Small Business Organizations in the Hungarian Economy

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Introduction

Hungary is undergoing deep socio-economic change. The serious economic situation and widespread consumer dissatisfaction make it imperative to create conditions for a reform of the entire decades-old system of economic and social management.

The roots of the current problems lie in the 1948–53 period when a Soviet-type centralized system of economic management, the so-called socialist planned economy, was built in Hungary. The main features of such a system are:

- ○ Almost total liquidation of private ownership of the means of production and thereby replacement of private economic decision-making by centralized planning targets.
- ○ Replacement of market-based co-ordination of production and consumption, supply and demand, and cost-and-benefit decisions, by bureaucratic co-ordination, resource allocation and target selection.[1]
- ○ Central management on the basis of hierarchic organization.[2]

It is easier to allocate tasks and distribute the means necessary to fulfil them (money, machines, material and manpower) if only a few organizations constitute the lowest level of the hierarchy. Therefore, the many organizations of different sizes in every branch of the economy – industry, agriculture, trade, services, etc. – were amalgamated into large ones which were deemed easier to control.[3] Independent crafts and retail trade were also centralized into co-operatives, using ideological justifications but in reality to serve the needs of centralized power.[4]

The planned economy was beset by serious functioning problems right from the start. To ease those problems, among them shortages of goods and services felt by the whole population, liberalization methods were adopted in 1953 by the government of Imre Nagy. Since then the system has been reformed continually and many of its characteristics have been modified. The changes have speeded up in the past two years, mainly because of the changing international environment.

The first concessions, in the realm of property relations, were made in agriculture in the sixties. Co-operative members obtained household plots and were allowed to produce and sell on their own. Next came new forms of management in domestic trade and catering (contractual and own-account operation) which increased incentives for employees by giving them a share of the profits. These forms only simulated private property and were relegated to an 'auxiliary' role in relation to large organizations.

The first serious possibilities for private forms appeared in the eighties through the legalization of small entrepreneurial organizations whose size was held within narrow limits (ten to thirty employees). The breakthrough came in 1989 with the Partnership Law which allowed private organizations to have up to 500 employees, opening up areas for capital investment in versatile ownership forms (joint stock company, limited liability company, limited company). The Individual Enterprise Law, abolishing all staff limits, was passed in 1990. The government can now also start joint ventures with foreign and domestic private firms.

The Unified Entrepreneurship Law of 1988 abolished decrees discriminating against private firms. Now private property has equal standing with government and co-operative property. There is a good legal framework for the establishment and operation of private firms and for the development of an economy in harmony with proprietary calculations. However, many conditions are still unfavourable, among them the lack of capital market institutions and uncertainty over how large government firms may be privatized.

The management of the economy has been altered to a large extent. The first step in this direction was taken in 1968 with the almost total abolition of planning decrees and central allocation of resources to firms. The main tool of central control became monetary regulation. Although 'manual steering' survived in some areas (exports and imports had to be authorized item by item, wage and price increases were prescribed centrally, etc.) many steps were taken towards liberalization after 1985. For example, during the past few years some 2,000 firms have received export-import licences; in 1989 40 per cent of imports were liberalized and this is planned to rise to 60 per cent in 1990; central wage regulation has been almost abolished; and many prices are no longer controlled by the Price Office.

Several steps have been taken to ease hierarchical independence; for example, the number of ministries at medium levels of the hierarchy has been reduced, the remaining ministries cannot give orders and are allowed to supervise only legal aspects of firms' operations. The majority of firms have councils composed of employees' representatives (even more direct forms of workers' representation have been created in the smaller firms) and the state has handed over property rights to them. However, the largest firms remain under state administration.

Of course, the changes in the central management hierarchy cannot in themselves achieve results, because as long as there are no true proprietors interested in a return on their investment and in rational management, and as long as the regulating mechanisms of supply and demand are not functioning, central management is constrained to employ the tools of bureaucratic co-ordination. And where there is bureaucratic control, there is no room for market co-ordination.

The way is now open for private ventures, but the strengthening of small organizations, the extension of their market role and their co-operation with large organizations depend also on the transformation of large state firms. In addition, the whole hierarchy of state administration has to change and management decisions have to be handed over to economic actors. The goal is therefore no longer to reform a socialist planned economy , but rather to break it up and replace it with other forms of organization and management capable of dealing with Hungary's serious problems.

Small business organizations in the Hungarian economy

The economy's continuously worsening performance since the end of the seventies has forced the government to adopt new reforms. The declared programme includes transformation of the over-centralized organizational system, creation of small and medium-scale organizations and several other steps.

Two main factors led to the decentralization of large monopolies. First, their poor economic performance had to be counterbalanced by new loans and subventions from the government. The functioning of large companies could have considerable effects on the country and so they were able for the most part to obtain the funds they needed. This had serious consequences on the budget. The second significant incentive for organizational transformation was the experience of highly industrialized countries where small organizations improved their economic performance spectacularly while adapting to changes in the world market.

