

### **1. Re-start Loan for Unemployed People and School-leavers (1989-1990)**

The Re-start Loan was introduced at the national level, after pilot experiments in four counties, in 1989. Although there had been no unemployment as yet at that time, its advent had already been feared by most, mainly due to one of the major reform endeavours of the Hungarian economic policy of the eighties: restructuring. There was general consensus that the proposed alteration of the organisational structure of Hungarian economy, the decentralisation of mammoth state enterprises, the re-orientation of the product structure in order to introduce competitive products on the Western markets instead of supplying the Eastern ones with mass products would entail unemployment and the labour administration wanted to anticipate that, with the best intentions.

In the beginning, Re-start Loans were conditional upon severe criteria. The interest-free, max. HUF300 thousand loan could be allocated to registered unemployed meeting all the application criteria. (HUF300 thousand was the equivalent of more than twelve months' average pay.) Interests were covered by the Employment Fund marked off from the state budget. Although banks did request guarantees, if the claimant met all the formal requirements, the labour offices issued the necessary license upon which banks had to pay.

L. Neumann, a research fellow of the Labour Research Institute, summed up the history and results of this loan scheme as follows (Neumann, 1992):



In the beginning, only a few applied for this loan. This could be due to the following reason: at about 1988, when the unemployment rate was still insignificant, most of the eligible registered people were unqualified marginal workers without the necessary educational and financial backgrounds to enterprise. At the same time, the business consulting service network was not yet in place, either the branches of banks had to discharge the consulting function or, later on, the representative bodies of entrepreneurs tried to offer such services.

After July 1, 1989, the conditions were made much easier and so were the criteria of eligibility: school leavers as well as people without any previous employment were included in the scheme. The ceiling of the loan was raised to 400.000 Forints, at the same time the acceptance of interest service by the state was limited to the first four years of loan. No stipulation was made as to the period of unemployment prior to raising this loan. Thus, practically, it was available to people who had just given notice the day before. In the case of people whose previous salary was too high to find a new job, the officers often waived the one-month period of patience. Employment Service members told that most borrowers came not from those unemployed who were hard to displace. Jobs were left not only by highly qualified blue-collar and white-collar professionals, and not only housewives applied who used to work in the household farm, but also artisans and shopkeepers who returned their licenses and tried their chance in another business.

Applications for the loan became massive by the end of 1989 and the first half of 1990. The liabilities of the Employment Fund grew much higher than expected. This lending scheme was considered an extremely favourable one because of the high inflation rate and it eventually worked as an overall instrument of small business start-up support. The criterion of unemployment was absolutely not crucial. (At that time, by the way, there wasn't any credit facility for such purposes.) Finally, with quite a lag because of the discordance about the government change, this program was suspended in June 1990.

According to the data of the Ministry's analysis of borrowers, altogether 42.500 persons raised this loan in two and a half years. This popularity could be attributable to timing. The state offered an opportunity to do private business at a time when, based on the experiences of the eighties, enterprising was clearly associated with the promise of higher income, and there was an awareness of the emerging constraints of the market. With respect to the new jobs, it meant



another 25-30 thousand people employed by small business. Most of these units were 1 to 5-man ones, i.e., falling in the self-employer stratum. Most of the loans (34 %) were raised for agricultural and food production activities. Artisans (22 %) and retailers (25 %) also represented significant shares. (The others joined some business partnerships.) It is hard to state exactly how many really new jobs have been created by this project because, beside the former private entrepreneurs starting a new business, this scheme also assisted spin-offs from large organization, that is, some of the cases meant privatization of the borrowers' activity. In summary, the benefits of this scheme are indisputable: this "employment policy instrument" has managed to "redirect" nearly 40.000 persons from the state sector to the world of private business.

The interest burdens of the Start-Up Loan will debit the Employment Fund for three or four years ahead. {According to the analysis of the World Bank, loans totalled HUF4.5 billion in 1989 and HUF10.2 billion in 1990. (S. Wilson / A.V. Adams, 1994). According to Hungarian calculations, the Employment Fund was debited by c. HUF11-12 billion interest.}

There are no available data as yet about the failure rate of self-employers who got a too easy money and many of whom indulged in risky activities, mainly in agricultural production.

As I have mentioned already, this measure had been active at a time when there had been no real unemployment in Hungary as yet, and it had been cancelled by the time of its sudden and rapid growth. The avalanche, however, had been triggered by the collapse of the markets of the neighbouring countries, Hungary's major economic partners, and not by the desired restructuring.

