

Ms/28-hoz

The European Commission is preparing an overview on activities in support of small and medium size enterprises of a number of countries.

They have asked that the reports on individual countries follow the attached outline. (Section 5 of the outline refers to be filled out on the basis of an expert opinion of the countries.)

The present paper includes the report on Hungary. The main aim in preparing it has been to help the foreign reader understand the individual features of Hungary in this report.

Budapest 12 August SMEs in Hungary

Facts and Concepts for the European Council's Project:
"The Promotion of Small and Medium Enterprises in Europe"

Made by Teréz Laký

Budapest

1992

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Budapest 12 August 1992

Laky, Teréz

THE PROMOTION OF SMALL AND MEDIUM ENTERPRISES IN EUROPE

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REFERENCES

APPENDIX

SOME BASIC DATA

1. Number of legal-entity business units

	1989	1990	1991
Companies legal-entity business associations	2.399	2.363	2.233
	5.224	19.401	4.691 42697
out of this:			
-associations	105	201	231
-common firms	327	237	188
-limited liability companies	4.485	18.317	41.206
-share holding companies	307	646	1.072
cooperatives	7.546	7.641	7.245
out of this:			
-agricultural small coop's	1.333 3.233	1.348. 3.155	1.421 *n.i.

* no information

source: CSO monthly issues

1.1 Number of business units between 1988 and 1992
(investigated at year end)

	1988	1989	1990	1991	1992 March
Companies and coop's	9,792	9,946	10,004	9,997	9,889
Legal-entity business units	919	5,191	19,401	42,697	48,999
Legal-entity organi- sations total*	10,711	15,137	29,405	52,694	58,888
Business units not counting as legal entities	29,657	24,143	34,095	52,136	n.i.
Private entre- preneurs	290,877	320,619	393,450	500,000	532,984
Budgetary, social security and other institutions	28,500	31,200	38,300	43,000	-

* not counting 'sundry' legal-entity business organisations
Source: CSO

2. A breakdown of legal entity business units into headcount
categories

	less than 21	21-50	51-300	over 300	total
1989	5,150	2,387	3,459	2,617	13,585
1990	16,465	4,129	4,469	2,599	27,662
1991	36,809	6,169	5,362	2,396	50,746

source: CSO Monthly issues

3. Employment data

Activity of the population as of 1 January 1991
(thousand individuals)

<u>Labour resources:</u>	6,432.0		
- people in working age	5,007.4		
- other active earners (below 14 and over 60, females over 55)	101.6		
- pensioners employed after working age	333.0		
		1992	
		Jan	May
<u>Economically active population</u>	5,400.2	4,738.5	
- active earners	4,778.0	3,850.6	
- those on child care leave	247.4	259.8	
- pensioners in employment	383.6	222.0	
total employees:	5,299.7	4,332.4	
unemployed	100.5	406.1	522.7
Activity rate (%)	84.0	76.3	
Unemployment rate (%)	1.9	8.5	9.7

source: Statement of Labour, 1 January 1991
Central Statistics Office 1991

4. DATA ON JOINT VENTURES4.1 Number of enterprises with foreign participation
1989-1991; end of period

	entirely foreign owned	foreign majority	Hungarian majority	total
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No of enterprises

1989	25	155	1,170	1,350
1990	231	639	4,823	5,693
1991*	1,499	1,578	8,258	11,335

Equity MHUF

1989	415	9,929	114,035	124,379
1990	5,468	45,600	223,080	274,149
1991*	16,663	71,016	325,221	412,901

amount of equity
per enterprise MHUF

1989	15,4	73,5	96,0	92,1
1990	23,7	71,4	46,3	48,2
1991	11,1	45,0	39,4	36,4

* sum of 1990 year end data and
company foundations in 1991

4.2 Breakdown of legal entity enterprises founded in 1991 with foreign
participation acc. to amount of equity

	only foreign founded enterprises		for. and Hun. founded enterpr.		total equity	
	No of enterp.	equity MHUF	No of enterp.	equity MHUF	No of enterp.	MHUF
0 - 1	907	906.1	2,714	2,706.4	3,621	3,612.5
1.1-10	277	953.2	1,234	3,874.3	1,511	4,827.5
10.1-50	56	1,201.3	221	5,615.5	277	6,816.8
50.1-100	13	758.9	88	6,094.1	101	6,853.0
100.1-	15	7,375.7	117	109,266.1	132	116,641.8
total	1,268	11,195.2	4,374	127,556.4	5,642	138,751.6

source: The organisational structure of the national economy
Budapest, April 1992 CSO pp.15-16

A FEW BASIC NOTIONS

Legal entity business units

1. Firms

Generally the property of the State, but can be that of the local authority, or that of cooperatives. State owned firms need to transform themselves into companies, mainly in order that they can be privatised.

2. Business associations

Limited Liability Company [KFT]

Share Holding Company (Joint Stock Company)

Association } (Established by State owned companies
and cooperatives for joint business; they
are owned by the founding State company
and the cooperative)
common firm }

3. Cooperative

Cooperatives (in agriculture, industry and services)

Small cooperatives

(Allowed to establish from 1982, first by splitting off units smaller than 100 employees from traditional coop's; later allowed to private individuals to establish them with a workforce of min. 15 and max. 100 with an equity sufficient to finance one year of operation. The upper limit for workforce was later eliminated.)

Non-legal entity business units

1. Private enterprises

- small-scale industry
- small-scale trade
- agricultural enterprises (farmers)
- other entrepreneurs

2. Partnerships

- Business Partnership [GMK]

- possible to establish from 1982, with the partners' minimum number of 2, for industrial activity and services, but not for trade.

Business partnerships were the first privately established partnerships from 1982, even if only a quarter of the members eventually became full time employees. Most worked in them in their free time, keeping their full time jobs. It is popular even today, because - unlike in limited liability companies - their foundation is not a condition of a specified minimum amount of equity.

- Common Partnership [KT] 'közkereseti társaság'

They were first set up in 1989 and are rare. Legal and/or natural entities may establish them for joint business activity.

- Limited Partnership [BT] 'betéti társaság'

They have been in existence since 1989; their rules are similar to those of Common partnerships. If it only has natural entities as members, then its operation is based on guidelines for Business Partnerships.

A FEW FACTS FOR PROPER INTERPRETATION

Up to the change of the regime in 1990, all of the productive assets of the economy (banks, mines, companies with their buildings, their machinery, and all their equipment) were any of three types of property:

a., State ownership

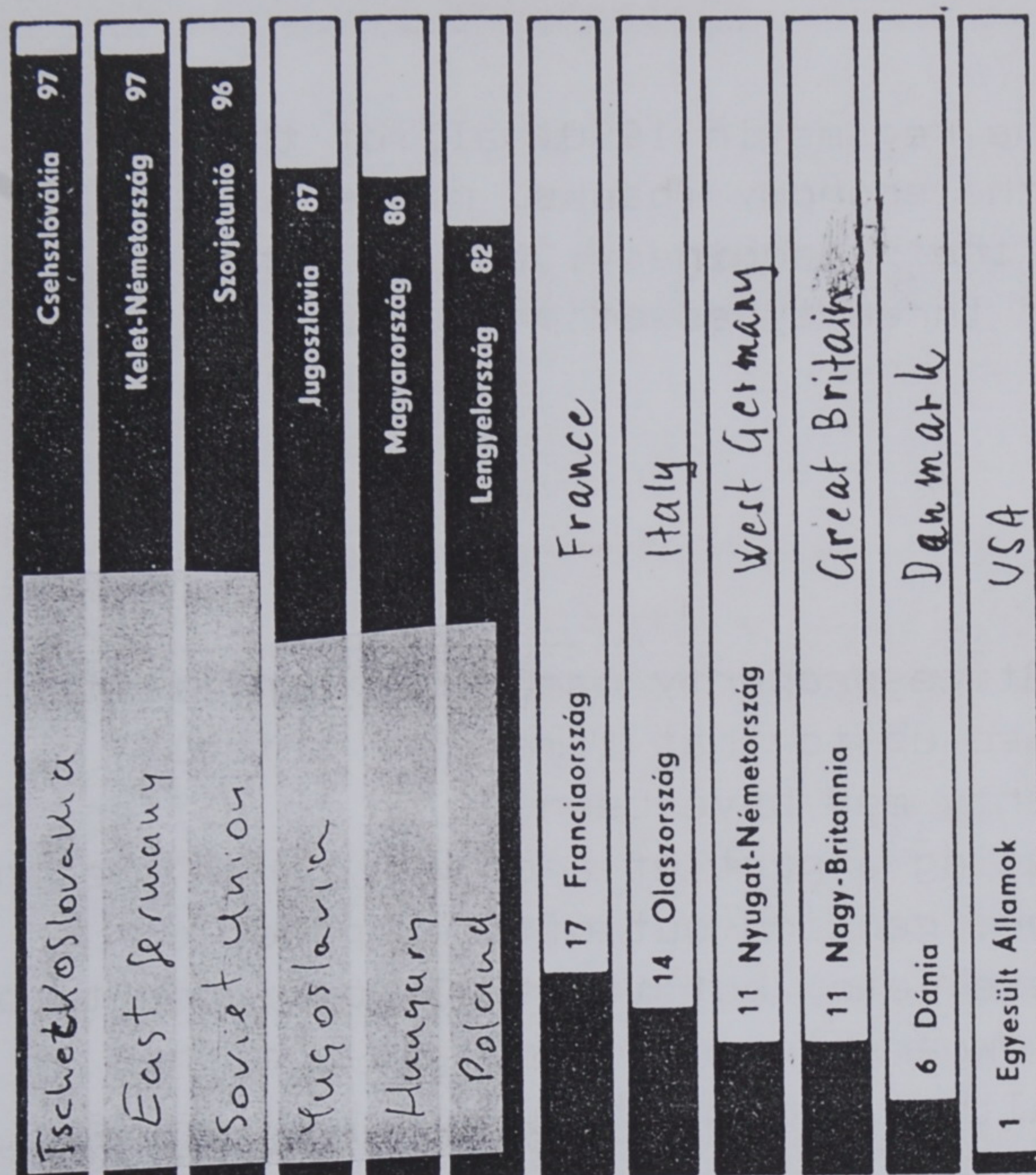
The majority of State property came from confiscated property privately owned up to that time. The actual segments of this property may have been given to different users, (such as separating a part of a company from one and attaching it to another, renting out office space, or restaurants for business, etc) but it still continued to be State property. State ownership dominated all branches of industry except agriculture. (Even though part of large pieces of land up to then owned by feudal lords also became State property.)

For comparison we list below the proportion of the State sector in national economies of a few developed countries:

France: 17%, Italy: 14%, West Germany and Great Britain: 11% each, Danemark: 6%, United States: 1%
(The Economist, 21 Sept. 1991 Survey p. 10)

The share of the State sector in the mid 80's

AZ ÁLLAMI SZÉKTOR RÉSZARÁNYA AZ 1980-AS ÉVEK KÖZEPÉN



b., Cooperative ownership

Another way of eliminating private property was to merge private production facilities into cooperatives. Such cooperatives were chiefly created out of agricultural property. (e.g. land, equipment livestock), but the same destiny became the share of small production units, workshops, that could not possibly be classed with large industries, same for a part of retail trade (the majority of this was turned into State owned trading companies), as well as all sorts of services, e.g. hairdressers' shops, even if there were quite a number of State owned hairdresser's shops, too.

Hungarian cooperatives differed primarily from West-European ones in that the former the members' rights were in many ways limited (the regional ones' and the national boards of cooperatives' were not, while the members really became employees, and similar wage controls applied to them

as to those in the State sector). The economic autonomy of cooperatives was restricted by central rule same as that of companies of the State sector.

c., The private sector

Up to the beginning of the 80s, only such operations were allowed to be privately owned as were for some reason not needed by either the State or the cooperative sector.

Up until 1982, the private sector suffered from strong limitations, such as taxes and staffing limits. A privately run workshop was not allowed to employ more than 3 people including the owner. Up to 1986 there was a special tax on having employees.

Staffing restrictions were lifted gradually later through the decade. From 1988 private enterprises were allowed to employ up to 500 staff. However, the average staffing level for private enterprises in 1988 was 1,3.

Staffing limits were completely eliminated in 1990.

Up to 1982 there were two areas belonging to the private sector:

- in agriculture, a 0,5-1 hectare strip of so called household plot was allocated to coop members, with the aim that it help them provide their own households with food. Later on some started to market most of the produce they harvested from these bits of land. Other than that there were a fairly small number of private small farms.

- outside agriculture there were the small manufacturers, small service enterprises, and retail shops. The above businesses mostly involved the entrepreneur and his/her family members due to the restrictions hitting this type of activity.

From 1982 onward, various forms of partnerships have been allowed in the private sector. (Business partnerships [GMK], [PJT]-partnerships 'polgàrjogi tàrsasàg', so called 'specialised groups' in construction and service enterprises, and 'company-housed- /work business partnerships' [VGМК], etc..)

Their main features included: for a large part of the members the activity was a part time job done in their free time, besides which they continued their full time job in either the State or in the cooperative sector. 'Company-housed-/work partnerships [VGМК] for instance, were only allowed to consist of the company's full time employees or, in theory, of its pensioners, and members did nearly exclusively surplus work for the company.

The size of partnerships was restricted depending on its type. Such restrictions were first alleviated, and later lifted. In 1990 several types of partnerships were disallowed, such as VGМК's, 'specialised groups', Civil law partnerships [PJT], to give way to more modern types of partnerships (e.g. limited companies [Kft]).

The size of partnerships averaged 3,3 in 1988, with a proportion of full time members of 40%.

We have no reliable data on their productive capital. The relative size of the three ownership types can only be illustrated by laying their staffing levels alongside each other:

A breakdown of ownership types [sectors] according to number of staff (%)

	1981	1985	1990
State sector	71	70	} 89
cooperatives	25,5	25	
private sector	3,5	5	11

Our estimate is that, in the middle of 1992, around 30% of the active population would work in the private sector, including foreign owned companies, foreign majority ownership companies, and those small cooperatives that have, from the beginning, operated as private partnerships. However, as we have said above, there is no information available on categories of ownership, or on those of size.

1. The role of SME's

1.1 Definition

There is no accepted definition to either small or medium size enterprises today in Hungary.

Up to 1988 there were small businesses in each legal form of ownership.

In the State sector, smaller enterprises were established through splitting off units of major country-wide companies in a process of decentralisation from 1982 onward, or through first becoming subsidiaries of large companies, then becoming quasi-autonomous and also smaller.

The proportion of State sector companies with a staff of below 100 was 23% in 1988. The average size was 44,2 staff.

In the cooperative sector the so-called 'small cooperatives' have been allowed since 1982. Part of them split off large cooperatives and inherited all conditions and circumstances of the large coops' operation. Others were founded cooperatives by private individuals - chiefly in the second part of the decade - as a result of the favourable taxing and other conditions introduced for this type of business formation. A significant number of them operate in the area of intellectual services such as software design.

Cooperatives with less than 100 staff were 53% of the total in the cooperative sector in 1988, their staff averaging 38,8. A significant part of the workforce only worked in small cooperatives in their freetime on a part time basis keeping their main jobs in the State sector. We have no data, however, on the proportion of full and part time employments.

In the private sector, though the restrictions on size were gradually relieved, all enterprises either already operating at the beginning of the decade, or established afterwards were by necessity small. (In Hungary the word small enterprise is in fact a synonym of private enterprise even today.)

Although there have been medium and large enterprises in the private sector since 1990, we hold no information on them due to the lack of statistical investigations.

Up to 1989 there was a variety of statistical investigations carried out on ownership conditions and size of enterprises. The differentiation of form of ownership, however, was abandoned with reference made to 'sector neutrality'. This is why it is impossible even today to have access to processed information on either the changes in the privatisation process or the natural pace of growth of the private sector.

In practice, however, data collection on small and medium size enterprises is currently done in either of two ways:

a., Statistical data collection based on number of staff.

Statistics uses the following categories of size:

10, 11-20, 21-50, 51-100, 101-300, 301-500 501-1000
etc..

Up to now it has been customary to regard anything below 50-100 staff a small enterprise, those between 101 and 300 a medium one, and one over 301 staff a large enterprise.

Besides this, since we have hardly any information on the self-employed or the companies smaller than 10 staff, present statistics only provide data on legal entity businesses with workforces over 50, even these strongly concentrating on total staffing levels and headcount categories.

b., The taxation system uses a different way of processing statistical information.