The appearance of small organizations in Hungary raised certain expectations: that their supply of goods and services would be able to meet demand and thus reduce shortages, that money hoarded or spent on personal consumption at some levels of society would be invested, and that the growing number of small organizations would compete with each other to the benefit of the consumer. These expectations have not been met fully as will be seen later.

Three campaigns to create small-scale organizations were launched at the end of the seventies and the beginning of the eighties:

- Decentralization of large state firms by government decree.
- Starting of new so-called small entrepreneurial forms.
- Easing of the very strict employment constraints on small-scale industry and retail trade, and improvements in their operating environment.

The campaigns can be summarized in the following way:

Decentralization

The government envisaged a large-scale decentralization of monolithic state firms. Its determination was quickly broken, however, by the strong resistance of the monopoly firms; its resolve was also weakened by the ambivalent interests of central management, for, as demonstrated by Vincze (1986) and Voszka (1986), reorganized central management invariably needs large firms which may be controlled through direct agreements and which at the same time justify the existence of bureaucratic management organs.

In sum, the results of the campaign were meagre. The successes were the decentralization of the large regional food firms and the splitting up of two large, nationwide service firms (one engaged in car repair, the other repairing household appliances and consumer electronics), making their service points independent all over the country. All in all the family of 'traditional' state firms was enlarged by 150–200 new firms.

Some of them are large, sometimes employing many thousands of people. But there are also state firms which employ at most 100 people. In 1982 their number was 215 and they employed a total of 11,300 people. (At the same time, some 2,000,400 people were employed by the 781 firms having more than 1000 employees each.)

Small entrepreneurial forms

Small plants

Two new small-scale forms arose from the decentralization of state firms. The first, the *small, state-owned firm*, was intended to be used widely but ended up being adopted only by the local units of the two service firms referred to above. This form was given several tax exemptions not enjoyed by other small-scale firms and had simplified management and accounting rules; however, it could not rely on the government to bail it out of difficulties. It was hoped that the new small units would be run as ventures.

However, the new form proved to be inappropriate. One reason for this was that activities such as car and electronic repair and hairdressing could be pursued efficiently only in small independent shops and not in centrally managed and regulated government firms. The large service firms had been decentralized because their performance had been far worse than that of small-scale industry, but the decentralized units had the same problems as their parent firm. Their employees could work on their own account (at the customer's premises or even at their own place of work) and pay only a minimal sum to the company. Instead of decentralizing, it would have been more appropriate to liquidate the large units and sell or rent relatively inexpensive equipment to employees who could then work as independents or in partnerships.[5] In spite of decentralization, small state firms only vegetated in the same way that the bigger units had done (Laky, 1988). This form existed till 1989, when the United Entrepreneurship Law ended the special status of small, state-owned firms and made them operate under the same conditions as other state-owned firms.

The second new form to emerge from decentralization was the *subsidiary*. It was different from its market economy counterpart in that its autonomy was nominal. The majority of Hungarian subsidiaries are units of large firms seeking independence. Some obtained operational favours and tax exemptions similar to those of small firms but they could not operate independently of their mother firms. They failed for the same reasons as the large firms did: they lacked the profit motive necessary for efficient selection of business options, they did not have to suffer the consequences of mistakes, they could not risk state capital or the limits within which they could do so were not clear, and so on.

In addition to these two forms there is another type of small venture in Hungary, the *small co-operative*. Small co-operatives came into being in two ways. Some split away, mainly in the beginning, from huge non-agricultural co-operatives and gained independence as autonomous units each with a membership of under 100 people. They inherited existing plants, tools and capital in the same way as small state firms did. New small co-operatives could also be formed if their membership was at least 15 persons. Most were established without or with only symbolic capital (one month's salary of members) and they continue to avoid creation of common – and therefore indivisible – co-operative capital.

The favours granted to 'socialist co-operative property' made this form very attractive. There was minimal or no necessity for investment in planning, organization, marketing, software production, etc. Many small co-operatives are in effect private partnerships which accepted the offered advantages, and the state closes its eyes to the low level of common property. It is no wonder that prospering private partnerships which had no capital to worry about were transformed by the dozen into small co-operatives. Profits were generally distributed. Members of small co-operatives earned more than those involved in other small venture forms.

Small co-operatives enjoyed the same privileges as state small firms and subsidiaries did not until 1988 when the United Entrepreneurship Law abolished the allowances for all three forms. In official statistics the three forms are listed under 'small plant forms'.[6] In 1987 there were 213 small state firms with 24,829 employees, 277 subsidiaries in small-firm form with 24,079 employees and 2,126 small cooperatives with 95,363 members.

Partnerships

Small entrepreneurial forms could also exist as four new kinds of partnership:

– *Enterprise Work Partnerships (VGMKs)*: These may be formed by at most 30 employees and pensioners of a firm. The authorization of the director is needed. The original aim of this common venture between the firm and its employees was to produce goods in short supply using excess capacity, or to provide specialized services to customers by working overtime. However, the majority of VGMKs never became ventures.