## **2. Self-employment promotion since 1991**

In February 1991, the implementation of the previous employment policy instrument was put in a new context by the Employment Act. The method of self-employment promotion for the unemployed was also altered. Loans are only available for them from banks under business terms and conditions, while the Labour Service either contributes to the costs of training, consulting or insurance for collaterals, or it makes a regular monthly payment in the first half year of the business in an amount similar to the previous unemployment benefit. Such



support is only available for people who had been unemployed for not less than 6 months.

Claimants may request the following services from the Labour Organisation:

- allowance equivalent to the unemployment benefit for another six months on presentation of the official entrepreneurial permit;
- repayment of max. half of the costs of professional counsel for business activities;
- reimbursement of max. fifty percent of the costs of training required for practicing the entrepreneurial activity;
- acceptance of max. fifty percent of loan security costs for a yearly period.

According to the data of the National Labour Centre, the above assistance types had been provided in the following proportions:

**Table 1**

**Unemployed beneficiaries of entrepreneurial support by assistance types**

Year Dec	Unem- ployment Rate	Beneficiaries of unemployment benefits*/  (000)	Entrepreneurial assistance		of which:			
			// no	// %	Further allocation of unem- ployment benefits	Training	Counsel	Loan security
1991.	7,4	76,5	1.041	1,3	1.042	24	3	2
1992.	12,3	476,7	5.466	1,1	5.466	124	5	5
1993.	12,1	326,7	10.972	3,3	10.972	159	6	1
1994.	10,4	191,6	9.416	4,9	9.397	78	6	1

\*/Registered unemployed entitled to benefits only, whose porportion had decreased from 70 to c. 40 percent owing to the restriction of entitlement criteria, i.e., half of the registered unemployed are not entitled to benefits now. Since self-employment promotion is conditional on long-term (min. 6 months) unemployment, figures refer to the latter.

**Data source:** NLC monthly and summary publications.

As can be seen from the above table, the majority of the participants requested unemployment benefits for another 6 month, and a small minority only applied for training, professional counsel or loan security.

In 1994, Mária Frey performed an evaluative survey on the efficiency of self-employment promotion (Frey, 1994).



The follow-up survey was carried out in two counties, in December 1993 and February 1994. It covered people who had received self-employment assistance in 1992. Survey information was collected from four-fifth of those concerned who had been trying to cope on their own for 6 to 18 months by that time. The 80+ percent response ratio (615 persons) gives a representative picture of the fate of formerly unemployed entrepreneurs.

Here are some of the major findings of the Frey survey:

- Relatively few unemployed voted for turning independent with the assistance of the Labour Organisation, but their activities proved highly successful: in the two counties, more than two-third and three-fourth, respectively, of the beneficiaries still pursued their original activity at the time of the survey (of course, many of them even at low profits and uncertain market perspectives, because they had no other legal work opportunity and could not have provided for their family otherwise). It is an important achievement that the enterprises in question usually supported one more person (an employee or a family member) on the average beside the owner.
- Former white-collar workers have proved the most successful of all. It can be stated in general that secondary or higher education gives the best chances of survival. The rate of failure is higher than average among those with inferior educational qualification (elementary school, eight years or less).
- The majority of the unemployed becoming self-employed (three quarters in one county, two thirds in the other) would have chosen the same course even without assistance. Most of them, however, had been acting under constraint: in their own opinion, they simply had had no other chance of work. (The share of "forced" entrepreneurs was 69 percent in one county and 58 percent in the other.)

The dead-weight effect of the assistance exceeded the corresponding values calculated by the already quoted World Bank survey for similar projects in the OECD countries {France 60 %, Denmark 56, UK 42, Australia 39, US (Massachusetts) 28.6 and (Washington) 26.6 percent}, albeit at one of the smallest costs, 1.2 percent in 1993, as far as active employment policy measures go.



All in all, that is to say, the programme did not weight much, as compared to the other employment policy measures: in 1994, for instance, training/retraining programmes involved nearly 90 thousand and public works nearly 70 thousand. Assistance to the 9 400 new self-employed was but a fraction of that; this costs exceeded 3,6 % of total ALMP expenditure.

The picture is somewhat different, however, if this number is compared to the total number of new entrepreneurs registered the same year (on the basis of social insurance data registering full-time employees).