It differentiates:

-those only paying personal income tax. In 1990, 95% of private entrepreneurs, all non-legal-entity small craftsmen, small retailers, private farmers, and a significant part of those working in a non-legal-entity enterprise belonged here and

-those paying corporate income tax (all legal-entity-enterprises - State, cooperative, or private)

This recognizes two further categories:

- those having to do simplified book-keeping, i.e. those, whose yearly turnover does not exceed HUF 50 million, and

- those having to do double entry book-keeping i.e. over HUF 50 million yearly turnover, and all legal-entity enterprises regardless of the size of the turnover

Tax statistics have not so far referred to data on staffing levels.

Tax statistics are not even supposed to rely on the differentiation between small or medium size enterprises.

c., In the draft of the act now under preparation, the Small Business Administration [OKFI] will propose to specify 60 as the maximum staff for small enterprises as definition. (This number was given in an answer in a questionnaire.) The draft will be proposed for discussion in the near future. The different practice used in the statistical system is expected to be the major objection; so far statistics has never used the category of 60, which would make the data presently stored impossible to use in comparisons. Another expected argument is that categories in staffing levels differentiated according to economic branches would be desirable. Further than that, when restructuring the statistical system, the introduction of the European nomenclature would be required.

1.2 Numbers of share of SME in output and employment

As pointed out in 1.1 above, there are two types of statistics currently available on enterprises:

- that of the Tax Office, and
- that of the CSO.

1.) Both are very uncertain, and for several reasons:

- in the statistics of the Tax Office (APEH) only such people will appear as submit a tax statement;
- CSO statistics generally cover legal entity organisations that employ more than 50 people, and are registered at the CSO (and have a CSO code); those smaller than that or not being a legal entity put outside the scope of investigation in 1989.

The differences between the two types of statistics are significant. on 31 December 1991 the number of legal-entity organisations registered by the CSO was:

52.694 (CSO Monthly Issues, 1992 2-3 p.65)

Those registered by the tax office:

55.057 (Figyelô, 16 April 1992)

The difference between the two data is 2.363, which means that more people submitted a tax statement than are registered at the Statistics Office.

The differences are likewise large in non-legal-entity organisations. On 31 December 1991, non-legal-entity - business associations numbered

40.436 according to the Tax Office [APEH]
(Figyelô, 16 April 1992), and
52.136 according to the CSO (CSO, Figyelô 4 June
1992)

- Private entrepreneurs numbered:
 - 436.882 according to the Tax Office (Figyelô, 16 April 1992) -
 - 500.000 according to the CSO (Figyelô, 4 June 1992)

By the end of March 1992 CSO data suggested that the number of private entrepreneurs exceeded 532.000.

One reason for the difference are the different registration systems; another is the different extent to which statistics endeavour to be thorough, which groups they include, which ones they leave out. This latter does not always come through the data published by the Tax Office. This is why we tend to use the CSO's statistics.

2.) As a result of the above, all distributions and breakdowns will depend on which database we use; on the other hand, many conclusions rely on estimates, chiefly as regards their contribution to the GDP.

According to CSO computations, production units' contribution to the gross domestic production looks as follows:

Number and economic weight of production units

	No of prod. units at year end		Contribution of major groups to GDP in 1990 (%)	Average contrib of one prod.unit HUF 1.000 1990 ^a
	1990	1991		
Companies and cooperatives	10,004	9,997	56.0	124,400
legal-entity business assoc.	19,401	42,697	13.2	11,900
Non-legal-entity business org'stns	34,095	52,136	1.9	1,500
Private entre preneurs	393,450	500,000	6.9	500
Household business activity of population	2,000,000 ^b	2,000,000 ^b	6.4	60
Budgetary, social security and other organisations	38,300	43,400	15.6	17,700

^a Average added values is not data base information, but refer to business organisations that submit a tax statement; they are rounded figures

^b Estimated data, intended to reflect about 2/3 of all households, where there is either a small agricultural operation/household plot or where pay-guests are received, or ones that are used for the family business

Source: CSO Figyelô, 4 June 1992

It is worthwhile noting at this point, that as regards publication data, one should be careful with the CSO. They estimated

already in 1988, that "Small enterprises' contribution to GDP was around HUF 133 billion in 1988, equal to nearly 11% of the total GDP." /Actors of the marketplace in the Hungarian economy, 1982-1989 (The role and development of small enterprises) CSO 1989 p.9/ As the previous table suggests, non-legal-entity organisations have only 1,9, private entrepreneurs 6,9%.

3.) We have only fragmentary data available, out of CSO's previously mentioned restricted data base on only legal-entity businesses.

This source suggests the following:

Number of legal-entity business organisations
in a breakdown of staffing levels - 31 December 1991

	less than 20	21-50	51-300	over 301
Companies	112	185	769	1.133
business assoc's	34.976	4.758	2.380	517
out of this:				
shareholding				
company	282	175	322	292
Limited C.	34.487	4.498	1.968	203
Cooperatives	1.235	1.185	2.156	746
out of this:				
small coop's	990	967	791	20
Total*/	36.323	6.128	5.305	2.396

*/ Note: subtotals in the original table do not reconcile with the total. The total figure is the actual one.

Source: CSO not published data.

There is no data on how many people are employed in the various categories. An estimate suggests that at the end of 1990 organisations with staff less 100 comprised 17,5% of the working population. (Draft proposal on the governmental duties of enterprise development, table 4 March 1992, estimate based on the CSO's data.

We have no information on the effect that the private enterprises or the non-legal-entity partnerships have on the employment rate.

It was, and apparently still *is* quite characteristic for legal-entity and non-legal-entity partnerships and for private enterprises, that those who are members of a business, or are themselves one, are so only as their second job. The number of those having second jobs, however, is not known.

There are probably significant numbers of members or employees of small cooperatives and limited liability companies among those having a second job. There must be also many among working in non-legal-entity partnerships, such as Business Partnerships [GMK], and in Limited Partnerships [BT] proliferating after a 1991 change in the tax regulations. We had more detailed information on second jobs in 1989. This suggests, e.g. that the 15.700 non-legal-entity partnerships include 7.000, where there were no full time members, and in nearly 12.000 where there were no full time employees.

The case is similar for the 174.837 small craftsmen, conducting their business at that time. These include the following:

- full time ('main job')	100.386 persons
- continuing after retirement	20.003 "
- licensed part time artisans	54.448 "

This means, that 42% of small artisans did not work full time in their own business.

In 1991 the same proportion still looked similar: as the interest representation organisation of the small artisans suggested, 60% of small artisans worked full time in their own businesses. (Figyelô, 11 April 1991)

Our latest (June 1992) information from the tax office - prepared on the basis of 1991 tax statements - suggests that the smallest enterprises paying tax after their personal income rather than the enterprise itself - mainly small craftsmen and small traders - the number of part timers has not changed.

More exactly:

Those submitting a personal income tax statement in 1991 numbered: 317,218

out of this:		per cent
full-timers	184,503	58,2%
part-timers	103,954	32,7%
retired and working	28,761	9,1%

At the same time the tax office has obliged even the non-legal-entity enterprises to submit a personal capital assessment just as those private entrepreneurs, (including small artisans and small traders who declared themselves 'entrepreneurs' (this possibility will cease for private entrepreneurs from 1 January 1993)

161,849 people have submitted a personal capital assessment. Among these there were 35,549 (22%) full-timers and 126,300 part-timers (88%).

This means, that less than half (46%) of 'entrepreneurs' working in non-legal-entity businesses, private enterprise or partnership, works full-time.

Before data on actual full- as well as on part-time employment becomes available, any estimate based on global numbers or on categories of staffing levels are

likely to be completely misleading, as concerns the labour market influence of SME's.

The above statement naturally refers to the statistics. Experience seems to prove an increase in the number of employees in SME's, while it is important to establish a difference - in the changing Hungarian economy - on the following bases:

- what form of ownership (State, cooperative private) does the small size unit in question belong to; maintaining State ownership, especially in SME units can only be provisional;
- how many fake enterprises are included in the number of the organisations; e.g. in limited partnerships [BT], or, as has been pointed out by the CSO, private enterprises very frequently start by a license for small artisans's, or retailer's business, then, without returning that license, the entrepreneur establishes a Kft, or a BT, or start a different business, or sometimes members of Kft's found other Kft's for more advantageous taxation. (Figyelô, 4 June, 1992)
- how realistic are they in terms of available employment, existential background, or are they only a complementation of other income, with the maintenance of the State job or the job at the cooperative

Until substantial data is missing, economic and labour market effect of SME's can only be assessed with a great deal of uncertainty.

1.3 Recent trends and their interpretation

The number of small enterprises have been increasing from year to year, especially since 1990. (See table 2)

Based on registered main activity, 1/3 of all legal-entity businesses were trading firms, 23% industrial enterprises, 1/5 services, and 13% construction companies.

The proportion of businesses below 20 staff is highest in trade and business services: 88%.

The number of terminations is low. As a report based on Tax Office data suggests, 9% of businesses conducting double entry book keeping terminated their activity in 1990, and 9,3% in 1991. This translates into 400 and 500 companies respectively. 10,6% of businesses having to conduct so called 'simplified double entry book keeping' ceased to operate in 1990 and 11,1% in 1991, corresponding 1000 and nearly 2600 businesses respectively. Figyelô, 7 May 1992 (Pethô, Mårton: The Nature of Termination)

To be more precise:

- in the case of legal-entity businesses, the termination of one, very frequently triggers the commencement of a different form of business (e.g. changing from a small cooperative into a limited company)

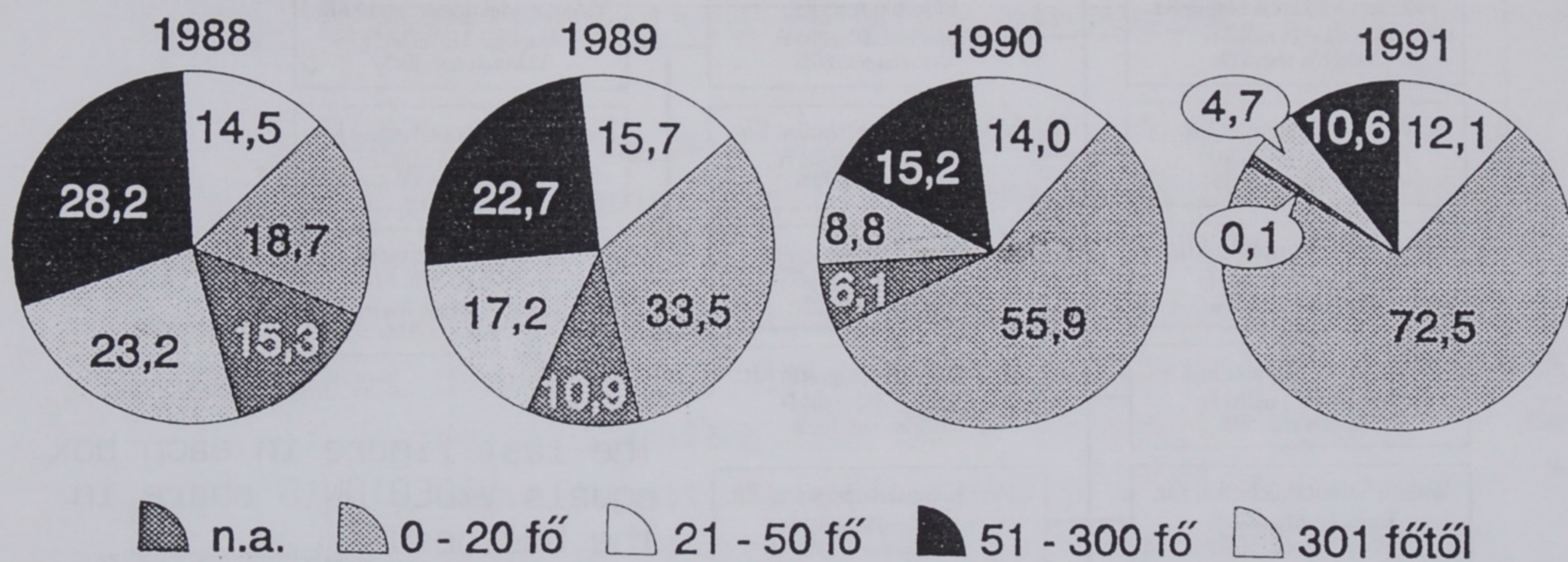
- there is no registered data on non-legal-entities. Interest representation bodies tend to complain about many cessations in small traders and small artisans, while it is not known whether the phenomenon is really a reduction of the number of full- or part-time entrepreneurs.

In legal entities it is the smallest size that grew the most significantly in number (see table 2). More

specifically, it is the limited liability companies [KFT] that started to proliferate as soon as the Companies Act went into effect in 1989 to allow such organisations to establish. 1989: 4.485; 1990: 18.317; 1991: 41.206; see table 1. Kft's constituted 78% of all legal entity businesses in 1991. At the same time, 84% of them had less than 20 staff, and another 11% between 21 and 50.

The following is a comparison of legal entity firms, based on CSO data:

CHANGES IN COMPANIES' SIZES - 1988-1991 (%)



published in Figyelô, 28 May 1992

Forrás: KSH / source: CSO

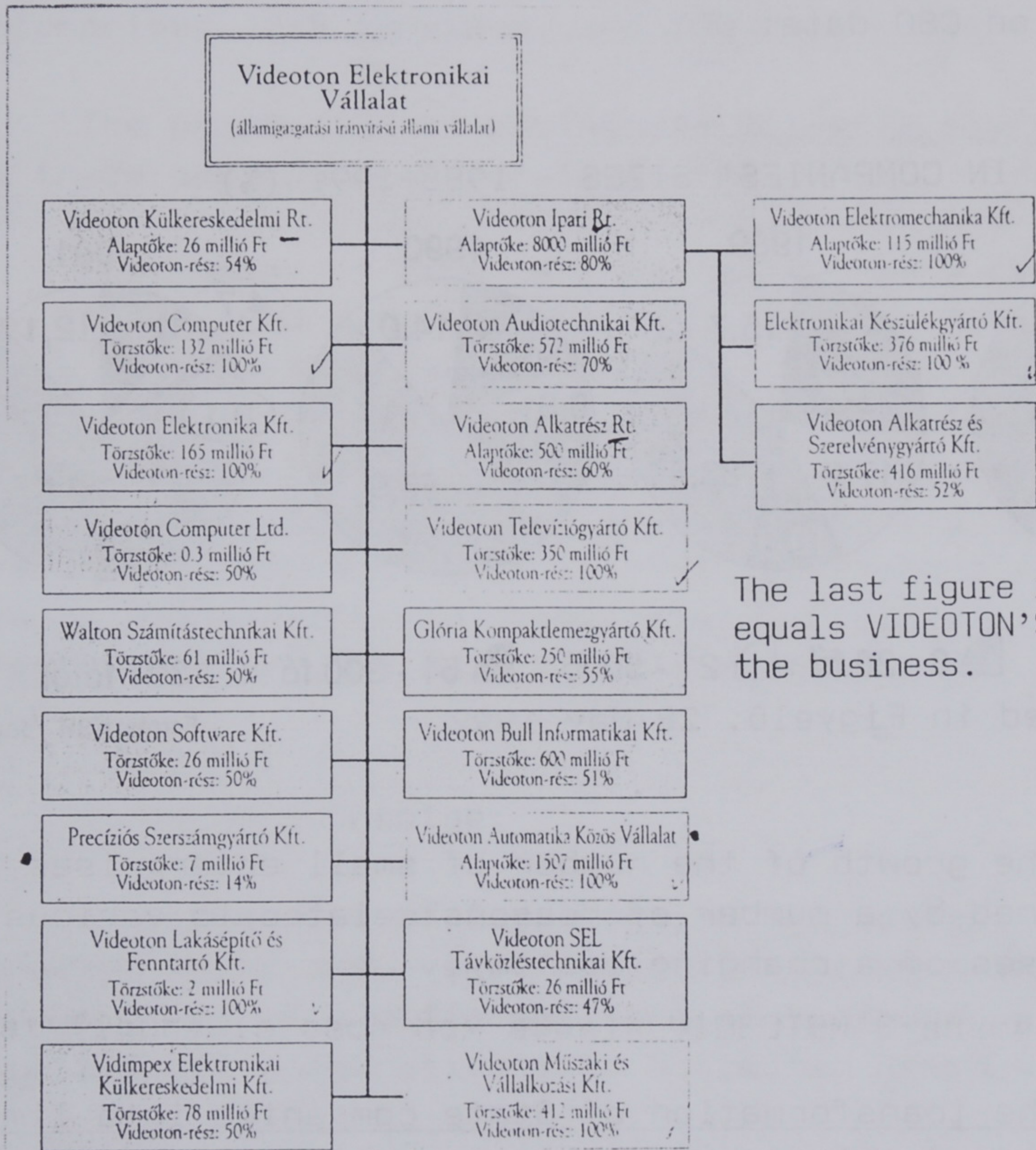
The growth of the number of small enterprises is explained by a number of reasons related to various processes of a changing economy.

a.) The transformation of State companies into limited companies/joint stock companies and the decentralisation of their operations

State companies were allowed to transform voluntarily into enterprises [Kft, RT] - an opportunity that most have eventually taken. The transformation has in the meanwhile become compulsory for all companies.