Work was done during leisure time, which did not fall under central wage regulation and thus could be paid for at a higher rate. Firms used VGMKs as an alternative way of producing their regular goods as well as improving the pay of key workers. The managements of several firms organized whole shops into VGMKs and norm overfulfilment was paid to workers at VGMK rates. This most popular form of small-scale venture meant only overtime work and, with a few exceptions, did not entail venturing into markets outside the firm. The partnership of mainly skilled workers which arouses interest in both East and West was successful primarily as a self-organizing work brigade.[7]

– *Specialized groups*: These partnerships are similar to VGMKs and may be formed in non-agricultural co-operatives. However, the important differences are that there is no membership limit and taxation is similar to that for co-operatives and not for the state sector. The majority of specialized groups work only for their cooperatives. A small number are autonomous units under the umbrella of a co-operative, with a membership of several hundred people and sizable capital – that is, they are serious ventures. They also have full-time members, sometimes several hundred of them. Often the whole small co-operative is a loose conglomeration of such specialized groups. Some groups are partnerships which obtained gestors for their activity: the gestor, who gives no more than his name, gets a fixed share of the specialized group's income. Small ventures starting with only a couple of members (for example, software groups) could develop strongly under the umbrella of gestors as a result of the many favours granted to co-operatives. Fully developed specialized groups transformed themselves into small co-operatives. Some groups are capital-intensive, large organizations from the start: six of the ten partnerships with the largest capital were specialized groups in 1987.

– *Business partnerships (GMKs)*: These are private partnerships having no more than thirty members and thirty employees. (Before 1988, the number of employees was ten.) GMKs were formed in every branch of the economy, but primarily in industry, construction and services. Their members were recruited from every walk of society: among them are unskilled and skilled workers, university professors orgaizing language schools, sportsmen establishing sports schools, administrators who have become match-makers and high-level company managers offering their specialized knowledge or business contacts.

The main characteristics of this very popular form are: low starting membership (six on the average), part-time work (70 per cent of members retain their full-time jobs and work in GMKs only in their leisure time) and paucity of fixed assets (three-quarters have no fixed assets at all). GMKs doing industrial and construction work (almost 60 per cent of the total) have polarized during the years: partnerships with considerable capital have appeared among those having fixed assets and they function in essence as small-scale ventures.

Before the United Entrepreneurship Law of 1988, the most successful GMKs transformed themselves into the more preferred, less restrictive (in terms of an employment limit) small co-operative form. Growth-orientated GMKs, for whose activities members have unlimited liability, are expected to choose the limited liability company as an organizational form in the future.

– *Civil law partnerships (PJTs)*: This form has no employment limit, can engage in trading activities and may be established by individuals. Until the enactment of the United Entrepreneurship Law it was taxed heavily and therefore not popular. During the last two to three years only retail traders set up PJTs. All in all, in 1988 there were more than 31,000 partnerships with more than 300,000 members.

Table I The number of partnerships and their members in 1987–8

Partnership	*Number*		*Members*	
	1987	*1988*	*1987*	*1988*
VGMK	19,120	15,427	241,194	178,018
Specialized group	2,336	1,416	85,123	47,800
GMK	11,186	10,889	68,047	58,397
PJT	2,200	3,161	6,875	9,152

Sources: For 1987: Gálik *et al.* (1988). For 1988: Central Statistical Office (unpublished data).

Easing of constraints on small-scale industry and the retail trade

In 1982 the crafts and retail trade were given new operational rules and growth possibilities. Several constraints on sphere of activity were lifted (private taxi cabs and common carriers appeared, and boutiques were able to stock fashionable clothes and shops to sell a wide range of consumer goods). To establish an independent source of living is now a citizen's right; the authorities can no longer withhold a licence provided professional and other preconditions are fulfilled.

Staff of craftsmen's shops were first allowed to be increased from five to fifteen; later, under the Partnership Law, the limit was raised to 500. In 1990, the Individual Enterprise Law abolished staff limits altogether. Very strict limitations affecting the retail trade were also eased gradually. Since the end of the seventies state retail outlets and restaurants have been rented out to the private sector; about 12,000 such rental contracts existed in 1988. As a result, private crafts and retail trade began to grow, even if somewhat cautiously. All in all the number of self-employed and their employees grew by 94,000 between 1981 and 1988. (Nevertheless, the total number employed in small-scale industry and retail trade – family members and apprentices included – is only half that of 1940.)

Table II Number of persons engaged in private small-scale industry and retail trade, 1981–8

	Small-scale industry			*Retail trade*		
	1981	*1988*	*Change*	*1981*	*1988*	*Change*
Full-time	68,915	90,299	+21,384	13,439	37,984	+24,545
As employees	18,224	55,921	+37,697	3,023	13,287	+10,211
Part-time	30,837	53,062	+22,225			

Source: Central Statistical Office (unpublished data).