**Table 2**

**Annual Increase of the Number of the Self-employed (000)**

Year	Newly registered full-time self-employed	Of which assisted unemployed	
		number	proportion
1991.	65,5	1,0	1,5
1992.	65,4	5,5	8,4
1993.	92,0	10,9	11,8
1994.	64,9	9,4	14,5

**Data source:** National Health Ins. Fund Administration Yearbooks

That is to say, the share of formerly unemployed people in one-man and non-legal-entity business enterprises is increasing every year. This has become one of the essential routes of escape from unemployment among the present, ever more limited, employment oportutines.

## **II. Economic and Social Role of Self-employment**

The strongly felt transformation of the global economy has brought about, especially in the developed European countries, a re-evaluation of self-employment, accompanied by many doubts and hopes.

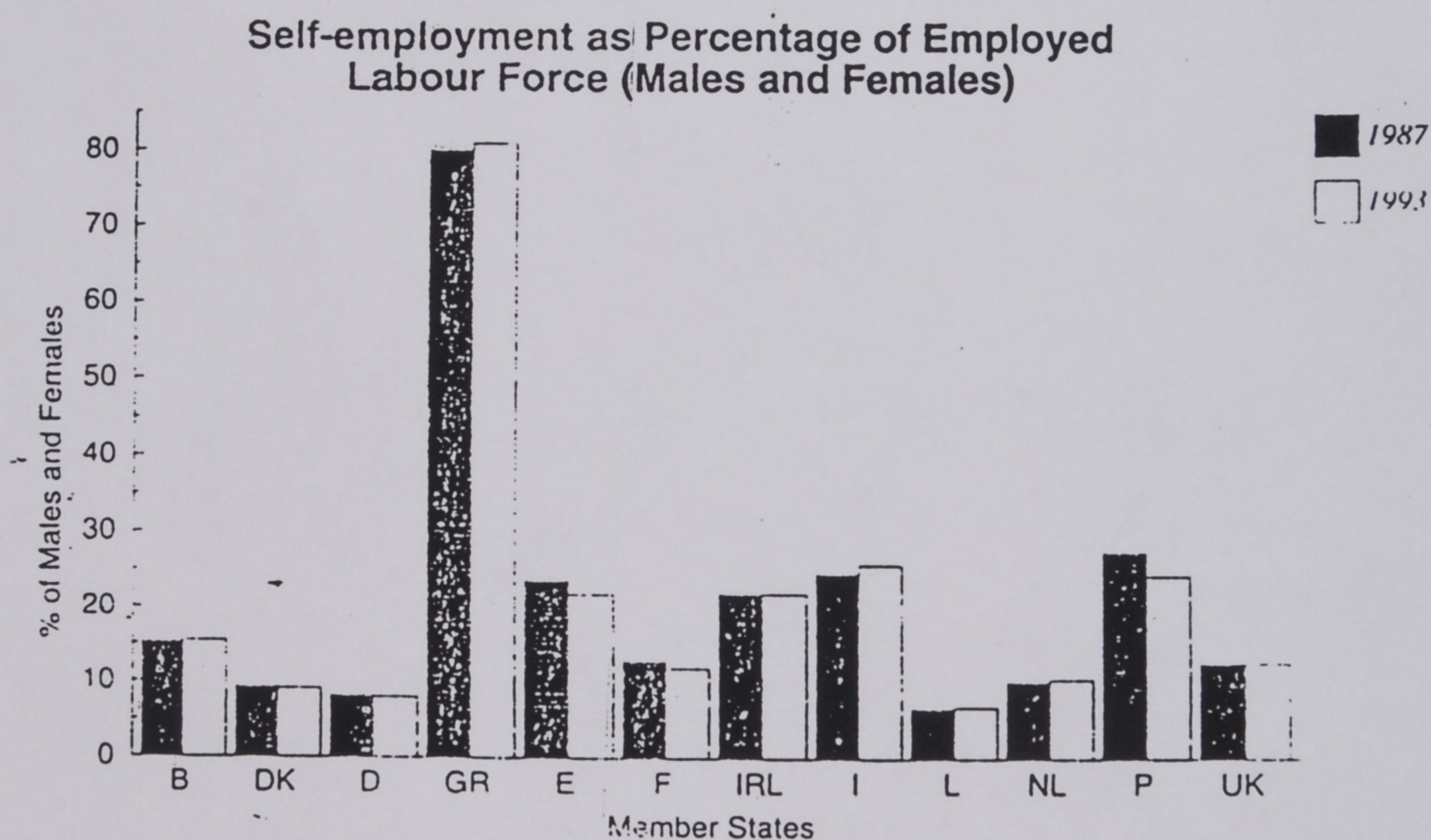
In the developed European countries where, for more than two decades now, every tenth adult has been unemployed for a shorter or longer period of time, governments have made outstanding efforts to make self-employment, i.e., the creation of an independent and self-supporting existence, easier for those concerned. There are innumerable institutions, state-level and local, governmental and voluntary ones, that offer counsel, training and loans. Methods are spreading from country to country: everyone tries to learn from the other.