Through the transformation, the companies' countryside operations, or those units having a profile of their own became formally independent, their assets remaining State property.

Transformation meant the establishment of hundreds of formally 'independent' units (one of Hungary's company giant broke up into 21 'new' Kft's and Rt's).



The last figure in each box equals VIDEOTON'S share in the business.

Out of 21 'new' companies 15 remained - entirely or with majority ownership - the property of VIDEOTON.

In each of Hungary's 19 counties a State Construction Company operated, responsible only for the county. One of them broke up into 9 Kft's and 8 Rt's through transformation. State companies set up to repair and service cars or home appliances in a countrywide network of service

units equally started to operate their several hundreds of such units as separate Kft's.

Large numbers of new enterprises started on their way in trade, as the mammoth State trading companies disintegrated. The intention was to sell the smallest shops (employing less than 5 people) to private individuals, for which even a special loan, the so called 'Existence loan' [Egzisztencia-hitel] was available. This is how they managed to sell about 1.500 shops (or the rental right) until April 1992. In part of the larger shops Kft's were founded involving the State property and the employees' money as initial assets. Shop chains (clothing, cologne, etc.) went partly or entirely into foreign ownership.

Since there is a complete lack of statistics on ownership conditions, only hypotheses suggest that a significant part of Kft's established by the hundred are still State-owned organisations. An article by the scientific director of the Privatisation Research Institute - functioning alongside the State Property Agency - seems to prove this same point by estimating that only about 3% of the State owned productive capital has so far been privatised. (Mellár, Tamás, Two years of privatisation. Nèpszabadsàg, 22 May 1992).

Part of the companies becoming independent through decentralisation, and primarily trading companies, have been successful in attracting some foreign or domestic private capital. The end of 1990 saw 5,693 joint ventures, added up by another 5,642 in 1991 (totalling 11,335). Most of them have minimal equity, i.e. the lowest required sum for the transformation, usually with modest participation of private capital (which entitled the company to tax reductions) (see tables 4.1 and 4.2) As the CSO suggests, the tendency, whereby ever smaller business units are formed with mixed capital is continuing. 64% of new foreign groups of investors had next to minimal equity to establish a Kft (HUF 1 million).

CSO data seem to suggest that businesses with foreign participation have been most active in the area of trade. In 1991, out of the 11.335 companies with foreign participation, 6.507 (57%) were involved in trading. (s in joint ventures the manufacturing industry only amounted to 23%).

Decentralisation of State companies is now about to end. It is now the turn of ownership change, and it is hoped that smaller outlets sell more easily. Employees are likewise welcome to apply for purchasing smaller units. They have already purchased several smaller shops with the help of a loan to assist privatisation. Parliament have passed the new buyout concept similar to ESOP in June 1992.

b.) The Cooperatives' property has to be divided (at least formally) among the members and employees of the cooperative (including pensioners as well as inheritors). Part of the agricultural coop's will likewise transform into Kft's and Rt's. Many new independent farms are equally expected to take off. The number of (small) organisations is expected to grow primarily in agriculture in the next period.

c.) The natural growth of the private sector

In legal-entity enterprises, a slow growth of the domestic and the foreign private sector's participation can be expected - chiefly in conjunction with the progress of privatisation.

Non-legal-entity private enterprises are becoming more and more numerous, as sporadic data tends to indicate; The creation of an independent existence is mostly hampered by the shrinking and continual downdrift of the solvent demand. The interest representation organisation of small artisans knew about 180,000 artisans in 1992; 60% were full-time workers, while 28% part-time, and 12% pensioners. Estimates

suggest that small artisans employ a total of 90,000 staff. (Small Artisans's Protest, Népszabadság, 24 January 1992). This supposition - as we have seen above - roughly matches the data of the tax office.

The number of Limited Partnerships [BT] /non-legal-entity partnerships/ and, to some extent, Kft's suddenly grew at the end of 1991 due to a tax allowance for those who founded their firm before 1992. This turned out very popular among intellectuals who would otherwise have lost the allowance they had had up to that time, for activities such as study writing, while as a firm, they could write off most of their expenses, such as flat rent, telephone, heating, etc. A significant number of these are dummy-firms.

The changes of the tax regulations - as before - will continue to have consequential effect on the legal organisation of SME's, on their transformations and their cessations.

Even some of the unemployed try to establish small enterprises [Small coop's, GMK's]; especially those who had earlier worked in one, and those who have some skill that sells well. Although unemployed people starting a business may receive an initial sum equal to 6 months' benefit, this opportunity still remains rarely taken. One of the most important facts to account for this is that half of the unemployed were semi-skilled or unskilled with no more than 8 years of primary school [minimum compulsory schooling] at the highest. About 34% of the unemployed registered in March 1992 had some kind of skill, but only a part of these would sell as an independent service. 2,7% of the unemployed have been through higher education; part of them are in a position very similar to skilled workers.

Summing up:

The current processes are greatly determined by the country's economy: inflation amidst recession at domestic and outside markets, the financial shrinkage of the economy due to the repayment obligation of the country's

debts, the slow progress of privatisation, mass bankruptcies due mainly to the collapse of former Eastern markets, growing unemployment and, as a result of this, the gradual decline of solvent demand. At the same time, the service industries - in their broad sense - are still in an early stage of development. In a more favourable economic climate, especially the SME's could create a varied market in many areas.

1.4 Contribution to employment creation

Until 1989 there was no unemployment in Hungary, moreover, there was steady shortage of workforce in several industries and professions.

3.2% of the working population had worked in the private sector in 1982.

The private sector, growing slowly but gradually created about 280.000 new full time jobs up to 1988; the number includes small enterprises and partnerships, newly founded coops, and, in each of these, there are the entrepreneurs, the members, employees, and family members. ; not counting agriculture and free-lance intellectuals (see Appendix 1).

Besides full-timers there are at least the same number of people working legitimately in various types of enterprises as part time entrepreneurs, employees, half-involved family-members.

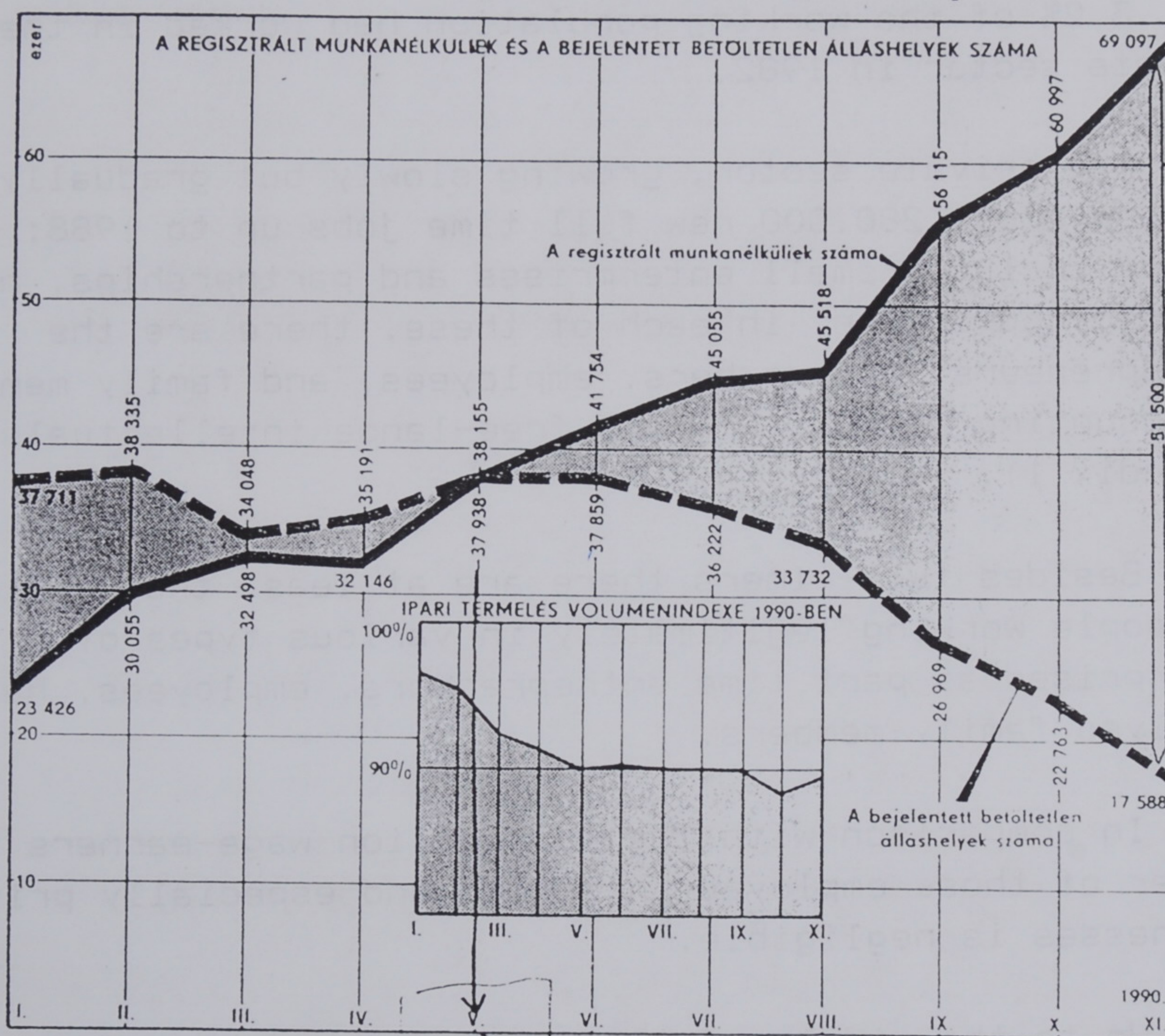
In comparison with the 4,8 million wage-earners the number of those employed in small, and especially private businesses is negligible.

Up to the middle of 1990, Hungary had more vacancies than job seekers.

SAMPLES FROM THE LABOUR MARKET

The number of registered unemployed and the number of reported vacancies

Munkaerő-piaci mutatók



(Az adatok az 50 főnél többet foglalkoztató vállalatokra vonatkoznak, s a KSH havi közlönyéből, valamint az Országos Munkaerőpiaci Központból származnak.)

1990

The above data refer to organisations employing more than 50 staff, and take their origin in the CSO's monthly issue, and from the National Labour Centre

In June 1988 - that is, when there was virtually no unemployment yet - the unemployed who either started or restarted their career i.e. the potentially and the actually unemployed were given interest free credit to motivate them to become entrepreneurs. The coverage for the credit and the interest was a provision in the central budget called the Employment Fund.

The interest free credit proved to be extremely popular. It was in fact the nature of the matter that it was not the unemployed who took it, but rather those, who wanted to become independent. The provision in the Fund soon ran out, and this type of assistance came to an end at the end of 1990.

However, during the 2,5 years of its operation there were 42,533 people applied successfully for it, receiving an average of HUF 345,500 credit; the enterprises thus started created jobs for not less than a further 25-30,000 people.

This has been the most successful campaign ever to create new jobs or to start new businesses; a survey made in 1991 indicates that 95% of the enterprises born with the help of this credit turned out to be successful. (for more details see attachment 1.4.2)

Unemployment has been an ever increasing and ever worsening problem since May 1990.

From May 1990 unemployment has been increasing, thus causing a gradually growing problem.

MUNKANÉLKÜLISÉG—UNEMPLOYMENT
1992. JÚLIUS 24.

	A regisztrált munkanélküliek száma Number of Unemployed, registered	A munka- nélküliség rátája Rate of unempl. (%)
1990. jan.	23 426	0,49
feb.	30 055	0,63
márc.	33 682	0,70
ápr.	33 353	0,70
máj.	38 155	0,80
jún.	43 506	0,91
júl.	50 292	1,05
aug.	51 670	1,08
szept.	57 931	1,21
okt.	61 010	1,27
nov.	70 269	1,47
dec.	79 521	1,66
1991. jan.	100 526	2,10
feb.	128 385	2,70
márc.	144 840	3,00
ápr.	167 407	3,50
máj.	165 022	3,40
jún.	185 554	3,90
júl.	216 568	4,50
aug.	251 084	5,20
szept.	292 756	6,10
okt.	317 692	6,60
nov.	351 285	7,30
dec.	406 124	7,52
1992. jan.	442 000	8,19
feb.	455 000	8,43
márc.	477 987	8,90
ápr.	501 000	9,30
máj.	522 000	9,68
jún.	546 676	10,10

Source: Leading indications, Figyelô, 28 May 1992

The reason of unemployment is primarily the collapse of the Eastern European markets. Industrial companies and cooperatives much developed - for decades - to the market requirements of Eastern European countries, mainly to that of the former Soviet Union, lost their clients as soon as it came to converting trade into dollars from roubles. Similarly, agriculture lost its market, one that used to be able to take whatever amounts the soil produced. This caused many mainly large employers to lay off workforce, after the enterprise could no longer operate.

Another reason is the economy's dependence on the State. The State tried, from the mid 80's, to reduce the subsidies for the development and the operation of its companies, moreover it tried to drain off even more of their revenues than before. This led to a general scarcity of cash, and companies started to deliver to each other on credit. Lining up in circle for outstandings became a mass phenomenon. In 1992 Government issued a regulation to carry out bankruptcy procedures, a decision postponed several times before. 3,045 bankruptcies and 3,898 winding up procedures were registered at the courts up to 30 April 1992. Bankruptcies, while hitting chiefly the largest firms, they work their undesirable effect on suppliers to the latter, sometimes small private firms.

As a result of the insolvency, companies speeded up shedding the labour artificially blown up over the last decades. Bankruptcies and liquidations are expected to further increase unemployment by several thousands of people, each time a company shrinks or closes down.

Another reason - much less important than the previous ones - is privatisation. In companies fully privatised and in joint ventures, the owners will only employ staff required to do the work, which inevitably results in some redundancies. Jobs created by new investors are negligible. (for details see: appendix 3)

Summing up:

The situation does not compare to the processes seen in the 70s and 80s in developed Western European countries. (My view is that the promotion of self-employment and small enterprises, a successful campaign in these countries some time ago, would not be a success any more, partly, because the process of the economic restructuring has slowed down, partly because the recession reduces demand, and the market for services and products is saturated, and possibilities of small enterprises have shrunk.

The formation of small organisations in Hungary is a natural process, however, amidst international recession we will have to reach a point where we manage to economically supply a product mix to the market of countries more developed than ourselves, and to the domestic market, where large amounts of foreign goods arrive as a result of import liberalisation. Restructuring our product range, however, would require major (international) investment. At the same time, it would likewise require a radical change in the ownership structure of the whole economy, i.e. a large-scale reduction of State ownership. The prime question is obviously, whether there will be buyers to the State stake. Also, it supposes a revitalisation of the domestic consumers' market, in a situation, where solvent demand - due partly to the increase of unemployment - is expected to shrink.

One can by all means expect minor results from a naturally paced upswing in small businesses, if only from the surviving units of enterprises split off larger units in the process of privatisation. There is justified fear, however, that in a perpetually worsening state of the economy dummy enterprises and black business will proliferate.