Some 90 per cent of craftsmen and retail traders worked alone or with family aid. In 1988 only 9 per cent of small-scale industrial ventures employed one or two persons and only 2.6 per cent more than three. Of them, a few dozen ventures reached the level of small plants employing ten to 100 (Craftsmen's National Organization data). Retail traders belong in the category of one to five employees.

A host of craft-shops are operated with inexpensive tools and practically without capital. Partly because competition does not compel them to modernize and partly because of stop-go politics, small-scale industrial organizations are averse to taking risks.[8]

Table III gives an overview of how small-scale organizations operated in Hungary in 1988.

Impact of small forms on the organization of the economy

With the expansion of small-scale organizations, and thus also the number of craftsmen and retail traders, the organizational structure of the economy has changed markedly. (VGMKs and similar specialized groups are not being considered here because they are not autonomous market actors.)

Along with the nearly 50 per cent growth in the number of organizations, the whole structure in terms of scale of organization (as measured by employment) has changed (see Tables IV–VI).

That means that on the surface the scale structure of Hungarian business organizations – as measured by employment – attained that of the business sector in developed capitalist countries. However, such a mechanical comparison is deceptive. It does not take into account the unchanging position and economic role of the big organizations.

Table III Small-scale organizations in Hungary, 1988

Form of organization	*Set up since 1982*	*Existed till 1988*	*Number of units*	*Total employed*	*% Full-timers*	*Average membership*
Small plants						
'Traditional' state firms and co-ops#		×	1,823	307,413	100	169
Small state-owned firms	×		213	24,829	100	117
Subsidiaries	×		277	24,079	100	87
Small co-ops	×		2,126	95,364	100	45
SUB-TOTALS			4,439	451,685		
Partnerships						
EWP (VGMK)	×	×	19,120	241,194	0	12.6
Specialized groups (in co-ops)	×		2,336	85,123	25	36.4
CLP (PJT)	×	×	2,200	9,289+	66	4.2
BP (GMK)	×		11,186	74,795+	30	6.6
SUB-TOTALS			34,842	410,401	11	
Independents						
Small-scale industry			154,611++	215,468+	66	1.4
Small retail trade			35,099	59,087+	100	2.0
SUB-TOTALS			189,710	274,555		
TOTALS			228,991	1,136,641		

\# Those having fewer than 300 employees.
\+ Including family members.
++Including part-time licensees and pensioners in work.
Source: Central Statistical Office (unpublished data).

Table IV Number of economic units, 1982 and 1988

	1982	1988
Large state firms and co-ops#	2,859	2,574
Small state firms, small co-ops and subsidiaries+	2,156	5,398
Private partnerships, GMKs, PJTs, autonomous specialized groups	2,681 ++	9,383
Independents	90,355	128,283
Made up of: Craftsmen	(73,048)	(90,299)
Retail traders	(17,287)	(37,984)
TOTALS:	98,031	145,683

\# More than 300 employees.
\+ Fewer than 300 employees.
++ Without autonomous specialized groups.
Source: Central Statistical Office (unpublished data).

A breakdown of capital and labour employed shows that, in spite of the growing number of small units, the characteristics of an overcentralized organizational system are still evident. In the early eighties 'traditional' organizations of the state and co-operative sector employed 97 per cent of the wage-earners, of whom 0.5 per cent belonged to the smallest units (having fewer than 100 employees). Only 3 per cent of the population of active age worked in the private sector. In 1988, 88 per cent of wage-earners worked in 'traditional' organizations; a further 4 per cent worked in small-scale state and co-operative organizations. Of the total membership of small-scale state and co-operative organizations, 3 per cent belonged to the smallest units. In the private sector, full-time employees of partnerships and individuals, self-employed craftsmen, private retail traders, renters of commercial premises and their employees – some 300,000 people – made up only 8 per cent of the wage-earners in the economy.

Table V Units in the economy, 1988

Number of employees	*Firms, co-ops*	*Small firms, small co-ops, subsidiaries*	*Partner-ships+*	*Independents*
0	–	–	1,936	87,599
2–10	115	355	6,170	39,484
11–20	176	517	749	1,000
21–50	364	959	396	150
51–100	365	537	106	40
101–300	1,531	469	21	10
301–500	900	13	3	–
501–1,000	863	1	2	–
Over 1,000	797	–	–	–

\+ Total number of full-time members and employees. Without the 6,637 partnerships which have no full-time members.
Source: Central Statistical Office (unpublished data).

Table VI Economic units by number of employees, 1988

Number of employees	Number of organizations	%	Total no. of employees#	%
Over 1,000	747	0.5	2,237,840	55.7
501–1,000	866		611,858	
		1.2		24.3
301–500	916		361,816	
101–300	2,031	1.4	383,837	9.6
51–100	1,048		80,744	
21–50	1,869		57,797	
		35.4		7.8
11–20	2,442		47,160	
2–10	46,124		125,435	
Independents	89,535	61.5	102,729	2.6
TOTALS	145,638	100.0	4,009,216	100.0

\# Full-timers only (independents, members, wage-earners and family members).
Source: Central Statistical Office (unpublished data).