There are some very promising models, too, like the industrial district approach {cf. for example, S. Brusco (1982, 1990), Piore and C. Sabel (1984), Sengenberger (1990)} where a network of self-employed small entrepreneurs provides support to assure the well-doing of all, but even without an industrial district there is some hope that the self-employed shall be able to gain a permanent foothold on the labour market.

Thanks to these efforts, the number of the self-employed is on the rise in many countries, at different rates, though, depending on their respective traditions, the relative weight of agriculture, the level of industrial development and other factors. Statistics suggest a tendency of gradual growth.

## Self-employment as Percentage of Employed Labour Force



Source: Employment Observatory 22 Annual Report p.25.

However, certain doubts have also emerged. Two ILO seminary studies of 1986 and 1988 covering five European countries ranked self-employment, with some other forms, among the precarious activities (G. and J. Rodgers ed., 1989).

The studies in question have demonstrated that the weekly working hours of the self-employed - and their family members - are much longer than those of the average employee, and although many hold their freedom in high esteem, they often have to struggle hard on an unsure market to earn their living. Moreover, in many countries, they enjoy less social protection than the employees.



As is well-known, the self-employed stratum includes many groups with highly different educational backgrounds, qualifications, incomes etc: window-cleaners and well-educated professionals, street vendors, agents, renown craftsmen and retailers. Some inherited the vocation, the workshop, the store; some insisted on being independent, while others had no alternative. Some have relatively high standards of living, others could not manage without at least another regular income in the family, however modest that might be.

The social composition of the self-employed is similar in Hungary {Kuczi-Vajda (1990), Czakó-Vajda (1994), Laky (1989, 1994)}, but, after the initial years of hope, we seem to have reached a period of doubts and uncertainty. Although in Hungary self-employment, i.e., small enterprising, had been possible ever since the early eighties, the dam burst in 1989-90 only: that is when people first realised they might be independent, independent of state employment. They needed no outside assistance to take their chance: the re-start loan seemed an unexpected present. The share of the self-employed rose from 7.2 percent in 1988 to as much as 21.7 percent by 1994.

**Table 3**

**Active Earners Employed in One-man and Non-legal Business Entities,  
1981-1994 (000)**

Year 1 January	Independents	Assisting family members	Employees	Total	% of active earners	Annual change in number
1981.	118,2	61,8	0,3	180,3	3,6	-
1982.	119,9	56,7	2,5	179,1	3,6	- 1,2
1983.	129,4	55,6	6,1	191,1	3,8	+ 12,0
1984.	144,3	54,6	9,9	208,8	4,2	+ 17,7
1985.	158,1	59,0	11,5	228,6	4,7	+ 19,8
1986.	167,5	61,6	19,7	248,8	5,1	+ 20,2
1987.	176,5	64,0	25,6	266,1	5,4	+ 17,3
1988.	194,3	67,7	32,4	294,4	6,1	+ 28,3
1989.	218,4	81,0	48,0	347,4	7,2	+ 53,0
1990.	332,2	80,1	71,0	483,3	10,1	+ 135,9
1991.	419,3	113,5	144,6	677,4	14,5	+ 194,1
1992.	466,0	97,4	144,0	707,4	16,7	+ 30,0
1993.	n.a.	n.a.	n.a.	780,3	20,7	+ 72,9
1994.	n.a.	n.a.	n.a.	805,1	21,7	+ 24,8

**Data source:** CSO, Labour Force Situation of the National Economy in the eighties and labour force balances



However, the Hungarian economic situation has changed dramatically in the meanwhile.

The economies of the neighbouring East European countries, the major markets of Hungarian economy until then, had become insolvent. The collapse of the export markets has spread over the internal economy as well. The largest companies and co-operatives laid off their employees by the hundred and the thousand: some 1.5 million jobs were lost in 1990-1994. The highest unemployment rate was registered in February 1993 at 705 thousand, 13 percent of all active earners. And although the unemployment rate is around 10 percent now, according to the CSO Labour Account, employment has kept decreasing even in 1994: on January 1 1995, there were 91 thousand less employees than a year before.