1. Attachment to question 1.4

passage of the report prepared for the World Bank bearing the title "The situation, operating conditions and potential for further development of small enterprises in Hungary" CSO, 1990

The capability of small ventures to create jobs in the period between 1982 and 1988

The number of active earners in the Hungarian economy was 5 million in 1981. The traditional forms of individual small ventures functioning that time /small-scale industry and private trade/ gave work to 103 thousand persons, that is 2 per cent of active earners. In 1988, parallel with the decrease of the number of active earners to 4.8 million, the number of those working in main occupation in small cooperative societies, partnerships established since 1982 and at

independent artisans and retailers increased to 370 thousand, thus their proportion rose to 7.6 per cent. /Taking into account also traditional enterprises, cooperatives with less than 100 heads, as well as small and affiliated state enterprises, 11.4 per cent of the active earners worked in their main occupation in small ventures. This sphere, however, is not covered by the study since they generally did not create new jobs./

In the new organizational forms created between 1982 and 1988, in small-scale industry and retail trade /regardless of the 100 head size limit/ more than 326 thousand new workplaces were created, and the overwhelming majority of them could be found in small-size organizations. The number of members, self-employed in main occupation and that of employees increased by 152 and 170 thousand, respectively. The number of unpaid family workers increased but modestly. The share of small-scale industry and private trade in new workplaces came to 54 and 11 per cent, respectively. Working teams contributed to new jobs by 8 per cent, while the share of specialized cooperative groups and other partnerships was 4 per cent, equally.

The number of really new jobs, created from own resources, is somewhat less, since a part of small cooperative societies was formed through transformation of or separating from traditional cooperatives. /According to the statistics of the National Council of Cooperatives some 20 per cent of small cooperatives can be classified into this category./ If supposing that 25 per cent of those working in small cooperatives belong to this category, the number of new workplaces created during 8 years can be estimated to some 280 thousand.

The number of new jobs by years and organizational forms
(members, self-employed, employees and unpaid family workers in main occupation)

	1982	1983	1984	1985	1986	1987	1988	Together
Small cooperative societies	5,505	4,198	4,926	21,000	31,593	38,347	71,199	176,777
Specialized cooperative groups	4,630	6,290	14,171	6,362	-2,111	-8,811	-6,971	13,560
Cooperative sector, together	10,135	10,488	19,097	27,365	29,482	29,536	64,228	190,331
Working teams	3,238	4,550	4,576	5,711	3,785	466	4,359	26,685
Other partnerships ^{a/}	-	706	362	725	2,048	2,281	5,381	11,503
Small-scale industry	4,380	5,561	275	2,892	3,480	19,876	25,297	61,761
Private trade	4,425	4,911	4,424	4,172	6,118	6,714	5,539	36,303
Private sector, together	12,043	15,728	9,637	13,500	15,431	29,337	40,576	136,252
All together	22,178	26,216	28,734	40,865	44,913	58,873	104,804	326,583

^{a/} Limited liability companies and share companies excluded.

The yearly figures show that the capability of small ventures to create jobs increased every year, and grew especially in 1988.

The increase is dynamic but only if compared to itself. Labour force analyses pointed out that the demand for labour of traditional organizations /state enterprises, cooperatives/ lessened. The increase of the labour supply, because of demographical reasons, and the decrease of staff numbers accompanied with the planned structural adjustment of the economy, make more important than ever the job creating capability of small ventures and within this of the private sector. In the present situation the number of created jobs can be regarded low until now inasmuch as was mentioned before the average size of small ventures is rather modest, and their staff lag far behind even from the staff limits given by previous orders.

Before 1989 government regulation had at least the same /if not more/ role in the capability /and willingness/ of small ventures to create jobs, as the market conditions of the firms. So the capability of the forms of small organizations functioning under different regulations differed significantly. /The most attractive forms were small co-operative, receiving several grants, up to 1988. By the introduction of the uniform venture tax, artisans and retailers should not pay tax for their employees - the number of employees increased suddenly that time./ The regulations of the new Venture Act, being independent from ownership forms, and the Act about individual ventures, abolishing staff limits, cleared away the legal obstacles of the increase of the staff numbers of small ventures in 1989.

Adatforrás: Hungarian Central Statistical Office
The Situation, working conditions, and possibilities of
further development of small ventures in Hungary.
Budapest, 1990.

Job creation in small business with state support

The most effective administrative program to date has been the Start-Up Loan (literally translated its official title: Restart Loan for Unemployed and School-leavers"). This employment policy project was devoted to support the creation of new small businesses and the dissemination of self-employment between 1988 and 1990. After four pilot implementations in four counties in 1988, it has been applied in the whole country as from 1989. Initially, the conditions of the credit facility were rather severe. Free loans up to the amount of 300 thousand forints were made available to persons registered as unemployed and meeting the eligibility criteria of the benefit. Although the Banks asked for financial collaterals and/or guarantors, whenever the formal conditions were met the Job Centers gave their approval and the Banks usually granted the loan. The State, more exactly the Employment Fund controlled by the Ministry of Labour, accepted to pay the full interests.

At 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 the 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 those 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 unawareness of the emerging constraints of the market. With respect to the new jobs, it created another 25-30 thousand people employed by small business must be also considered. Most of these units were 1 to 5-man ones, i.e., falling in the self-employer class. Most of the loans (34%) were raised for agricultural or 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, besides 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 undisputable: this "employment policy tool" 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. The problems of finding new occupations for bankrupt businessmen is another burden. 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. However, a part of this credit line was not channeled to private business but it was used to transform co-operative farms working in adverse natural conditions in the Northern Borsod county region. The loans raised in the name of the members laid-off were used to fund small co-operatives, however, they were unable to operate profitably. Severe conflicts must be expected around the repayment of this loan by many failing ventures.

For quite a long while the employment policy tools include a system of support of job creation investment projects by a credit facility or irrevocable subsidy. Companies making investments in regions qualified by the administration as "underdeveloped" or "depressed" could apply for this subsidy. Applicants were selected by the Ministry of Labour. A recent ministerial investigation of five counties revealed that the agreements made over the last two years subsidized the creation of about 6 thousand jobs. The pool of recipients also included private entrepreneurs with small establishments. (Unfortunately, no data are available about their share.) Private entrepreneurs usually complained for the bureaucratic process and for delayed access to monies.

In February 1990, the implementation of the said two employment policy tools was put in a new context by the Employment Act. The source of the funds is that part of the Employment Fund which is distributed between counties. The County Labour Councils consisted of the interest representative bodies and local government together with the County Employment Service is to decide about allocating the available funds. The method of assistance to unemployed to become self-employed has also changed. 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 a year of the business in an amount similar to the previous unemployment benefit. Such support is only available for people unemployed for a long time (not less than 6 months). All in all the system of regulation is very similar to the "Enterprise Allowance Scheme" adopted in the UK. The legal terms of supports for job creating investments were also made tougher, recipients are bound to employ registered long term unemployed.

We do not yet have a comprehensive picture about the spending practice of counties. We understand that the preferences of the Councils strongly vary with counties. In some counties half of the available funds have been allocated to enterprise support and job creation. Some of the County Employment Services provide their clients subsidized enterprise training facilities and/or free signpost, consulting services for business start-ups. However, the overall spending on enterprise support have robustly decreased over the times of the Start-Up Loan. According to our experiences gained in two counties (Baranya and Komárom-Esztergom), those schemes are usually preferred which offer some solution for many unemployed people for some length of time or which can prevent redundancy, such as shortened working hours, subsidized employment in community work and retraining. Compared to this, job creation and enterprise support are "expensive" exercises and only help a few people out of work. (In these two counties the available funds were allocated as follows: enterprise support 1,5-3%, job creation investments 12-30%.) At any rate, it is a paradoxical turn of the Hungarian employment policy and a sign of the scarcity of resources that those funds have turned out to be expensive which are known to be comparatively cheap in western countries (e.g. if compared to subsidized employment).

László Neumann

**LABOUR MARKET PROBLEMS IN THE COURSE OF
ECONOMIC TRANSFORMATION IN HUNGARY**

TERÉZ LAKY

1. Some facts

From the 10,3 million Hungarians, nearly 6 million people are in working age. The economically active population represented about 85% of the population for several decades. The value of 84% recorded on January 1, 1991, was still a considerably high share by international comparison.

Table 1.

Activity of the population as of January 1, 1991

(thousand individuals)

<u>Labour resource</u>	6,432,0
- people in working age	5,997,4
- other active earners (age 14, males over 60 and females over 55)	101,6
- pensioners employed after working age	333,0
<u>Economically active population</u>	5,400,2
- active earners	4,778,7
- absentees on child care leave	247,4
- pensioners in employment	383,6

Total employees:	5,299,7
Unemployed	100,5
Activity rate [%]	84,0
Unemployment rate [%]	1,9

Source: Statement of labour, January 1, 1991.
Central Statistical Office 1991.

Unemployment as a palpable social problem entered into the scene in Spring 1990. It had been already expected earlier by the administration as an inevitable outcome of the necessary restructuring of a more and more heavily indebted low performance economy. Nevertheless, labour shortage prevailed till the beginning of 1990. The insatiable labour shortage experienced for several decades was somewhat relieved and some unavoidable actions (such as the reduction of military orders and the thinning of subsidies for the state owned firms) resulted in an at least provisional redundancy in the range of 10 or 20

thousand, however, the registered unemployed were far outnumbered by vacancies until 1990.

Preparing for economic change, the registration of applicants was initiated in 1986 by the (previous) administration. An Employment Fund of 1,2 billion Forints was allocated from the budget in 1988 to imminent unemployment management. This fund was used to cover early retirement programs, organization of communal works, job creation investments, retraining, etc. Although the 1988 unemployment rate did not exceed 0,2%, the unemployment benefit scheme was implemented in 1989 in the advent of the internal business rationalization process and the growth of consequent unemployment. The Employment Fund was doubled to 2,4 billion Forints. (Only 499 beneficiaries were recorded in January 1989.) The rate of unemployment increased to 0,3% in 1989. There were about 100 to 150 thousand vacancies vs. about 13-14 thousand registered unemployed people. (In this same period the governments of advanced European industrial countries were taking powerful efforts to cut back unemployment from the settled rates of 6, 8 or 10 percent.)

After modest initial growth since the mid-nineties, unemployment has been growing at an accelerated rate to reach 9,2% in January 1992, in less than two years' time.

Table 2

Unemployment and vacancies
in the period January 1990 to January 1992

Year/month	Registered unemployed	From this: beneficiaries	Unemployment rate	Registered vacancies
1990				
January	23,426	9,901	0,5	37,711
June	43,506	25,875	0,9	37,859
December	79,521	58,460	1,7	16,815*
1991				
January	100,526	76,866	2,1	12,949
June	185,554	145,612	3,9	14,860
December	406,119	313,207	8,5	10,867
1992				
January	442,532	343,714	9,2**	10,258

*In 1991 the firms were not liable to report vacancies.

**The method of unemployment rate calculation was based on the number of earners till 1992. Since January 1, 1992, it is based on the number of economically active population. According to the new method, the rate of January 1992 is 8,2%.

Source: National Labour Market Centre, Monthly and Annual Reports.

Unemployment will be probably further increased by economic recession in 1992 but there is wide disagreement about the likely rate. Forecasting has a high degree of uncertainty in the present environment where the favourable and the unfavourable trends have equal chances.

Some economic factors of unemployment

The objective of this panel is to study the implications of political and economic changes from the point of view of unemployment.

My colleagues from East-European countries will not be surprised if I say that the interaction between the political system change and the emergence of unemployment is insignificant and very indirect. Even though the transformation from planned to market economy has become a declared objective following the system change, unemployment is actually not a consequence of transformation. There are no available direct data on the causes of unemployment nor on the weights of the different factors. However, there isn't much disagreement about prioritizing the underlying reasons of emerging unemployment based on quantifiable impacts of economic processes.

The paramount reason has been the loss of markets in the former socialist countries and especially in the Soviet Union. This loss has not been rooted in the economic transformation processes internally. It happened in the period of 2 or 3 years preceding the collapse of the Soviet Union.

It is well known that the socialist countries represented a critical share in Hungary's international trade. This share dropped from 50-52% in 1988 to 16% at present. Figures translate to lost customers, unutilized capacities and jobless employees of many a Hungarian organizations ranging from uranium mining to shoe production or food processing to the engineering sector.

This loss of market has been absolutely independent of the political system change. Its precedents were deeply rooted in the Comecon system as a whole. However, the immediate precursor was the change from rouble to dollar accounts in Soviet-Hungarian trade. The dollar clearing agreement was made in the late eighties - to be followed by a dramatic drop of sales volume because the Soviet firms did not have dollars to pay for their orders.

For a while the Hungarian firms, especially the traditional suppliers of the Soviet market, still hoped that the historical relations would come back to life. In the meanwhile they tried to manufacture on stock, to find barter deals and even to supply by circumventing the prohibitive Hungarian regulations. They sent the staff on forced leave or employed them in reduced working hours but tried to keep them together expecting to restore the old relations. In the first quarter of 1990 it was realized that it was and would remain to be hopeless to wait for

dollar orders from Soviet partners. That is when outplacements began and the number of outplaced people was growing month after month, following suit with the collapse of the former Comecon market. Government circles now suppose that the share of the eastern market in Hungary's foreign trade must have reached the lowest possible level and the relations can be rebuilt in some form, the collapse of the Soviet Union notwithstanding. However, the high unemployment rate generated by the ruined Eastern markets might persist for several years ahead to determine the state of the Hungarian labour market.

The reasons attributable to the own internal processes of the Hungarian economy are secondary to the external factors of unemployment. The most important factor is the declining performance of the economy caused by draining away resources from the economy to finance the heavy debt services of this country; durable inflation; systematic withdrawal of supports from firms and activities - and, in turn, higher prices to desiccate effective demand - and it is hard to see a way out from this vicious circle.

Jobs are steadily devoured by recession. Initially, the working pensioners were steadily removed from the labour market. Then, actually since the first appearance of unemployment, the lowest education, lowest qualification strata have been squeezed out. Half of the unemployed now belong to this more and more hopeless strata. Young people entering the labour market in growing numbers in a current demographic peak cannot find any employment.

Thus recession is the most important internal factor of growing unemployment and not the long hoped for and desired change of economic and product pattern. Up till now the efforts to restructure operations and products - which would needed substantial costs especially in the case of big organizations - could not balance for the erosion of business.

Privatization or returning state owned working capital to private control has not played any appreciable role in the growth of unemployment. Only a few big organizations have been transferred to domestic, international or, more typically, joint ownership. On the other hand redundancies entailed by privatization have been offset to some extent by the natural growth of the private sector through small self-employing spin-offs of big organizations and especially through the growing weight of small business. (The share of employment in the private sector has increased from 3,2% in 1980 to 25-26% at present. Self-employing artisans, retailers, private farmers working with family assistance account for at least half of this figure.)

It can be drawn a few important inferences of the economic aspects of unemployment.

- First of all, it is a fact mentioned earlier that no close or direct links exist between unemployment and the political system change and transition from planned to market economy in Hungary. The political system was perfectly changed after the 1990 elections. A couple of weeks was enough to shift from the typical socialist one-party system to a pluralist democracy. The new parliament has been passing transformation laws by the dozen, among them the legislation of privatization (including a recent law of unpredictable implications on the transfer of cooperative property to members and employees as registered holders). For the time being the annual fiscal budget with the direct and indirect consequences of its unsuccessful efforts aimed at cutting back its deficit has been the most important internal factor affecting the state of the economy and employment.

While the political system change practically did not have any particular antecedents, the economic system change was prepared by several decades of reformism. All these historical efforts notwithstanding, transforming from planned to market economy is a slow process and much slower than expected.

While the political system change has given green light to de facto change, to business based on private ownership and thus to the establishment of market coordination, the emergence of private ownership has been found to be a rather slack process. Every sector of the economy is dominated by state owned companies even if they have assumed a new form by going private. Out of 52,756 business organizations with legal entity formed till the end of 1991, 42,275 (80%) operate in the different forms of companies, however, ownership has remained with the state, especially in the case of organizations with more than 50 staff. Employment has been affected more and more powerfully by recession but it has not yet been affected appreciably by transformation.

- The analysis of the factors of unemployment suggest that for sure in Hungary and quite probably in the other former socialist countries, the actual reasons of unemployment differ from the reasons of the high unemployment rates persisting in the advanced industrial countries since the 1970s. Naturally a number of similarities can be found on the level of generalities such as "the pressure of economic adjustment" or "the requirement of higher efficiency". A more thorough scrutiny, however, reveals a multitude of profound differences, specifically, the differences between traditional market economies versus systems advancing from planned economy to market economy. It follows that even though we can learn and adopt a lot of the wealth of therapies designed to manage unemployment in advanced market economies, our specific situation requires us to find our own ways tailored to the specific requirements of change of business ownership to combat unemployment in this region. For the time being we

have come to a point where a) it is difficult to understand each other with economists bred on the theory of general equilibrium using the corresponding theoretical approaches and definitions because there is a misfit between the processes of economic transformation and the existing theoretical frameworks; b) we often misunderstand each other with international experts trying to assist us because a good part of their advises the best of experiences pooled by several countries do not have any functional match with the assets, financial potentials and opportunities of our country.