The shift, though perceptible, is not significant. The preponderance of large firms and co-operatives remains: the proportion of traditional organizations employing more than 1,000 people was 19 per cent in 1982 and they employed 64 per cent of the wage-earners. In 1988 this proportion was 16 per cent and they employed 56 per cent of the wage-earners.

In addition, the big firms own the productive assets.[9] Data on the productive assets of independents are unavailable, but of the total assets of the other forms mentioned here 98.8 per cent were owned by 'traditional' organizations in 1985; the bulk of these assets belonged to the biggest firms (Gálik *et al.*, 1986). In 1987 98 per cent of total assets were still with traditional firms. This shows that, although the size structure changed, *the propagation of small organizations did not alter the position, dominant role and property forms of the big ones. Despite some changes, the organizational system created under the planned economy has remained almost intact up to the present.*

Thus a peculiar dual organizational system has emerged: on one hand there are overweight, inflexible, difficult-to-change large organizations; on the other there are small ones increasing rapidly but, however important, barely perceivable agents in the economy. The two spheres hardly touch one another. The big firms pursue autarchy, and either do not need the activity of the small ones or do so only if they have no free capacity. There is no system of subcontracting or other co-operation between satellite firms and big ones. The market of the smallest organizations is very small and concentrates only on the local environment. They do not reach even larger regional markets, let alone national and international ones. Regional markets, where they have emerged, are dominated by large organizations whose local units are denied the possibility of autonomous economic action. Since no strong and durable relationship can arise between big firms and those in the local market, the production and services of the latter are used in a haphazard way.

Several decades of experience in the developed industrial countries shows that the role of small units today is much more than to simply provide for and serve the population of an area and participate in the production of larger firms. Today the activities and products of the future are invented all over the world in a host of small units; in their workshops are shaped the many technical novelties of tomorrow and in their small markets the new structures of supply and demand – and with that the new social relations of small, local communities.

Small organizations constitute a growing market for the population and for each other. This, combined with their growth in numbers, is a healthy phenomenon. However, small units can develop only with the co-operation of medium-sized and large ones, and only if the dual market is replaced by a rational division of labour between organically linked organizations.

The modest economic role of small organizations is caused not only by the survival of large-firm dominance, but also by their own characteristics. As stated previously, the majority of small organizations in Hungary are not independent ventures in the Western European sense. They differ from their counterparts in developed industrial countries in three important ways:

- Small organizations in *state ownership*, like the large ones, cannot go into ventures because of government regulations and the whole system of restrictive management. All their employees work for wages.
- A host of *private* small organizations are based on work done during the leisure time of their members who retain their official jobs in the state and co-operative sector. Thus the financial security of the members does not come from their work in the small organizations. Of the 605,000 self-employed and employees of private and partnership ventures in 1988, 309,000 (51 per cent) worked in the small organizations only in their leisure time in order to earn surplus income.
- The majority of *individual and common property* private firms (and also newly founded small co-operatives) are pursuing activities which require little or no capital investment. Working for the firm and with the firm's equipment, members of a VGMK or specialized cooperative group have no need for their own tools. A host of GMKs were formed for activities needing no capital. PJTs accumulate within modest limits (for example, shop furniture) which, however, exceeds by far the average accumulation of other small organizations. Even craftsmen and retail traders, who base their living on their venture activity, invest the least possible amount of capital because the competition is insufficient to force them to incur modernization costs.

Investment in small ventures is growing at a lower rate than that of efficiency indicators: output and net income are growing twice as fast as capital. Small co-operatives formed in 1987 had an investment level even lower than that of those already in business: 76 per cent of GMKs had no capital assets in 1987. Partnerships with capital assets invested only 2 per cent of their value added in 1987 (Gálik et al., 1988).

The next section discusses the characteristics of Hungarian small organizations in more detail.

Types of small organizations

The many small organizations in Hungary can be arranged into three main types corresponding with their economic roles.[10]

Organizations using only surplus labour

The shortage of labour and unfulfilled demand for goods over several decades made double employment widespread in Hungary. Those working in agriculture were the first to get legal authorization (illegal moonlighting already existed) to produce in their gardens and household plots more than needed by their families. According to the Central Statistical Office some 1.5 million households covering all social strata have household and auxiliary plots. The 4.5 million members of these households (almost half the total population of 10 million) expended 2.7 billion work-hours on farming at the beginning of this decade. This is more than the total work capacity of 1.2 million people (CSO, 1984).

Qualified journeymen obtained licences to work in leisure time from 1968 owing to the serious shortage of services. This proved to be an attractive offer: in 1970 craftsmen did 15 per cent of their work on a part-time basis; in 1975, 25 per cent; in 1980, 31 per cent; and in 1985, 40 per cent. In the seventies firms were allowed to contract with their labour force for extra work, thus effectively raising wages above the official rates. The already illegal off-hours work was in this way made an attractive legal option for new social strata.