At the prospect of unemployment, many fled the labour market. Some retired - early retirement was encouraged by employment policy; mothers with small children applied for the two to three-year-long child-care allowance, a social provision, and many, especially young school-leavers, became dependants. Of an active population of c. 6 million, students not included, more than one million had become inactive by end-1994.

The other escape route was provided by self-employment, but while in 1989-1990 some 330 thousand (self-employed, employees, assisting family members) entered the self-employed sector, after 1991, this movement slowed down and in 1993 there were only 25 thousand newly registered self-employed (see Table 3).

The weakness does not inhere of self-employment promotion, but of the general situation.

This tendency was due to several reasons:

- Dramatic decline of the national income and the corresponding radical decrease of production and massive reductions. The 18.9 percent recession of the national income in 1990-1993 (Tímár, 1994) brought about a marked decline of the domestic purchasing power. The situation of both the old and the new self-employed has kept deteriorating: they found it ever more difficult to conquer and keep their small markets. High taxes also had a deterrent effect. Self-employment, a rather attractive alternative a few years before, had become more and more of a forced choice.



- Composition of the unemployed. Labour exchange agencies can only place a monthly 4 to 5 percent of the ever more restricted circle of the beneficiaries, and even some of these only to subsidised jobs (public works, jobs maintained with wage subsidy). Unemployment benefits are allocated for a maximum of twelve months to those who meet the allocation criteria. After that, social assistance (income-supplementing allocation for the unemployed) is provided for a maximum of another 24 months to those who need it. In September 1995, of the 491.4 thousand unemployed registered at the labour offices, 163.3 thousand were receiving unemployment benefits and more than 200 thousand the income supplementing allocation (NLC monthly report). According to the quarterly CSO Labour Force Survey (of the unemployed, as defined by ILO), in the III. quarter of 1995, long-term unemployed out of work for 12 months or more made up 53 percent of the 415.4 thousand unemployed. The survey also registered another 109.6 thousand passive, discouraged unemployed.
- The proportion of long-term job-seekers is increasing steadily, the same as that of the passive unemployed. The majority cannot escape unemployment, owing to their disadvantageous situation: nearly 40 percent have elementary-school qualification at best and no skills. The majority of the skilled workers, on the other hand, are school-leavers with no vocational experience and practice whatsoever, or aged people with vocations for which there is no demand any more. The majority live either in the broken industrial districts (Ózd, Miskolc), where ten thousands are waiting for the creation of new jobs or in small settlements where there is no demand for any activity, apart from seasonal agricultural work maybe. The majority had missed their opportunity to benefit from self-employment promotion, if they had been entitled to it at all in the first place, and, anyway, they are lacking the necessary capacities, too.
- Employment policy offers rather modest self-employment promotion. Entitlement to unemployment benefits after six months is conditional upon the possession of an entrepreneur's permit, but that also means that the self-employed must leave the system of unemployment insurance that is for employees only. The self-employed are entitled to social insurance on the basis of their own contribution. The monthly average unemployment benefit is rather modest (c. one third of the average pay of full-time employees). This might be essential for a living, but it could hardly be expected to cover even half of the costs of counsel, for example.



Luckily, there are some enterprise and self-employment assistance institutions and organisations providing counsel, help and even preferential loans for would-be entrepreneurs for free. (The county enterprising centres of the Hungarian Enterprise Promotion Foundation, for example, provided HUF3-500 thousand micro-credits to a total of 4 thousand entrepreneurs thanks to the Phare credit scheme. Six thousand applied for the credit and the counsel that goes with it.) All the interest representation organisations of small entrepreneurs and many foundations, too, some of them foreign ones, assist self-employment in various ways.

As compared to the above, the labour organisation provides assistance to a rather restricted circle, those, whose entitlement to benefits has not expired yet.

- The black economy, yet another escape alternative, also plays an important role in self-employment. No entrepreneurial permit means no tax office and social insurance registration. Therefore, many work black or employ workers illegally, i.e., without registration, if possible. The perspective of tax evasion makes black work attractive, despite the relatively high risks involved. (Estimates suggest that the proportion of the black economy is high and on the rise.) The unemployed tend to accept and even seek out offers to work in the black economy where they do not have to share their income with the state, especially after the expiry of their entitlement to benefits.