Some social factors of unemployment

Society has shown a growing trend of differentiation in the past two years. A scissor opening wider and wider between the financial conditions of different strata is clearly discernible in the background.

The members of strata coming on the top are recruited from successful businessmen, managers of international companies based in Hungary and mainly young qualified multilingual experts. (Besides the yuppies also the other employees of international firms are much better salaried than their counterparts working for Hungarian organizations.)

Unemployed people, mainly those who are jobless on the long run, are descending in masses to the lowest registers of the pyramid of society. Two or three years ago, in the actual absence of unemployment, benefits were generous including nearly the full salary, free loans to enter into business, substantial grants to job creating investments, etc.

Benefits are shrinking along with the growth of unemployment. The Employment Act adopted early in 1991 introduced compulsory outplacement insurance to complement for the lost incomes of the unemployed. The so-called Solidarity Fund is generated from contributions of 1% of wages by employers and 0,5% of gross wages by employees. The government made a commitment to allocate 12,6 billion forints to the Employment Fund covering the so-called active labour-market tools (retraining, communal works, job creation). The funds available for active tools have been distributed by the National Reconciliation Council Labour Market Committee between counties in markedly different positions. (In January 1992, the recorded unemployment rates varied between 2,8% in Budapest and as much as 17% in several counties.)

In December 1991, 77% of the registered unemployment received support¹.

1. This support has been renamed several times. Initially the amount received in the first year was called benefit and that in the subsequent period was called allowance. Since the adoption of the Employment Act and the Solidarity Fund, the term allowance is used for both terms.

Till 1991, the minimum level of allowance was fixed at 80% of minimum wages (then about 4,000 Forints) or at the actual salary paid by the last employer in case of lower earning. The ceiling could be not more than three times the actual minimum wages. The allowance was paid in the first phase for a term of one year in the amount of 70% of the previous salary of the unemployed person. Thereafter, a reduced allowance up to 50% of the previous salary was available.

The allowance was further reduced in 1992. The smallest amount of allowance payable on basis of insurance was still set at the minimum wage level (then already 7,000 Forints), however, it was maximized at two times the minimum wages. The allowance payable after one year of unemployment is only available for another six months. As from April 1992, those who could not find a job after one and a half year or who was hired but has been outplaced once again without being eligible for unemployment allowance can get 4,000 Forints of social allowance. Family incomes are also considered in qualification for the social allowance: if the per capita family income is more than the actual minimum amount of widow pension, currently 5,000 forints a month, the unemployed is not entitled to social allowance.

According to the latest calculations, the minimum cost of subsistence of a person is estimated at 8 to 13 thousand forints depending on family type.

According to the last available data, the average sum of unemployment benefits and allowances paid amounted to 7,231 forints. (In this same period the average gross pay of industrial earners was 16,759 forints.)

Table 3

Amounts of unemployment support by category
January 1, 1991 to November 20, 1991

Category	People concerned No.	Average period %	Average period of support day/person	Average monthly allowance forints/person
Qualified labour	124,274	34,0	142	7,703
Trained labour	108,926	29,8	164	6,628
Unskilled labour	76,134	20,8	203	6,170
Total blue-collar	309,334	84,6	165	6,879
Total white-collar	56,199	15,4	192	8,997
TOTAL:	365,533	100,0	169	7,231

Source: Labour-Market Information No.12 1991 p.40 OMK.

In other words the Hungarian society offers very basic and steadily thinning support to the unemployment. Even though the amount of legal solidarity insurance contributions to the Solidarity Fund has been increased as from 1992 to 5% of wages payable by employers and 1% of earnings payable by employees.

The government only contributes 13,5 billion forints to the Solidarity Fund from its budget in the red. This is supposed to finance all the support to pave the way of the unemployed back to the active world. (For the sake of comparison: the budget still spends 61 billion forints on subsidizing state owned companies.)

Even this small amount is of doubtful use. There is the communal work, typically meaning the lowest activity of road and ditch cleaning or sometimes taking care of poor ones or nursing. Such jobs were given to 11 thousand unemployed people till September 1991. There are the retraining problems attended by about 75 thousand people in 1991, although it is not clearly known what skills will be wanted in business. 24 to 26 thousand people had the opportunity to work in reduced hours at organizations with capacities unutilized in lack of orders. Lost incomes have been partly financed from the Employment Fund. The total of about 70-75 thousand recipients of some kind of support represented 17-18% of 406 thousand registered unemployed in December.

Thus the unemployed are practically left to their fate by the society despite the declared objectives of solidarity. Naturally this is closely correlated with the general situation of the people such as the steady decrease of real wages, inflation and recession. It is hard to expect people already living much below the standards of advanced industrial countries to part with still more in favour of other members of society. (By the way, society is in the process of establishing its new values. The proportion between pursuing personal interests and solidarity as a value of community will be a critical choice to be made in the coming decades.)

However, it is the most handicapped strata of uneducated and unskilled people who suffer the most from unemployment. They have represented a substantial share in unemployment since the beginning and accounted for half of the numbers registered in November 1991, indicating that the members of these strata are the most vulnerable to outplacement from the labour market.

Table 4

Unemployment by schooling and qualification
November 20, 1991

	Concerned people		
	No.	%	
<u>Education</u>			
Less than 8 terms	36,315	10,34	} 45,86
8-term primary school	124,794	35,52	
Apprentice school	106,624	30,35	
Industrial school	5,076	1,44	
Secondary school	28,359	8,07	
Technical secondary school	11,220	3,19	
Grammar school	27,358	7,79	
High school	7,448	2,12	
University	4,092	1,16	
TOTAL:	351,286	100,00	
<u>Qualification:</u>			
Qualified labour	110,219	31,38	} 49,91
Trained labour	80,680	22,96	
Unskilled labour	94,660	26,95	
TOTAL BLUE-COLLAR:	285,549	81,29	
Senior manager	468	0,13	
Manager	6,278	1,79	
Supervisor	6,407	1,82	
Administrator	25,392	7,23	
Administration employee	27,191	7,74	
TOTAL WHITE-COLLAR	65,736	18,71	
TOTAL:	351,285	100,00	

Source: Labour Market Information No. 12 1991. pp. 26-27 and 30-31.

It is also clear from the data that the members of these strata have the most difficulties in returning to the world of organized legal work. The collapse of the eastern markets has buried many kinds of operations and skills, however, the qualified and graduated ones have much better chances to be hired or to change profession than the ones without any qualification.

As a rule, the period of unemployment has become much longer. This is shown by the data of allowances:

Table 5

Break-down of recipients of unemployment benefits
according to period of allowance
(on April 22, 1990* and November 20, 1992)

Date	0- -60	61- -120	121- -180	181- -240	241- -300	301- -360	More than 360	Total
<u>April 22, 1990</u>								
persons	32,533	37,257	18,078	11,354	8,000	5,495	7,575	120,292
%	27,0	31,0	15,0	9,4	6,7	4,6	6,3	100,0
<u>November 20, 1991</u>								
persons	72,118	54,205	45,449	29,746	27,819	17,365	26,272	272,974
%	26,4	19,9	16,6	10,9	10,2	6,4	9,5	100,0

* The date of the first issue of detailed statistics.

Source: OMK Monthly Reports.

A hard core of unemployed people has developed. We have found that a decisive part of people without employment for more than a year belong to the unschooled unqualified strata. (A research program will be started this year to assess the situation of people in lasting unemployment.) A major agricultural transformation to be launched now (distribution of cooperative holdings as registered properties of members and employees and the ensuing structural changes) will probably cause this same strata to be redundant and unemployed in agriculture.

In the context of the grave social problem of unemployment the high share of strata without a horizon of employment opportunities but heavily burdened with social disadvantages will most probably represent one of the critical strains and a host of risks of deviance in the coming years.

Prospects

H.A. Simon, a world famous American scholar (responding to fears about the exposure of jobs to computerization) wrote this several years ago: the rate of unemployment and/or employment is a function of the performance of the whole economy. The validity of this paradoxically simple and clear statement is obvious. For a good while our economies will be in a process of transformation and exposed to many kinds of undefendable external effects, working hard to come abreast with advanced industrial countries.

It is impossible to predict the impacts of the changes expected in the coming months. The government is optimistic. It expects that the inflation rate will decrease; there will be no growth in GDP but its downtrend will come to a halt and it may even grow in the next year. These expectations are based mainly on the rearrangement of foreign relations, namely, the growth of export to advanced industrial countries, the mushrooming of international investments and the infrastructural projects to be supported by the Expo. However, the opposition is much less optimistic. It is expected that the implementation of the procrastinated bankruptcy act will become a hard fact this year; insolvent companies are already declaring bankruptcy or they are put into liquidation by the tax authorities, the social insurance authority and other major creditors.

However, a cascade effect might be unleashed by the fact that many organizations, mainly big corporations, some of which are heavily indebted, cross owe each other for several years. This cross indebtedness can have incalculable impacts, among others from the point of view of unemployment. The consequences of implementing the cooperative act mentioned several times represent another incalculable factor mainly in the agriculture. This is the reason of the extremes of estimates about the unemployment rate of this year, naturally matched to the interests of the different lobbies. (For example the agricultural lobby forecasts 100,000 outplacements in this sector and use this estimate as one of their arguments to negotiate for subsidies promised to agriculture. The bad thing about this is that the forecast may even come true.)

In the grip of the unemployment insurance scheme where no further increase seems to be possible and a budget in the red, the employment policy tries to put further constraints on eligibility and to make the available tools more efficient. It also has some ideas about new tools, including non-profit organizations under the auspices of local governments. It is also considered to adopt the German "job creation organizations" (Beschäftigungsgesellschaft). The big question is about the chances of employment policy in the race with galloping unemployment.

1.5 Other economic functions

One main area where SME's could succeed is services.

Differently from an already strong position held by services in developed industrialised countries, the service industry in Hungary is relatively underdeveloped.

In 1991, 18% of active earners worked in agriculture in 38% in industry and 44% in services.

The majority of services - public services, health, insurance, banking, etc. - is fundamentally controlled by the State, their operation is first of all financed from the State budget. The so called major service-systems such as health, education, old age pension-insurance are in a few years' time planned to be separated from the State budget to become at least partly independent.

One issue that eventually *has* started - even if on a modest scale - is private enterprises starting to organise in the health service and in education; the development of the tendency would require the improvement of the demand.

The furthest ahead are business related services, even if in many cases - such as brokerage companies or investment funds - State owned banks have significant part of the shares.

Many services - language teaching, music teaching, sports schools - still largely operate as part of the black economy.

- Another possible economic function of small enterprises could be small scale goods manufacturing. The main tendency today for new businesses - as we have mentioned above - is trade. Goods manufacturing has been in the hands of the mass producing mammoth industry over the last decades. Clothing industry, shoe manufacturing, but manufacturing of many other 'end products' on the one hand, (e.g. furniture,

household products in general) or, on the other hand, small workshops with a special profile, to join in and complement the mass production of other items are likely to be successful.

- An economic function much hoped for - especially now that the decades of planned economy are over - is to implement new ideas and to further develop already existing products in small workshops.
- It is possible that it is the products based on new ideas that will have a chance to fuel exports.
- An important chance for SME's could be to become a network of suppliers around large organisations, setting up themselves into specialised flexible units. Earlier on, large plants tried to produce nearly everything themselves from the maintenance of buildings to translations and from vehicle repairs to cleaning. It is hoped that - parallelly - to transforming into enterprises - many such activities will become separate business units/enterprises. A condition to this would again be that there be enough demand for these services.

1.6 Social functions

- One of the most important processes - already on the way - is the formation of a new social set of values, where independence, enterprise, risk-taking, and success in business is valued higher than being State employed.
- Small enterprises open a new opportunity before university graduates. In small enterprises formed after 1982 there was higher participation of graduates than their national average even if only as a second job for most. It is commonly known, however, that the most successful enterprises, some of which grew quite large, were formed by highly qualified people. Some graduates, e.g. research engineers of large institutes, agricultural experts of large operations, are actually forced to enterprise instead of their former employee status.
- Small enterprises will set up new social links and networks partly alongside their business relationships, partly through professional and other organisations or interest representation bodies, locally and nationwide. Today the only such existing link is between small artisans and retailers in the traditional sense of the word; locally, however, there is a lack of endeavour to cooperate; it seems that segregation on the basis of sympathy in the new political parties is stronger.
- The most generally hoped-for social function is still the establishment of independent existence, and then, through successful businesses, the building up of a wide middle class. Entrepreneurs today are a rather heterogeneous social layer ranging from street merchants with uncertain income to millionaires. The massive average of entrepreneurs still have, until today, enjoyed a higher standard of living than those living on average wages and salaries. The class of entrepreneurs, still comparatively modest in number may, with the economy recovering, could grow into a wider wealthy middle class.

1.7 SME's in Europe and other parts of the world

There are different trends to be expected in countries at different levels of development:

- In highly developed countries, where the middle class has increased in size and strengthened over the last decades, and where consequently people are properly supplied with the material goods of everyday life, such as flats, furniture, cars, home appliances, etc., the need for traditional mass products significantly and gradually reduces.

The need for the most varied types of services (tourism, maintenance, health, sports, business services) is very much on the increase. Services require typically small organisations and on the most accessible local levels. Mass production facilities can only be maintained if they manage to export most of the output, preferably to new markets.

- Medium developed and economically more vulnerable countries will, for a long time to come, need mass products of higher quality than what they themselves can domestically produce, but still at acceptable price levels. Once this need is satisfied, demand can be expected to rise for services of the kind mentioned above.

In these countries - and Hungary belongs to this group - SME's can play a role far more complex than just satisfying the need for services.

= as supplier subcontracting to mass production

= living up to the needs of the local market (small-goods manufacturing, small trade, reparations services). This would be of great importance, since these local markets were once swept away and they have only partly recovered since. These local markets in Eastern European countries are at different levels of development.

= regional (larger than local) markets also need to be reorganised. This would ensure that smaller units be able to join the activity of medium and larger organisations by supplying to shops and stores of an entire region, or subcontracting to them to manufacture goods to sell at the regional market

= national and

= international markets are usually only accessible for smaller organisations if they go through a larger one.

The formation of local as well as regional markets would require significantly more small enterprises. It is only afterwards that - supposing the best - economically less developed countries can start to go the way of economic restructuring that the more developed have been through for long.

1.8 Future trends

My view is that there are so many uncertain factors in the Europe of today that it would be too bold an attempt to consider future trends.

There are inevitable processes on the way in Hungary. One of them is the completion of privatisation alongside the substitution of the current bureaucratic coordination of the economy by a coordination relying on the inherent law of the market guided by supply and demand.

Implementing this substitution depends on a number of circumstances outside the competence of the government. These include the question whether there will be buyers to the State property, and if so, from which country would they be; would the market open for Hungarian products either in the West or in the East, and as a result of this, would the ever deepening recession of the Hungarian economy be able to stop; would the wars now fought in the region still down, or on the contrary, would they cover larger areas, etc.

- the decentralisation of major organisations will still continue for a while, primarily due to new formations, bankruptcy procedures, liquidations and the privatisation process. This is how the number of small organisations is expected to increase.
- it is essential from the point of view of small organisations, that they be fully privatised regardless whether they had been entirely State owned or having had only majority State ownership; there is no room for State participation in small businesses. This, however, will depend on buyers applying for the sales tenders. At the same time managers and employees may likewise apply, moreover, the smaller the organisation, the higher the chances are. Management and employee buy-out might be a way of saving production tools, market

relations, the local culture of production, and the jobs. Management and employee buy-out as a process is gaining more ground, and could be considerably more popular should credit conditions be more adequate. A loan policy in support of buy-out is currently contrary to the government's anti-inflation monetary policy targeted at repaying debts internationally.