The small ventures in which people work only in their leisure time display the following characteristics:

- The aim of the members is to earn extra income, to imitate the consumption patterns of their reference-groups.
- The scale of operation is determined by the work potential of members; reaction to changes in market demand depends on the specialization and capacity of the members.
- No capital is invested: the activity does not need capital and such investment would conflict with the aim of earning extra income quickly.
- Thus profit is earned by selling individual work capacity.
- Income is consumed, it shows up in the market as consumer demand.

The sale of surplus work capacity means many small individual markets, supply-demand relations up to the level of personal capacity. These small markets are useful because in most cases they fulfil real, existing demand. Some unfulfilled demand of this type will always exist and will need to be met in this way.

However, if organizations prefer to carry out all their work only with surplus labour, do not react to the call of the market and do not venture into growth and accumulation, the economy will miss out on important economic possibilities.

Small producers

This type exists all over the world and forms the basis of capitalist economies. In Hungary, small-scale production is limited outside agriculture. The main characteristics of small producers are:

- They aim to secure for their families a standard of living commensurate with that of reference-groups.
- Their economic role is to fulfil demand in a definite sphere of activity, employing the necessary labour and capital; they react to changes in demand, their supply growing continuously so as not to endanger their standard of living. The organization is oriented towards stability rather than growth and tries to create and preserve a clientele necessary for survival.
- Capital (equipment, machinery, shops) is invested in the minimal quantities necessary to win and retain a stable market position; further capital investment is enforced only by competitors.
- The role of labour is decisive; capital is validated only as a supplement to labour.
- Most of the income shows up in the market as consumer demand; the smallest proportion is recycled in the form of capital investment.

Small-scale producers earn their living autonomously. Their capital investment consists in many cases of some simple tools or equipment. However, in the majority of trades requiring professional skills, the activity postulates the existence of an independent workshop, special machines or equipment, or, occasionally, significant capital investment. There is insufficient competition to act as an incentive towards modernization.

The role of labour is decisive in earning income ('labour' in this case also means the time spent on stand-by, that is, keeping the shop open or ensuring 24-hour availability to potential customers). Some part of the work is undertaken by family members. The shop or workshop of the small producer is often a family work organization.

Entrepreneurial organizations

According to Weber (1967, 1979) and Schumpeter (1928, 1980) such organizations have the following characteristics:

- Their goal is to obtain profit, and capital investment is channelled towards this end, being reduced or increased as necessary.
- Their economic role is to fulfil demand in profitable areas and they are limited only by their capacity to do so; they react sensitively to changes in demand, seeking not stability but development of emerging possibilities. They invest as much as possible under given profitability-risk conditions; they are ready to mobilize their own resources as well as foreign capital for the rapid, dynamic expansion of supply.
- The role of capital is preponderant in earning income; intellectual, physical, organizational and other forms of labour serve only to make capital profitable.
- A preponderant part of the organization's income is recycled into the economy: it serves to extend profitable activities and start new ones. Personal consumption remains on the level of the reference-groups but does not rise steeply even if profit grows rapidly.

Thus the active participation of capital is indispensable in this form of enterprise. Investment is fundamental to it. The enterprise strives to preserve its flexibility and is ready to adjust to demand even if it is necessary to borrow more capital in order to do so.

For a long time the system in Hungary punished growth-oriented enterprises instead of encouraging them. As a result, only 100–200 craftsmen, GMKs, PJTs, small co-operatives and specialized teams are functioning as entrepreneurial ventures. This compares with several hundred thousand people selling their surplus labour and 100,000 small producers. It is thus easy to understand why, although some 870–900 thousand people were employed in 168 thousand small ventures (30 per cent of extra-agricultural employment) in 1988, the supply of goods and services hardly changed. Large and small organizations (excluding the crafts and retail trade for which data are unavailable) produced Ft851 billion value added in 1987, a Ft91 billion increase over the previous year. Of this increase, small-scale units contributed Ft16 billion and partnerships a mere Ft0.6 billion (Gálik *et al.*, 1988).

The hoped-for capital investments have not come about. Money accumulated by certain sections of the population could not be absorbed by small ventures.[11]

Although small entrepreneurial forms have not lived up to expectations they have become a transforming force for both the economy and society, and active participants in a historic turn-around. Their very existence proves that there are possibilities for breakthrough even in an economy dominated by large organizations. Tens of thousands of people are no longer employees and are instead building up their own markets and learning management and entrepreneurship. Their example shows the way to hundreds of thousands more, beginning with those who have retained their jobs in the state and co-operative sector and are taking part in small organizations only in their leisure time.

Prospects for the 1990s: an assessment

As was mentioned earlier, the new Hungarian laws have significantly altered the organization of the economy. It is hoped that with other social and political changes, they will transform the distinctions between small organizations and spread the spirit of entrepreneurship throughout the economy.