In Hungary, the same as in the more less developed countries, the rate of the self-employed is rather high. A well-known Hungarian economist, István R. Gábor expressed his worries that, from the economic point of view, their presently evolving high rate in Hungary is a dead end: the self-employed have practically no capital, they rely on their own capacities, education, physical skills and contacts and, what is more, usually live up their income and, therefore, they cannot contribute to the upswing of the economy. Although this is most probably true, we must not ignore the other aspect of the problem, namely that the self-employed do their best to earn a living for themselves and their family. Instead of expecting social assistance, unemployment benefits or social allowances, they try to work and live on their proper resources - a venerable commitment that deserves all the assistance that society can provide.



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**Teréz Laky:**

**Why the unemployed are uninterested  
in self employment promotion in Hungary  
(Summary)**

From 1989 onwards, two kinds of self employment promotion schemes were implemented in Hungary, among the instruments of active labour market policy. From different reasons none of them can be seen as a successful implementation.

**1. Re-start loan for unemployed and school leavers (1989 - 1990)**

Interest free loan, up to 300 thousands HUF (later 400 thousands HUF) was available to unemployed, who fulfilled the eligibility criteria of benefit. (The amount was equal to a yearly average wage). This loan has been lent to 42,500 persons over a period of two and a half years until this support has existed.

The idea of implementing this instrument was directed by best intentions and hope that mass unemployment, which was feared but seemed as unavoidable, can be prevented.

However, the situation, the target group and the method were based on misinterpretations.

At that time there was practically no unemployment in Hungary. Unemployment registration existed already, registered vacancies (37,7 thousands) exceeded the number of unemployed (23,4 thousands) in January 1990, still a few months before the end of the whole program. The unemployment rate was 0,9 percent in June 1990, when the re-start loan program has been canceled. Number of unemployment beneficiaries reached up less than ten thousands persons at that time.



At the same time, thousands of employed people became self employed, leaving their jobs in the state owned sector by their own intention. More than 200 thousands people appeared in the small private sector, as self employed, employees or family member. While the number of new members of this stratum was 28,3 thousands in 1987 their amount nearly doubled (53 thousands) by the next year (1989) and grew up to 135,9 thousands in 1989.

Most of them had been waiting for years to become independent and were eager to establish their own small business at the first appropriate moment.

For the lack of the assumed target group, i.e. unemployed, the initially severe conditions of the loan has been loosened. Everybody, who had the chance, tried to grasp the opportunity to reach the loan. In many cases people having a job asked being fired, making themselves eligible for the very attractive, interest free re-start loan.

All in all, re-start loan helped mostly for those to start small business who intended to start anyhow, in a promising period of the economy.

## **2. Promotion to unemployed (since 1991)**

The newer instrument of ALMP is very similar to those existing in many West-European countries.

The Labour Office offers contribution to the costs of training, consulting or insurance for collateral's, or a regular monthly payment for an additional 6 months, in an amount similar to the previous unemployment benefit. (The average sum is very close to the minimum wage and is about one third of the average monthly



earning.) Support is available only for those people who have been unemployed for not less than 6 months.

This instrument is far as popular as the previous one had been. This is one of the smallest among the other ALMPs. Meanwhile more than 200 thousands unemployed participated in different ALMP programs in 1994, there were less than ten thousands only in the self employment promotion program. Costs of this shared 3,6 % of the total ALMP expenditure.

However, the number of participants has been steadily growing, as well as among the new members of self employed stratum. (14,5 % in 1994). Meanwhile the circumstances have changed remarkably. After the boom of 1990, when 194 thousands people became self employed in one year, their number decreased significantly in 1993, to 24,8 thousands.

Under the continuously worsening living conditions people are not eager to become self employed any more.

So the weakness of the scheme does not inhere in the self employment promotion but in the state of the economy.

Main reasons of the decreasing number of self-employed:

- General state of the economy. Diminishing of national income as a result of the last years deep crisis, nearly 1,5 millions jobs were lost; the continuously tightening purchasing power; consequently general bad conditions for self employment.
- Composition of unemployed. High rate of low-educated, unskilled, untrained people, living mostly in depressed areas.
- Other - and sometimes better - supporting schemes besides the Employment Fund. Different organizations - international



foundations among them - free of charge trainings, business advices; the Phare program gives loan, micro-credit, etc.

- Opportunities in the shadow economy.

In Hungary the number of self employed among the employed reached about 25 percent. It is quite a high rate, similar to the less developed countries. Economists expressed anxiety, seeing this high rate as a dead-end street because of the lack of capital, of investment. However, until more than half million unemployed unable to return to the labour market (do not mentioning another one million people, who became inactive) self employment has to be seen as an expedient solution, possibly the only solution, for the time being.