- if taxation regulations change, then the cessation of the dummy-businesses may be expected, chiefly in non-legal entity enterprises. A reduction in the number of enterprises, however, would only show the real number of actors on the market-stage.
- A natural growth of enterprises cannot start before the recession of the whole of the economy is over.
High inflation is itself very much against investment in enterprises, since a 20% interest on deposits - otherwise a loss beside a 30% inflation rate - is still a more certain return than the possible profits of a business. Thus, while bank deposits are high, and rising - at least nominally, keeping up with inflation, the willingness to invest is still very scarce. A lasting recession gradually reduces solvent demand, wherefore the number of small private organisations increases at significantly lower speed than desirable.
- a continuation of recession and high taxes induces more and more enterprises into the black economy.
- an economic condition of at least partly reentering the Eastern European markets is that these countries become solvent. Today this is to a great extent a function of the support from developed countries. At the same time, the supporting countries will appear as competitors at

the same markets, which they hope will help them fight their own recession. For several years, major - mainly Western - companies have opened offices in Hungary with the hope of gaining entry into the Soviet market.

- access to Western markets could be feasible through the comparative inexpensiveness of Hungarian labour, which, in many instances is of high quality. Low wages and an internal price system more or less in harmony with it, are, however, increasingly in clash with Western prices. As a straightforward consequence of imports liberalisation, American and Western products literally flooded the country. In spite of huge promotion campaigns, high prices tend to eliminate demand for products that are perhaps of higher quality than domestic products. It is fair to add, that the quality is not always higher than that of domestic products, e.g. clothes, cosmetics, etc.

If, however, the Hungarian wages and price system is laid alongside the Western European, the market advantage arising from a lower wage level soon disappears.

Further than that: Western European recession does not favour the growth of Hungarian industrial or agricultural exports.

2. ENVIRONMENTAL INFLUENCES

2.1 Cultural

In Hungary, as in other countries entrepreneurial culture - similarly to any other cultural value or tradition - varies according to ethnic groups, religions, sex, regions, education, etc. For example, women tend to start business much less frequently than men do. Their activities tend to center around a number of professions, such as dressmakers, hairdressers, gastronomy, small convenience stores, etc. Gipsy men characteristically become horse dealers, while Gipsy women's business is frequently flower-stands on the street, etc.

It is an important phenomenon in Hungary, that an entrepreneurial culture still lingered on in very small groups even during the decades of planned economy (just a reminder: in 1982 3,2% of active earners belonged to the private sector), and even in those small groups it survived very with deformations. Their constantly uncertain position prevented them from planning or developing the enterprise a long time ahead, for future generations. Therefore they never reinvested the proceeds of their business, but lived it up, buying expensive cars, houses, doing expensive sports, going on long trips, etc. In the early 80's, part of those entering the private business sector completely lacked any type of culture, and all they strove for was getting wealthy as soon as possible, cheating clients and the State alike. Moreover, during the decades of 'shortage economy' buyers were exposed to an extent where entrepreneurs could get away with lousy work resulting in low quality.

Elements of entrepreneurial culture remained over among small artisans, dependent on a set client base and among part of the small private farms, where members calculated with the revenue on the produce of their farms. Among the latter were many quasi-entrepreneurs, who were unable to properly calculate expenses, profits, or to assess their opportunities at the market.

On the other hand, although among those starting their business after 1982 there were few who conducted an actual family (small artisans's) business. Many among the new entrepreneurs started to bring in a new type of entrepreneurial culture. According to a survey carried out on a representative sample in the late 80's 32% of the fathers of new entrepreneurs had been independent entrepreneurs for at least a period of time in their lives. (For details see 'Social Composition of Small Entrepreneurs' - joint investigation in 1988 by CSO and the Labour Research Institute on the basis of a 3% representative sample; Budapest, 1990)

A significant number of those starting after 1982 were graduates. Many started their businesses part time - e.g. software designers - and have gradually become completely independent. This group produced many of the leaders of today's successful large organizations, mixing intellectual expertise with high-level business culture. The representative survey quoted above suggested that nearly 20% of the leaders and members of partnerships then new, were graduates. In the same period the proportion of graduates, among the comparable population, was 14% of active urban earners, which is the part of the population comparable to newly started entrepreneurs.

The other major group, more educated and more receptive to business culture, consisted of those with secondary school leaving certificates and vocational training school certificates. They represented 45% of the sample in question; only 30% of urban earners had similar qualification.

Still, there are many factors still lacking before we manage to establish a general entrepreneurial culture. One of the most important ones would be economic stability, whereby integrity, reliability and performance based competition would become a value in business in the long run.

2.2 Education and training

Nearly 64% of the population of Hungary only has up to 8 years of primary school education and no professional skill at all.

The ratio of those with professional skills is 12 %. Those with degrees of secondary and higher education represent 24%.

Highest qualifications of the part of the population aged 7 and older* (1 January)

Highest qualification	1970	1980	1990	
	per cent			1,000 people
Without qualification	2.4	1.7	1.6	154.6
Finished 1st - 7th years of primary school	51.8	39.3	30.0	2,843.2
Finished 8 years of primary school	28.5	29.7	32.0	3,033.5
Finished intermediate vocational secondary school	4.8	9.7	12.1	1,152.0
Finished secondary school	9.4	14.5	17.3	1,642.5
Finished high school and university	3.2	5.1	7.0	667.1
Total	100.0	100.0	100.0	9,492.8

*/ universal census, in 1990 based on a 2% representative sample selected from the universal census .

Note: The census of 1990 regarded those with degrees as having graduated from higher education, those with secondary school leaving certificates as having finished secondary schools. Hungarian Statistical Yearbook 1990, p. 25.

The ratio among the working-age population is naturally better from every point of view than in the whole population. And, as it is mentioned earlier, according to the data collected in 1988 the level of schooling and professional skills is even higher among independent entrepreneurs. However, potential entrepreneurs had no access to knowledge regarding entrepreneurship or any opportunity to prepare themselves for entrepreneurial activities before becoming entrepreneurs. Those from entrepreneurial families, who acquired their skills from the daily practice of the family form an exception to this rule.

The situation changed a few years ago in that entrepreneurs' training appeared as an available service. In several grammar schools entrepreneurial skills are being taught with the help of an English textbook - an initiative sponsored by the SEED Foundation. Several international manager training centres have been established. Universities and colleges have organized business courses. Interest representation bodies have started regular wide ranging business consultancy services. Entrepreneurs' courses have likewise been organised for the unemployed. Training courses are being held (by the name of 'start-up') for starting entrepreneurs. A large number of these courses receive major assistance from abroad; a large part of their expenses as well as the teaching material used are provided from international aid.

Demand for these courses, available at different levels, is rather modest. One of the graduate entrepreneurs starting his business in the early 80s and having achieved a great deal of success would not have taken this opportunity even if he could have afforded it; and now he admits that there would have been a lot to learn. A large number of starting entrepreneurs likewise do not believe in the practicality taught at these courses. The majority of starting small entrepreneurs is reluctant to spend his/her money and time on learning, even if part of the expenses will not have to be covered by themselves.

Incidentally, the professional and retraining courses have had no great success so far either. The real problem of the courses, mainly organised to combat unemployment, is that it is uncertain, in the present state of the economy, what skills are worth learning.

Entrepreneurs' and especially starters' willingness to learn is expected to increase considerably with their numbers growing and with competition increasing.

2.3 Capital markets

There is an abundance of capital funds, domestic and foreign, available today in Hungary to assist the starting and the growth of enterprises.

The following is a list of the most important domestic resources:

- Hungarian Enterprise Development Fund

The Fund, created back in 1989 grants advantageous loans on an application basis.

- 'Egzisztencia' - loan

The credit line created in 1991 was first meant to assist private individuals in purchasing State property. Up to April 1992 it was primarily available for the sale of the State-run network of retail outlets: up to April 1992 they granted the loan for the purchase of 2000 outlets equal to about HUF 4 billion.

- The Privatisation-loan

This loan was also targeted at helping the sale of State property (or parts of it), although the conditions of the loan were severe enough (the amount of debtor's own resources, collaterals (mortgage) so that only larger, financially strong companies could take it. In April 1992 it was merged with the 'Egzisztencia' loan.

Access to the 'egzisztencia' loan was made easier in April 1992 by lowering minimum debtor's resources, by reducing the restrictions on possible beneficiaries, and by increasing the purchasable items (or, the purchasable portion of it, if it was a segmented sale) of state property. Also, the interest rate, formerly excessively high, was lowered. The current interest rate is 17,2 % , equal to 60% of all times' national bank's interest rate, with a mark-up of 4% , which is the bank's margin.

At the same time, the establishment of the state collateral fund is in progress, which is meant to overtake some of the very high collateral obligations - 1,5-2 times the amount of the loan - so far required from applicants.

Besides the above, also as a soft loan construction, a modest sum of loan is available from OMFB - 'National Technical Development Committee' - for technical development and innovation.

The most important loans with foreign assistance include:

- start-loan

was the credit line especially for starting small enterprises initiated and founded by Germany, with further contributions from the Hungarian government in operation for a maximum of 1-2 years). It also came with very strict conditions, such as mortgaging obligations. Since autumn 1991 a total of 1566 applicants have received it out of a budget of HUF 3 billion.

- A World Bank credit line to support economic restructuring, available for small enterprises. Applications are mainly expected from industrial manufacturing or servicing units of not more than 60 staff, but it is open for virtually any branch of industry (e.g. tourism, construction, trade, agriculture). The interest rate of the loan always adjusts to all times' National Bank interest.

- The International Financial Council has a credit line of 40 million German Marks, where applications are expected from Rt's, Kft's and cooperatives in full or majority private ownership. 30% of the HUF loans is provided by Budapest Bank, the managing bank of the loan. The loan may be applied for in German Marks as well, chiefly for the purchase of fixed assets. The interest rate on the huf loans is not advantageous; it equals the basic interest rate of MNB ('Hungarian National Bank'). Loans in Marks have an interest rate identical to DEMILIBOR (the English interbank interest rate) with an additional 2,5%. The allocation of the loan is subject to strict conditions (own resources, mortgageable collateral, etc.)

Besides these, many countries have created enterprise development funds (Hungarian-American Enterprise Fund, Swiss-Hungarian Enterprise Development Fund, British Council Know-How Fund, PHARE-Hungarian Enterprise Fund, Italian, French, Finnish, Japanese, Swedish, Bavarian-Baden-Württemberg credit), etc. Mainly to promote the financing side of common enterprises *with*, or purchases (chiefly machinery and equipment) *from* that particular country.

The fundamental obstacle to hinder the use of these resources of capital is the high interest rate dictated by

inflation. Only a low proportion of businesses are as profitable as to be able to pay 25-28% or even higher interest, especially in a period of lasting and gradually deepening recession. This was compounded by another factor also to hamper the popularity of the credit constructions: most enterprises did not have either their own cash, or their own real estate for collateral as prescribed in the loan conditions.

Interest representation bodies have long raised their voices against loan conditions impossible to satisfy, especially for small businesses. The loans impossible to place induced the government to alter the domestic loan constructions (-> lowering the interest and create the collateral fund).

The stock-exchange is in principle an important institution of the stock market. At the stock exchange established in Hungary in 1990 there are only 21 shares quoted. It has a low turnover, and, as pointed out above in 1.8, for the population it is safer to rely on the bank interest of their savings, than investing in shares quoted at the stock exchange, which are, by necessity, of lower return and higher risk, than bank deposits. Moreover, unlike on bank deposits, one may even lose on shares.

2.4 Macro-economic conditions

It is comparatively simple administrationally/legally to become an entrepreneur.

According to Act V of 1990, the private entrepreneur applies at the local government for a licence to conduct a business. This is a citizens' right. It is a precondition of issuing the licence that the licensee have no criminal record.

Nobody may receive a licence who had been found guilty of any crime against property personal or other, or of violating the rules of common probity.

The intention to establish the business has to be reported to the CSO, where, after determining the main business of the enterprise in question, it will be classified to the line of business it belongs to on a national economy level, which, at the same time will serve as a basis for classification in the V.A.T. payment system. Then the enterprise will be allocated a sequential identification number, whereafter the Registration Court registers the company.

The establishment of various types of businesses is bound to a set of legal conditions.

In a wide range of private enterprises - such as small scale manufacturing, services - it is also a requirement, that a member or two of the enterprises prove their expertise concerning the trade in question (special qualifications of vocational schools, courses, degrees, diplomas, artisans' master qualification, etc.)

Only in the case of certain types of businesses is there a legal requirement to have a given size of capital (equity) necessary for the enterprise (e.g. limited companies [Kft's] formerly could be started with HUF 1 million, today the same is HUF 5 million). Usually, in the case of non-legal-entity businesses, there is no legal requirement that they have the equity necessary to run them. Banks, however, do conduct a serious investigation in the same issue, once the entrepreneur wants a loan.]

The process has become significantly simpler over the last years for Hungarian entrepreneurs. Up to the mid 80's the authorities had the right to refuse the issuance of the licence if they so decided, and it took a tremendously long bureaucratic process to obtain one. Today there is overall satisfaction concerning the simplicity of the procedure. The same for foreigners seems to be a different matter; here there are frequent complaints about the excessively complex, pointlessly lengthy procedure.

Conditions of infrastructure are not satisfactory. The telecommunication network is antiquated, and insufficient. Hungary is still lagging behind as regards the number of phonelines per capita. The development and upgrade of the complete network is now the subject of international tenders.

The road network is likewise inadequate and obsolete.

The majority of this subject has been discussed above, see especially 1.3 and 1.8

The following is a brief outline of the same:

Neither inside, nor outside conditions favour an economic restructuring and, by the same token, the numerical increase or the strengthening of SME's amidst heavy recession.

The most important outside circumstances include:

- recession hitting the developed countries causing high unemployment and triggering a policy to defend domestic markets
- the collapse of the Eastern European countries, especially that of the Soviet Union, leaving behind countries in economic crises, and the loss of these countries as potential markets. (In the 80's, up to 1988, 54% of dynamically growing Hungarian exports went to COMECON countries; by 1990, this proportion sank to 32%, with the total volume itself substantially lower. The share of former socialist countries in today's Hungarian foreign trade moves around 16%.)

The most important ones among the internal circumstances:

- the charges of the repayment obligations of international debts, which cause the government to drain liabilities off the economy to use it for repayment, or interest payment

- At the end of 1990 domestic State debts reached HUF 1,835.9 billion, 65.3% of budgeted GDP for that year. In addition, the current budgetary deficit is high and rising: in 1991 it reached HUF 114 billion instead of the budgeted

79; in May 1992 the deficit rose to HUF 178.6 billion, while the budgeted sum for the whole year was HUF 70 billion.

This fact motivates the government to increase revenues into the State budget; at the same time, rising taxes tend to reduce solvent demand.

- Privatisation, raising the hopes of the government for material revenues yielded more modest results than expected in 1991. No more than 2-3% of the whole of the State property has so far been privatised.
- Inflation, although slowing down, is still high, in the ballpark of 25-26%. Inflation, around for many years now, also greatly reduces solvent demand.
- The loss of markets, and recession resulted in high unemployment, 9.3% in May 1992. About 400,000 out of over 522,000 unemployed receive benefit; the period of unemployment increases.
- The debt that state owned companies have piled up, as well as domino-debts caused bankruptcy procedures against several thousand companies. (Courts registered 3,045 bankruptcies and 3,898 liquidations up to 30 April 1992.) Bankruptcy procedures currently in progress concern 89 traditional companies, 153 legal-entity business partnerships, and 139 cooperatives. 80 of them are small, i.e. employing 20 staff or less, and 65 others employing staff between 21 and 50. Ownership conditions of companies where bankruptcy procedures are in progress are not known.

Bankruptcy and liquidation procedures are likely to greatly worsen the overall situation of employment. The future of economic restructuring is impossible to foresee. If things take a lucky turn, and if the required amount of loans are available, the assets of liquidated companies can help other companies to start a fit-for-life business.

2.5 Public policy

The political parties. The six political parties sitting in parliament all find the increase of SME's equally important, at least in their declarations - differing little from each other in the emphasis that the subject receives in their programs.

In their election campaign, the leading party of the coalition (MDF, 'Hungarian Democratic Forum') promised to lay a great deal of emphasis on overall privatisation.

"The State, and State companies will offer their assets, their shops, their restaurants, their maintenance shops, etc. for sale to company employees, to citizens becoming unemployed against their free will, and to all other enterprising members of the society. ... we will grant unlimited credit with state warranty without collateral up to huf 5 million for repayment in 7 to 10 years to all those individuals, groups, who show willingness to purchase state property.

A group of friends, a team of workers or colleagues may join forces and take an 'egzisztencia' loan of HUF 100 million, which then they can use to buy a factory, or some industrial plant." (extract from the invitation to MDF's electoral session, September 1990).