VGMKs were disbanded in 1989 but those that go into ventures with their firms, producing goods and services for the outside market, may be re-established. Venture- and growth-oriented small co-operatives and specialized groups will probably turn into true private partnership forms (co-operatives are already called 'common property of private persons'). The PJT will cease to exist as a form but the number of small private and mixed firms will grow rapidly. There are three ways of setting them up: as *new* autonomous ventures initiated by private persons, through *decentralization* of existing large state and co-operative sector organizations, and by founding partnerships for the *extension and transformation* of the activity of existing organizations with the participation of state and private (foreign) capital. This last form is not dealt with in this paper.

The processes unfolding from the early eighties favour new, privately initiated small firms. The majority of those set up have taken root in the economy and relatively few have been discontinued. Sixty-one out of 2126 small co-operatives were discontinued in 1987; for GMKs the proportions are 10 per cent in 1986 and 15 per cent in 1987 (Gálik *et al*, 1988:91). Liquidation does not necessarily mean bankruptcy; on the contrary, in the case of GMKs it means the choice of the much more advantageous small co-operative form. The absolute number of such small firms continues to rise.

The rate of turnover is high among craftsmen and in the retail trade. Among the former, entries and exits amount to 30 per cent of the total, in the latter 47 per cent. In small organizations of the private sector, the share of full-timers has grown steadily if modestly: between 1981 and 1988 some 67,000 people became independent and the number of employees in these organizations grew correspondingly (Kovács, 1989).

However modest these numbers are, they do indicate growth. The background of the independents also provides the basis for a healthy future: most come from the best-educated sections of society. A survey on social stratification of independent entrepreneurs, conducted together with the Central Statistical Office, is at present in the processing phase. Based on a 10 per cent sample, it found that 20 per cent of those interviewed were graduates, 45 per cent had high school education and a qualification, 26 per cent were skilled workers and only 9 per cent had no more than basic education. The majority had some experience in their chosen trade: 55 per cent thought that their previous occupation had led to their choice of enterprise (Laky *et al*, forthcoming).

This means that enterprise attracted people whose talent and broader views would be useful in weighing the drawbacks and advantages of projects, acknowledging the consequences of decisions, making accurate business calculations and adapting more efficiently to supply and demand changes.

Waiting in the wings to join those already in the private sector are tens of thousands of potential entrepreneurs: the 52,000 part-time GMK members and 53,000 part-time craftsmen. If sufficient incentives are provided or if the normal full-time work is endangered, some of these may become independent. Shortages of labour are the rule in Hungary today: there are 74,000 unfilled jobs. However, open unemployment is also present: in mid-1989 there were 19–20 thousand people seeking jobs, of whom 3000 were on the unemployment benefit list. That explains why the majority of those working privately only in their spare time try to keep their official jobs: the secure income supplemented by earnings from the venture is much more appealing than income dependent totally on supply and demand, personal adaptability and luck. It is not only lack of confidence which stops people from being enterprising; an equally serious problem is that whole generations are no longer accustomed to shaping their lives autonomously.

Small entrepreneurs now need a modification of the Unified Entrepreneurship Law. Although this very progressive law did away with the privileges of state and co-operative firms and gave equal rights and responsibilities to the private sector, it does not differentiate by size. However, small firms cannot bear the same burdens as large ones and they also need help with taxation. Therefore the interest groups of small organizations are fighting for the law to be modified.

Small firms are necessary for a healthy economy and they can be operated efficiently only as private ventures. But as the experiences of the eighties attest, their increase in number cannot be expected in itself to bring about a decisive change. Many changes are needed in property relations, management of the economy and the organizational system. The most important step would be to decentralize the large firms and to separate the units from them so that they could appear as independent actors in the market.

It is not enough to simulate private property as was done in the case of household plots in agriculture and the different leasing and rental forms of trade and services. (Behind these solutions there were always the interests of the large organization, reinforced by the ideological dogma of preserving the wealth of the state and co-operative sector.) For a truly efficient economy, proprietary interest which calculates the chances of success and decides on that basis to expand or restrict activity is essential.

From an organizational point of view the division of artificially created large organizations into smaller units would reinstitute the original conditions: the

1000 or so Hungarian industrial firms have some 10,000 plants most of which were autonomous small or medium-sized firms before nationalization.[12]

Hidden small-scale organizational networks also exist in other branches of the economy, under the umbrella of large firms and co-operatives created in accordance with the exigencies of central management. Some experts suggest that the government should decentralize large organizations and sell the parts to proprietors directly interested in the profitable use of capital.[13] Individuals or partnerships would be the natural choices for such ownership.

The government also needs to liquidate the large domestic trade companies sometimes operating several hundred shops, and to sell or rent the shops to retail traders. Government subsidies should be withdrawn from loss-making large firms, thereby encouraging them to break up their monoliths. The most probable solution is the breaking down of large organizations to the level of the smallest possible operational units (the workshop, for example) and their sale or leasing to the collective of employees.[14] Liquidation of small government firms and giving of autonomy to workers are also envisaged.

However, many interests oppose such changes. A substantial part of the administrative apparatus is afraid of redundancies, and managers of state firms and company councils endowed with property rights are reluctant to give up their control: to them even unprofitable units are valuable because they represent workplaces, structures, land and means of production. The deteriorating economic situation and inflation increase their value in comparison with cash.

Only firms in very serious condition have parted with bits of their edifices up to now, and then mainly with non-productive nurseries, workmen's hostels, etc. Productive capital has been sold only in the context of bankruptcy procedures. Some large firms are now decentralizing on their own, but in a way that will maintain the firm's capital. (One of the main forms of quasi-decentralization is to establish a joint stock company. Formally autonomous units buy one another's shares, and the capital-managing unit formed from the previous corporate headquarters has control over almost the whole capital. Another way is to form a limited company which is already a 'natural proprietor', with part of the capital.)

While bureaucrats try to preserve their empires, many employees do not want to become proprietors. In some firms facing staff reductions because of serious economic problems, employees, trade unions and local councils demand paternalistic aid from the state: they want the state to give them job security as it has done in the past.

Piore and Sabel (1984) gave an excellent analysis of what leads to the emergence of large industrial organization, and later flexible specialization and with it the mass appearance of small organizations, in developed industrial countries. In Hungary, other paths will hopefully lead in that direction.

and the International Centre for Public Enterprises, Ljubljana. The group, with the cooperation of other economists, consultants and politicians, is implementing the project at commune level in different parts of Yugoslavia.

Laky

1. Kornai (1983) gives an analysis of market-versus-bureaucratic co-ordination.
2. According to the much-cited scheme of Tardos (1972) the highest level of the three-tier hierarchy is the power centre which decides on targets and distributes resources. On the middle level there are organs with nationwide authority (for example, ministries) which are responsible for a specific function and which forward tasks and means to lower levels. The lowest level of the hierarchy is constituted of the places where the tasks are to be carried out: firms in the economy, schools in the education sector, hospitals in the health sector, etc.
3. In industry, for example, 4075 plants were operating in 1938; in 1950 there were only 1632 (Petö-Szakács, 1985: 114).
4. Before World War II there were almost as many craftsmen as factory workers. In the forties there were almost 150,000 independent craftsmen employing 283,000 people, and craft-shops accounted for almost one-fourth of the industrial production (Szalay, 1943a). By 1953 the number of craftsmen had dropped to 47,000, of whom 110,000 were working in the 1,600 craftsmen's co-operatives (Kovács, 1989).

   Before World War II retail trade was mostly made up of family ventures. The 110,000 retail trade outlets employed 189,000 people (Szalay, 1943b). In 1956 independents operated 9700 shops and 340 restaurants; the others had been merged into the networks of the 270 large state and 1300 co-operative firms.
5. However, that would have led to another problem: employees find it advantageous to work for a state firm, whose machines and material can be used for illegal – and therefore tax-free – private work obtained through the firm and which pays social security contributions for them; as a result, independence holds no attraction.
6. That is, in the statistical elaboration prepared by the Ministry of Finance, based on firm-level balance sheets and tax statements. See Gálik *et al.* (1986), 1987, 1988).
7. Its main interest to foreigners lies in its self-organization, with a natural and instinctive reliance on job enlargement and job enrichment, the selection of members and a considerable overfulfilment of official worktime performances (Neumann, 1986, 1987, 1988; Stark, 1989; Dallago, 1988).
8. The abolition of small units is presented in Aslund's extremely well-documented book (1985). The procedure in Hungary was the same as in the GDR and Poland. Gyula Tellér has written excellent studies of Hungarian small-scale industry being forced into co-operatives (1972, 1989).
9. Data for this date back only to 1986.
10. They are dealt with briefly here. For a detailed treatment see Laky (1987).
11. Those who could invested money in hard currency, valuable goods and real estate. In the past fifteen years 110,000 holiday homes have been built in Hungary.
12. At the beginning of the eighties a study dealing with the internal structure of industry investigated the size and role in production of 2000 industrial plants. It found that 43 per cent employed fewer than 100 people, 16.5 per cent fewer

than twenty people. Activity outside the main profile was important; according to the author's calculations 56 per cent of industrial workers are engaged in extra-profile activities (Bagó, 1984).

13. An important alternative is to transform large organizations into joint stock companies, create a stock and capital market, etc., but those problems will not be dealt with here. Various ideas on ownership (people's shares, employees' shares, etc.) will also not be considered.
14. According to the Industry Minister: 'Industrial management is considering the rechannelling of certain production units of bankrupt large firms – forges, cutting-shops – their equipment and capacities, into small-scale industry through favourable credits and share in capital' (Népszabadság, 13 August, 1989).