Privatisation, however, followed a different path, with more modest results so far. This is mainly so, since the government's intention to turn masses of people into owners of State property landed in conflict with its other main

objective, i.e. the priority it gave to international debt repayments.

One party of the other two coalition parties, the Small Holders, claimed above all the peasants' land to be given back to them. At the same time, in agreement with the christian democrats, they gave top priority to the compensation of those, whose land was nationalised after 1949. The compensation act was passed by parliament in 1991; those, or the inheritors of those, whose property had been confiscated, received compensation vouchers, which they could spend either on repurchasing their land, or invest in specified enterprises, or convert into life-annuity.

From all opposition parties, SZDSz (Alliance of Free Democrats) is an outspoken promoter of market economy and enterprise. Fidesz (Young Democrats) follows a similar policy. MSzP (Hungarian Socialist Party), uniting the enlightened members of the former ruling party and following more or less social democratic principles, functions as the smallest opposition party of the parliament, declaring itself to be the party of the financially more exposed, (such as the self employed or the small artisans) and is a promoter of employee ownership of large factories.

As a whole one may say that all political forces consider themselves committed supporters of SME's. None of the theoretical declarations of the parties have, however, lead to a fundamentally enterprise-friendly policy so far. As a sign of dissatisfaction, the entrepreneurs' party has been founded (outside parliament), and the mp members of the interest representation organisations (some resigning from their parties, and forming the group of 'independents') keep

requiring an enterprise-friendly policy from the government. Entrepreneurs' interest representation organisations claim the same.

Still it is probably not the never-ending urging and complaint, but rather the deepening of the recession that ultimately motivated the government to decide to make loans - mentioned in 1.3 above - more easily accessible for enterprises, including small and new.

3.

3.1 Advice, training and information

supply seems to be sufficient in all three areas. State institutions have so far done the following:

- The Országos Kisvállalkozásfejlesztési Iroda OKFI - [Hungarian Small Business Administration] operating since 1990 is setting up regional organisations for the support of SME's, in cooperation partly with the PHARE project, and with the Magyar Vállalkozásfejlesztési Alapítvány [Hungarian Enterprise Development Fund].

- OKFI has issued several information booklets [e.g. on credit opportunities], given free to the people interested.

- The County Labour Market Centres, subordinated to the Labour Ministry organise retraining programs that include training and consultancy to the unemployed to start up new businesses.

All interest representation organisations have their own regular consultancy, training, and information provision programs. The biggest of these organisations (IPOSz, KISOSz, VOSz) have newspapers, periodicals of their own, which have their regular columns, where members find descriptions and explanations of legal problems.

From among foundations it is primarily SEED that organised - mainly with the help of foreign foundations - various start-up courses for beginning entrepreneurs. SEED

too, has published booklets on available credits. It was also SEED that tried to organise in a network and keep constantly up-to-date all consultancy offices operated as private enterprises.

One of the most popular choice of private businesses is consultancy; there are over 3,000 registered consultancy firms currently operating.

A number of major newspapers take their share from the spreading of information. A daily paper with the largest circulation, Népszabadság, has a weekly supplement called 'Market Economy'. Figyelô, an economic weekly writes several pages every week on small businesses. One of the most successful monthly papers 'Privat Profit' is published specifically for entrepreneurs. Besides this, Privat Profit also runs clubs, and organises business breakfasts on an American pattern, although chiefly for major private entrepreneurs.

Summing up: it appears that consultancy, training and information services are now up and running, even if the special, individual supply of various organisations have not yet separated from each other. The bigger problem is - as pointed out above - that the existing demand is less than the supply, especially, if the service is not free.

3.2 Taxation

Entrepreneurs' taxes in Hungary - as already mentioned - are comparatively high.

1. Value added tax

Domestic sales of products and services, as well as the import of products are subject to this tax.

It is a 3-key tax: 0%, 15%, 25%. Services pay usually 15%. Some services and products, such as basic health care, social, food industry, communal, cultural, administrative, etc. have nil key.

All business units that do sales on their own behalf, in order to generate revenue, have to pay tax regardless of the legal form of their business.

2. Personal income tax

This is payable by all private individuals who generate personal revenue. (wages of employees also count as personal revenue.)

Private entrepreneurs follow this pattern of taxation. from 1 January 1992 onward private entrepreneurs may only pay their taxes in this form of taxation on their revenue generated through their business. Earlier they had the option, and could also pay their taxes - if their turnover reached a certain limit - as entrepreneurial profit tax; this option will cease on 31 December 1993. All those

concerned will either have to formally subject themselves to the application of the personal income tax, or establish a firm.

According to the general rule of profits achieved through private entrepreneurship, all costs that actually incurred and can be justified with an invoice/receipt may be deducted from the revenue. The basis for the computation of tax will be the profit thus determined. Profits are taxed in spreads, the tax key mounting slightly degressively; in 1991 the tax rate was determined between 12 and 50%. Employees have 12% tax on their HUF 55,000 yearly income; a monthly HUF 8,000 - equal to the minimum wage - pays 18% tax on its yearly total of 96,000. HUF 500,000 per annum and over pays 50%. In 1992 taxes came down slightly, e.g tax on the highest income range reduced to 40%.

3. Corporation tax

It has been in use since 1 January 1992; the same function had earlier been performed by the entrepreneurial profit tax. Subject to it are enterprises residing in Hungary, business associations, cooperatives, etc.

When determining the tax base, a distinction is made whether the business is one that has to do double-entry, or simplified book keeping. All those whose net turnover exceeds HUF 50 million per annum, or are legal entities (regardless of the size of the turnover) have to do double entry book keeping. simplified book keeping is allowed to those non-legal entity businesses whose net yearly turnover does not exceed HUF 50 million.

The extent of the tax is 40% of the enterprise's yearly profit. Tax rebate is available mostly to business associations with foreign participation. Depending on

certain conditions, the extent of the rebate may reach 60 - 100%.

In order to compensate for the alleviations given to foreign part-owned enterprises, and to ensure more even conditions to domestic enterprises, those enterprises that had already been established in 1991, and have exclusively Hungarian members, enjoyed 50% rebate in 1991-92-93. The rebate given for 3 years in 1991 does not apply to enterprises established in 1992.

4. Local taxes

Local authorities have the right to levy the following taxes on entrepreneurs:

- Kommunális ['communal'] tax based on the average yearly statistical headcount of locally employed persons (owners, employees, members). The upper limit of the tax is HUF 2,000 per year per person.

- Industrial activity tax, which may be levied on any business unit operating on the territory of a particular local authority. The basis of this tax is the net turnover of the business in question, the extent may not exceed 3% of the tax base.

Due to the sobriety of local authorities, in 1992 only 95 levied 'communal', and 132 industrial activity tax out of several thousands of settlements. The capital city local authority levied the industrial activity tax on 5 September 1991, equal to 3 per mille of the net yearly turnover.

Local authorities tend to assist local businesses and promote their ability to create jobs rather than taxing them. However, we have no sizeable information about the locally provided alleviations.

5. Employers' and employees' contributions

This is paid by employers into the Szolidaritási Alap [solidarity fund], from which unemployment benefit is dispensed; the amount payable is based on the number of full time employees: 5% of the total sum payable into the pension fund has to go into the solidarity fund, and is deductible from the tax base. Employees pay 1% of their wages into the solidarity fund.

Private entrepreneurs and members of partnerships are not obliged to pay this contribution, and are not entitled to benefit either. However, they can, by a special arrangement, pay the contribution, thereby acquiring the title to the benefit.

6. Vocational training contribution

This is a fund created to support the relevant institutions. The compulsory minimum is 1,5% of the total gross wages of the employees of all kinds of enterprises. In many instances, such as employing a trainee, or pursuing agricultural activity, etc. reductions are available up to 75% of the amount payable.

7. Social security contributions

The payment of these is the obligation of every citizen having any sort of revenue.

a.) Pension contributions - There is a 10% deduction of all wage-type payments (6% pension + 4% health insurance). The entrepreneur and his employees pay it fifty-fifty, and it is not expensable.

b.) Social security contribution it equals 44% of wage-type payments, and is deductible from the tax base. Social security contribution of full time private entrepreneurs is 54% (10+44%) of the P.I.T. tax base of the previous year. It has been a minimum of HUF 4,320 so far, (equal to 54% of the minimum wage valid on the first day of the year. This sum is payable even if the entrepreneur has in fact no income at all.

Parliament discussed the reduction of private individuals' social security contribution in June 1992. The proposal for the amendment suggests that the minimum monthly payment be reduced to 54% of 60% of the minimum wage, a sum equal to HUF 2,592.

Those who are employed besides running their own business ['complementary activity'] pay only 10% accident contribution. (So far it has been HUF 800, equal 10% of the minimum wage.)

The amendment proposal suggests the minimum sum to be HUF 480.

This overview of tax regulations probably proves the above statement about tax levels being too high. High tax levels keep many from building up their own existence. On the other hand, they incite many to dodge the regulations, and evade their taxes.

It is fairly common, primarily with services provided to individuals to fail to give a receipt, and, thereby, to 'forget' about the payment of the V.A.T. based on mutual agreement.

The tax authority has to put up with the fact that entrepreneurs state less monthly income each year, - and pay less tax as a consequence - than those living on wages and salaries.

Taxes increase from year to year. From all conditions entrepreneurs consider taxes to be the greatest hinderance to enterprises, while their interest representation organisations keep urging government to adopt an entrepreneur-friendly policy (i.e. one that reduces taxes).

So far SME's have not enjoyed any special advantages or alleviations.

Starting enterprises may be given tax holidays of some sort, but this only in areas that are hardest hit by unemployment.

Local governments provide local alleviations, especially if they expect enterprises to move into the area take off, and create jobs.

Interest representation organisations have been claiming for years that local governments do not handle them together with all others, but that it give them preferential treatment so as to compensate them for their disadvantage in

size. One example for such preferential treatment could be alleviations in social security payment obligations described above in this same paragraph. This, however, should only be a first step to be followed by numerous others.

3.3 Finance

It is characteristic of the firms of the planned economy that no detailed financial analyses were made about the part-activities; only global assessments were prepared. This is how nobody really knew what activities were profitable and which ones were not. This, by the way, is a rather difficult problem to solve currently, as firms are being privatised, and their assets need to be valued.

Financial and accounting order of enterprises is regulated by the Accounting Act, in effect since 1 January 1992. It requires businesses to follow international accounting standards, in order that their business documents reliably reflect their true financial status (income/revenue).

Anywhere in the world, the actual financial status of enterprises is the function of a number of variables.

It is usual today, that the majority of small enterprises only aim at generating the minimum amount of profits necessary for survival, and still seemingly authentic ('believable') for the tax authorities. Since a significant proportion of small enterprises are artisans, traders, self-employed, or are only part time entrepreneurs, and the *business* is closely related to the overall needs of the *family*, and, depending on their financial status, they apply restrictions in one, and allowances in the other, or the other way around.

In spite of the general recession, and contrarily to the content of the tax statements submitted to the tax

authorities, small enterprises are fit for life, and entrepreneurs' families enjoy a higher - sometimes considerably higher - living standard, than those living on wages and salaries.

Financial difficulties hit two groups of society mainly. One is those that are suppliers to major firms gone bankrupt, where the bankruptcy of the big firm can easily drive the small suppliers too, into bankruptcy. The other group is constituted by those that operate without a good financial background, and can, short of sufficient reserves, lose their chances for survival. Cab drivers, for instance, are chiefly part-time entrepreneurs. Their market is oversaturated. Those who do not manage to earn the costs of upgrading their vehicles, or purchasing a new one, cannot carry on with their business.

3.4 Premises

- The price and the renting fees of buildings, shops, offices, workshops is extremely high, due to the inflation, the significant amount of foreign demand, and the real estate business, where the mechanisms of a free market are now beginning to operate. During the years of planned economy State owned real estate was not allowed to be part of the real estate market (except for a part of tenants' houses, which the tenants were allowed to buy), and renting fees were insignificant. In the early 80's, however, a new tendency started, whereby private individuals were also allowed to rent small shops, or restaurants. The majority of State owned real estate - except for the property of State firms - has been transferred into the hands of the local authorities, who have considerably increased the rents, in order to generate their own revenue through that. That is why renting fees are now unreasonably high, even for former tenants but especially for new ones.

Many local authorities, however, are trying to support entrepreneurs by providing either free, or reduced rent land, with the aim that they build up a plant on it. In other instances local authorities cede - at favourable costs - empty offices (abandoned offices useable as shops or offices). It is hoped in many places, that former Soviet army barracks can be used similarly, once the property conditions are settled.

3.5 Purchasing

The negative discrimination that hit the private sector up to 1989-90 was abundantly proven by the regulation of the conditions of purchasing. (see attachment 3.5.1 of study prepared for the World Bank)

As regards domestic procurements, all discriminations are now gone. Manufacturers and distributors are free to set up their own market relationships.

Procurements from abroad have been liberalised in many respects. First, the international ban on the Hungarian imports of certain strategic products has ceased; although the ban on top technology machinery and equipment did not characteristically hit small enterprises. Secondly, the Hungarian State gradually lifted the formerly severe restrictions on imports. Now production, as well as consumers' goods are imported according to a uniform system of customs duty. What small enterprises, and enterprises in general are now finding a grievance is exactly the excessive liberalisation of import, which, as the interest representation bodies put it, does not provide enough protection to the Hungarian entrepreneurial sector, still not strong enough the weather so much freedom. It is said to have exposed Hungarian production too early to international imports competition. Moreover, the foreign owners of Hungarian-foreign joint ventures are not necessarily interested in promoting the production of Hungarian enterprises, but rather in increasing the sales of their own products in Hungary.

The trade of production-tools (formerly in the hands of large, specialised State companies) has now started to develop into a market. A great deal of items are available for domestic small enterprises, still, when it comes to high-tech products, they usually need to go abroad to purchase it, much more expensively than what domestic price levels would justify. This is why it is so important for many SME's to have a foreign partner in the business: it is usually them who bring the modern technology.

3.3. Regulations influencing the performance of small ventures on markets; the infrastructure of small ventures

There was a basic principle in economic policy for decades, that private ventures may play only a subsidiary role besides state and cooperative enterprises - primarily in meeting the needs of households and in supplying with special means and spare parts larger economic units. Thus when determining the economic licenses of private entrepreneurs not the rights usually necessary for economic functions were transferred to them, but the rights expressing civil existence of private individuals were supplemented with licenses, which the organs of economic control deemed necessary for carrying out economic activity.

The attitude defining such role of entrepreneurs basically influenced the market conditions of ventures. It presented itself in the measures regulating directly or indirectly their sales activity, and also in the availability of the infrastructure that ensured their functioning.

3.3.1. Measures influencing indirectly the appearance of small ventures on markets

Rules discussed in section 3.1. which making entrepreneurial existence possible influence the appearance of an economic unit on the market; that is how the entrepreneur may appear among all economic agents. Moreover regulations concerning the purchases of entrepreneurs, their appearance as buyers also have significant influence.

3.3.1.1. Domestic possibilities for obtaining materials and means of production

Up to the end of 1987 private ventures could obtain materials necessary for their operation - opposite to state and cooperative organizations - at a price including also turnover tax. Although since 1983 they were, in principle, entitled to purchase from wholesale traders, producers /at the price mentioned above/, dividing the "spared" retail or wholesale trade margin with their partners, wholesale traders were not obliged to serve private ventures, and in practice they did not deal with such "small" items. Thus domestic sources for the purchases of private ventures were essentially the same which supplied households as well.

Purchases of materials for artisans took place partly through the National Federation of Artisans. They could obtain certain import or contingency materials /for instance precious metals/ only through the Federation as well. From 1982 on private traders were entitled to purchase goods on the whole territory of the country /other private traders excluded/. Private entrepreneurs and also private traders - could obtain certain materials and goods, defined in Orders on Commodity Turnover, only at an assigned sales enterprise. Thus private transporters for instance could obtain their transport vehicles only through assigned trade enterprises /passenger cars in similar ways as private individuals/.

By the introduction of the general turnover tax the discriminatory acquisition of materials of small ventures at higher price was abolished for all economic agents. According to the new regulation producers may purchase at a price increased with general turnover tax, but the tax payed in this way may be deducted from the tax payable for their activity traditional economic units or private entrepreneurs alike.

Private ventures could obtain second-hand assets, equipments of economic units usually only through state intermediaries, the reason of which could have been found primarily in the attitude of state company managers, but this constraint is much less frequent nowadays.

Small ventures are also entitled to rent machinery and equipment. (Because of the measure of leasing fees and guarantees required most of them could not take this possibility). The order of 1981 on the establishment business working teams, however, provided an opportunity for these partnerships to rent the means possessed by state or cooperative enterprises, the use of which was otherwise not allowed by law for private individuals.

Entrepreneurs mainly pay in cash for their acquisitions, as sellers usually do not accept their cheque or transfer payment. As a considerable part of small ventures strive to conceal a part of their activity, because of taxation, they usually do not insist on non-cash payment which can be "followed up".

The previously mentioned conditions of obtaining materials and means resulted in a higher price of the inputs of priva-

te ventures as compared to the enterprises of the state and co-operative sector. All of these deteriorated the initial price position of their products appearing on the market.

The acquisition of machines, equipments of private ventures from imports showed a peculiar process. Foreign trade enterprises dealt at negligible extent with the purchase of means for small ventures, they were not obliged to accept the orders of small ventures and use the proscribed foreign currencies for their purposes. Thus imports of ventures took place mostly in private way, according to the rules of the Passenger and Gift Customs Tariff, up to the spring of 1989.

The orders of Ministry of Finance and Ministry of Foreign Trade on customs right permitted, first in 1981, artisans and retailers to purchase the means necessary for their operation /on the strength of the certificate of the National Federation of Artisans or National Federation of Retailers/ at a reasonable 40 per cent rate of the Passenger and Gift Customs Tariff, moreover they were entitled to tax preference up to 60,000 Forints once every five years. The upper limit of the tariff preference was lifted to 200,000 Forints on 1 January 1984. In 1985 the concerning part of the order was extended also to artists, designers, protographerars, managers of contractual shops and members of working teams. The custom tariff was lessened to 30 per cent on 1 June 1986. The scope of low tariff or duty free goods did not cover all the means necessary for the operation of small ventures. For instance motor vehicles and their spare parts could be clearanced

only under usual conditions which affected transporter artisans unfavourably. By the decree of the Minister of Finance at the end of 1984 and 1985 few more articles were classified among low tariff clearanced goods /50 per cent of the customs in the Passenger and Gift Customs Tariff/. Since 1986 for example personal computers /up to 128 Kbyte/ and their accessories, VHS video equipments and their accessories, electrical and mechanical hand tools, small agricultural machines are included here. The order of the President of the National Material and Price Office, issued in December 1987, raised significant obstacles for private imports of the means of ventures. The order prohibited also for legal entities and private ventures to purchase, rent for their own needs or sell, goods over 25,000 Forint single value, other economic agents imported by which were clearanced not in foreign trade turnover that is according to Passenger and Gift Customs Tariff within three years after clearance. This order was in force for one year and apart from that it limited obtaining means of high technology by small ventures, did not achieve its basic aim /restrain import activity of private individuals at profit/.

According to a survey carried out by the National Federation of Artisans, owing to the measures mentioned above, 30 per cent of the materials /of some 35-40 million Forint value/ imported from capitalist countries and used by independent entrepreneurs, and nearly the half of new machines they put into operation crossed the frontier of the country in the form of private imports. The value of gifts clearanced by artisans, business working teams, civil law part-

nerships and retailers came to 170 million Forints in 1986.

Customs policy caused many problems in the field of private imports. Until 1989 the domestic consumer price of goods and not the purchase price abroad was taken for clearance base.

Up to the base levied defined in this way was unreasonably high, often reflecting domestic shortages, and depended on the subjective judgement of customs officers.

The order of the Ministry of Trade, issued in April 1989, resulted in a fundamental change in the possibilities for imports. The order entitled also civil persons and their partnerships - as economic agents - to import means necessary for their production. At the same time the specific rules of the Passenger and Gift Customs Tariff referring to small ventures were abolished. According to the new regulation the means necessary for the operation of ventures are to be cleared according to the rates of the Trade Customs Tariff. The import liberalization similarly covered private ventures, too in 1989. The decrees of the President of the Hungarian National Bank issued in December 1988, made provision for foreign currency necessary for import transactions.

To make use of the possibilities provided by the new provisions of law requires also that private ventures should be capable, from professional point of view, carrying out import activity, and that foreign trade enterprises accept their orders. /The latter is probably positively affected by the overall inability to pay in the sphere of state and co-

operative enterprises, as foreign trade agencies may higher appreciate private consigners, as their ability to pay is often better.)

3.6 R & D and technology transfer

The trade ban, in effect for several decades, provoked numerous domestic developments, chiefly in large state companies. Part of these developments can be said to be successful in the long run. With the lifting of the ban, and the liberalisation of the import, the developments substituting for top technology became redundant. There is a fear in large companies that the foreign partner may simply eliminate the R&D section, especially, if he is only out for production capacity and market for his own product.

Although several smaller firms were established after 1982 for R&D in their own areas (various instruments), these operations grew into major enterprises dealing with a variety of businesses.

There is a separate fund now available at the Országos Műszaki Fejlesztési Bizottság ['Committee For National Technical Development'] to carry out ideas born in today's small companies. One way of using this support is apply for funds, another is to take loans with favourable interest rates for development purposes. There are local offices of this fund, which provide consultancy to the entrepreneurs.

The majority of the technology transfer is currently done in the framework of Hungarian-foreign joint ventures. It is either the foreign partner who brings in technology as initial asset, or - as pointed out in 2.2 - the governments in question provide advantageous loans for purchases from their own country.

3.7 Deregulation and simplification

The need for deregulation came as an endeavour to simplify the regulations of the planned economy in the late 80's. That was a time, when several hundreds of regulations were swept away, each a hinderance to the smooth running of the economy.

Legal guidelines issued in the meantime, while having commissioned the process of change, such as the companies act in effect since 1989, require further correction. If quite slowly, the done process is advancing continually.

At the same time, there is a multitude of legal regulations of fundamental importance that need to be elaborated.

The above is to suggest that instead of deregulation and simplification, what is really at stake is a regulatory system to transform the functioning of the whole of the economy.

Within this, - as already mentioned - the guiding principle is still neutrality, with no differentiation of size or other of enterprises. This principle is hoped to change, primarily to the advantage of small enterprises.

3.8 Competition policy

It is the consequences of privatisation that are in the centre of Hungary's competition policy today. Although the proportion of the already privatised State property is comparatively small, foreign firms already have the monopoly in certain branches of the economy (retail trade of clothes, sugar industry, etc.)

The regulation of the competition according to the size of firms is still of secondary importance behind questions such as the elaboration of reasonable guidelines of privatisation.

As we have said above: up to now the basic principle has been to maintain neutrality of conditions in competition for businesses regardless of size or sector, a principle that appeared to best answer the requirements of the market. Those responsible for the regulation of the competition have not yet taken into consideration what policies are in practice in many countries for the support of small enterprises.

3.9 Cooperatives and mutual assistance

1. As pointed out before, cooperatives had been the second accepted type of property for decades after the ever-present first-of-all State property. After 1949, virtually all small property not capable of being regarded as state property was forced into the strait jacket of cooperative property.

There were cooperatives in every sector of the economy. It was the main form of operation in agriculture, but there were countless cooperatives with industrial, service, trading profiles.

Cooperatives were the employers of about 1/4 of the active earning population in 1981 (3/4 were employed by the State). Out of an active earning population of over 5 million there were a mere 176,600 in the private sector.

Cooperatives operated under uniform state control, and were in all respects similar to State property.

In 1982 it became possible for non-agricultural cooperatives smaller than 100 staff to become independent. It was not long before private individuals too, were allowed to form cooperatives smaller than 100 staff.

Small cooperatives enjoyed all sorts of important advantages as opposed to private businesses: lower taxes, lower social security, etc. this is why it became the most popular form of business.

In 1988, 2,847 small cooperatives employed a total of 171,327 persons; about 2/3 of all coop's were privately founded. All other businesses - three times as many as coop's, exactly 9,383 - employing at least one full time employee each, had a total of 62,010 full-time members and employees.

The most successful private enterprises transformed into small cooperatives before 1989.

The number and headcount of small cooperatives has not reduced up to today. In 1988 there were 3,108 small coop's, at the end of 1991 there were 3,101; members numbered 71,199 in 1988, the same is not known for 1991.

According to a law in 1992, the property of coops' had to be divided among members (former members, their inheritors) and employees. The actual owners were to decide, in which form they wanted to carry on the business: as private entrepreneurs, as some kind of company, or stay cooperatives.

Former coop's have to transform this year latest. The consequences of this onto the structure of the economy and onto the number of small and large enterprises are not predictable. Transformations so far include examples for agricultural coop's converting into rt's ['joint stock companies'], a section of a coop becoming a Kft ['limited liability company'], while some remained cooperatives. In industry, most have chosen to stay a cooperative. In cooperatives that were re-established on the free will of the members, the basic principle is this: operate according

to the internationally accepted norms of the cooperatives' movement.

2. Mutual assistance

No industrial districts have as yet come to existence. However, several features of industrial districts are already entrepreneurial practice.

One such feature - a result of the lasting insolvency of large companies - is that small enterprises are in many respects sellers and buyers to one another.

Among entrepreneurs of either the same profession or of the same neighbourhood there is a relationship of information exchange besides just competition.

Joint transactions, however, are inspired by common interest.

3.10 Private sector initiatives

the private sector today urges primarily actions taken to ensure its survival: getting out of the recession, and reducing the burdens on its own shoulders.

All this is closely related to the world exhibition in 1996. Entrepreneurs' organisations have formed lobbies in order that government submit the application. VOSz ['National Association Of Entrepreneurs'], for instance started a nationwide collection of signatures - relying on the support of the public - with the intention that if they have the required number of signatures together, they will claim a vote. They eventually did have the signatures together, but the application was submitted anyway.

Great many - mostly medium size - enterprises seek to set up countertrade relations with states of the former soviet union. They organise exhibitions and business trips, and usually, at the cost of a great deal of effort they manage to enter into numerous if modest transactions.

Entrepreneurs likewise endeavour to cooperate with Western partners. The multitude of joint ventures is frequently the result of a former relationship between a State company and a foreign firm. Sometimes, however, mainly in the case of smaller companies, it is the fruit of personal links. It is worthwhile to note at this point, that as far as experience goes, small enterprises often have fictitious co-founders. Hungarian small entrepreneurs set up enterprises with their own money, using the name of a

4. Administration and delivery

4.1 Representation and consultation

The Minister of industry and trade has overall responsibility for SME policy, but every government body has special programs. There is the Hungarian Small Business Administration to coordinate and to help these activities of all government bodies, working under the authority of a State administration council led by the Minister of industry and trade. (Currently - after multiple substitutions of leading officers - the minister responsible for privatisation started to regard the development of SME's equally as one belonging under his authority.)

The Hungarian Small Business Administration is a central government body, funded by the central budget. Most of the ministries have a special organisational unit within their structure assuming the responsibility for the development of SME's. These are units that have mostly more than one function (e.g. 'enterprise and urban development', or 'enterprise and regional development', etc.)

In the Országos Érdekegyeztető Tanács ['National Council for the Reconciliation of Interests', a collective bargaining board], which is the body to discuss a number of questions related to taxation, employment, etc., and prepare decision making in the same issues (e.g. determine minimum wages) delegates of entrepreneurs' interest representation organisations also have a seat.

However, entrepreneurs' interest representation organisations sometimes complain, that, while they are most

usually asked to give their opinions when it comes to compiling a draft proposal, the government organisations that actually submit the proposals do not take these opinions into consideration, wherefor they do not have real influence on the forthcoming acts.

There was compulsory membership in the traditional interest representation organisations up to 1989. (Except for VOSz ['National Association of Entrepreneurs'], founded in the second part of the 80's to be an alternative to State-governed and -controlled organisations, which united a membership of all legal forms of businesses, and was built on voluntary membership.) Interest representation organisations transformed, and their names also changed. At the same time, membership also became optional. Although the majority of the membership remained in these organisations, it reduced slightly in each. Their many higher ranking units, e.g. regional (county) levels, representing local levels ceased, too. As a whole, the social prestige of interest representation organisations increased, even if their representational weight is more modest than would be often required by their membership, who take the standpoint that their organisations do not represent them as efficiently as they could.

Owners of large private enterprises have set up an organisation of their own, which numbers few members as a consequence of the basic situation.

The interest representation organisation of State companies, still in majority, is the Magyar Gazdasági Kamara ['Hungarian Economic Chamber'], which, as a consequence of the total assets and headcount of the member companies it

represents, is an important factor in preparing decisions. In the National Council for the Reconciliation of Interests the Economic Chamber and the interest representation organisations of private enterprises represent the employers, and it is obvious, that the State is still the largest employer.

The weakness of the representatives, the often formal nature of the discussions held with them are all indicators of one and the same thing: the government, having the priority in so many issues over the small social layer of entrepreneurs still manages to push the latter aside disregarding their interests.

4.2 Policy formation and legislation

The governing party and the opposition parties are not heading for concensus and compromise, but rather for wearing out each other. Two years after the first democratic election, drawing the balance of the first half period has started, simultaneously to starting the preparations for the next elections.

Since the social support of each party in parliament is weak and uncertain, and virtually all of the parties are divided within themselves, (the Small Holders' Party, member of the coalition, for instance has two distinct factions in parliament, while the leaders of the party - sometimes even making a scandal out of it - exclude each other from the party taking turns.) The outcome of the elections coming in two years' time are therefore entirely open. In this situation the parties are much busier generating political clashes, - such as relieving the president of the television, or that of the radio, or trying to object it at other times - than thinking about conceptual questions of the economy.

Though parliament have passed a rather large number of new laws (115 new laws and 110 amendments were passed from 1990 to summer 1992), part of which indirectly concerns the development of small enterprises (e.g. Act of 1992 on the division of cooperatives' property, on the principles of further privatisation, on employee ownership following the ESOP pattern, on the reduction of interest rates, etc.), no clear, consistent policy to support small enterprises comes through these legal regulations. (One exception is the

reduction of social security contribution for private entrepreneurs and part-time entrepreneurs described in 7./b of 2.3.) This is a major alleviation for entrepreneurs, mainly for small ones.

Further than that, parliament will have to create numerous law-guidelines [rather than specific regulations] (e.g. on the relationship of the large social provision systems and the central budget). At any rate, one could by now claim a clear-cut, well-contoured policy to promote and develop small enterprises.

4.3 The role of different levels of government (local, national, and supra-national)

There is a wide-ranging movement now unfolding on a local level: setting up organisations (enterprise offices) to directly promote enterprises on the one hand, and increase the local authorities' activity to develop enterprises on the other.

Enterprise offices are organised mostly by the Hungarian SBA. It endeavours to set up local offices, which provide entrepreneurs with all the necessary assistance, information, consultancy, and teach them how to properly prepare a business plan, etc.

With the active help of the local authorities, and backed by the PHARE program, they organise regional enterprise-promotion foundations (LEA).

6 such foundations are in operation now in 1992. The plan is to set up one LEA in every county (a total of 19).

There are several organisations trying to support the local authority's activity promoting enterprises (e.g. the national federation of local governments, the SEED foundation) this is of utmost importance both from the point of view of increasing local entrepreneurial activity, and the local employment issue. Part of the local governments still do not know the local business opportunities, or the various loans available to start them (world bank, phare program, etc.) although most of the local governments - soberly considering its own interests - have not levied any local taxes on enterprises (see 3.2.4 above), they do not

know how to actively assist them either. Significant achievements are to be expected in this area in a few years' time.

We have discussed the duties of the government on a national level at several points.

All we need to emphasize here is that the government should in several ways, mainly through tax exemptions support the smallest enterprises rather than leading a completely size-neutral policy. ('Smallest' could mean anything from self-employers up to 20 staff; moreover, this line could be drawn above 5-10, to produce even narrower limits, considering the real size of Hungarian SMEs'.

Although size-neutral policies are in fact in line with the nature of the market, many market economies do assist those who want to become independent breadwinners. Hungary would need such a policy both in order to create small local markets, and in order to create jobs as an essential tool in fighting unemployment.

It could later become a point to consider - similarly to us practice - to have small enterprises take a specific proportion of the state orders. This, however, could run aground on a number of conditions, e.g. infrastructure.

On a supra-national level, it would be practical if governments could help enterprises keep themselves continually informed. There is considerable scientific interest in small enterprises: there are European as well as world organisations, newspapers, conferences; the latter serve mainly business purposes today, wherefore much more are organised than would be in demand. National governments,

but the perhaps even european committee itself could
annually review scientific analyses, and the results of the
practice followed in various countries.