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KŐHEGYI

MARKET ENVIRONMENT, REGULATION AND SUPPORT FOR SMALL ENTERPRISES

**This paper was produced as part of the research project entitled ‘Economic competitiveness:
recent trends and options for state intervention’**

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This paper reflects the views of the author and
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Minister's Foreword

The Ministry of Finance aims to ensure that decisions on economic policy are based on the knowledge of facts and high quality professional foundations. This is the objective of the launching of the working paper series disseminating the findings of research projects carried out at the Ministry, economic research institutions and universities, in a structure aligned to the tasks of the Government. Our aim is to provide support for decision making, to inform professional circles and to promote exchange of opinions between research institutions and the state administration.

One of the key economic policy objectives of the Government is to improve competitiveness. The studies prepared by researchers of the Ministry and those commissioned by the Ministry are aimed at laying down foundations for the performance of the relevant tasks of the Government. The studies provide an insight into issues relating to the business environment, infrastructure, the influx of foreign capital, innovation, the labour market, social exclusion and environment protection, and disclose the possibilities for governmental intervention. The studies are published in the first few editions of the working papers.

The Government of Hungary is preparing a variety of major policy reforms. I personally believe that this series of working papers will have a major impact on the elaboration of successful economic policy actions.

Dr. Csaba László
Minister of Finance

Editor's foreword to the research project 'Economic competitiveness: recent trends and options for state intervention'

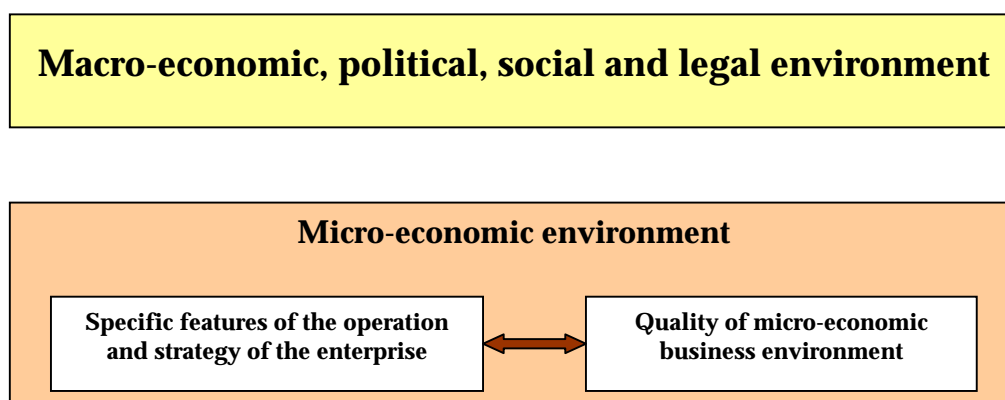
Competitiveness as 'growth potential'

Competitiveness will be interpreted in this series of studies as a '*growth potential*'. This is only one of the numerous existing definitions of the concept but in our view it is suitable for the identification of the framework of a comprehensive research programme. The macro-level indicator of *growth potential* is the change of the gross domestic product (GDP). One of the key determinants of the growth of GDP is the change of the *productivity of labour* - the value of output produced by a unit of labour. The *change of the activity rate* is another key factor, indicating the change of the share of workers within the working age population.

Competitiveness - both at the level of the national economy and at that of a company - depends on the *adaptability* of the economic unit, i.e. the extent to which it is capable of flexibly adapting itself to the changing environmental conditions and demand. The capability of adaptation and renewal are key factors explaining competitiveness.

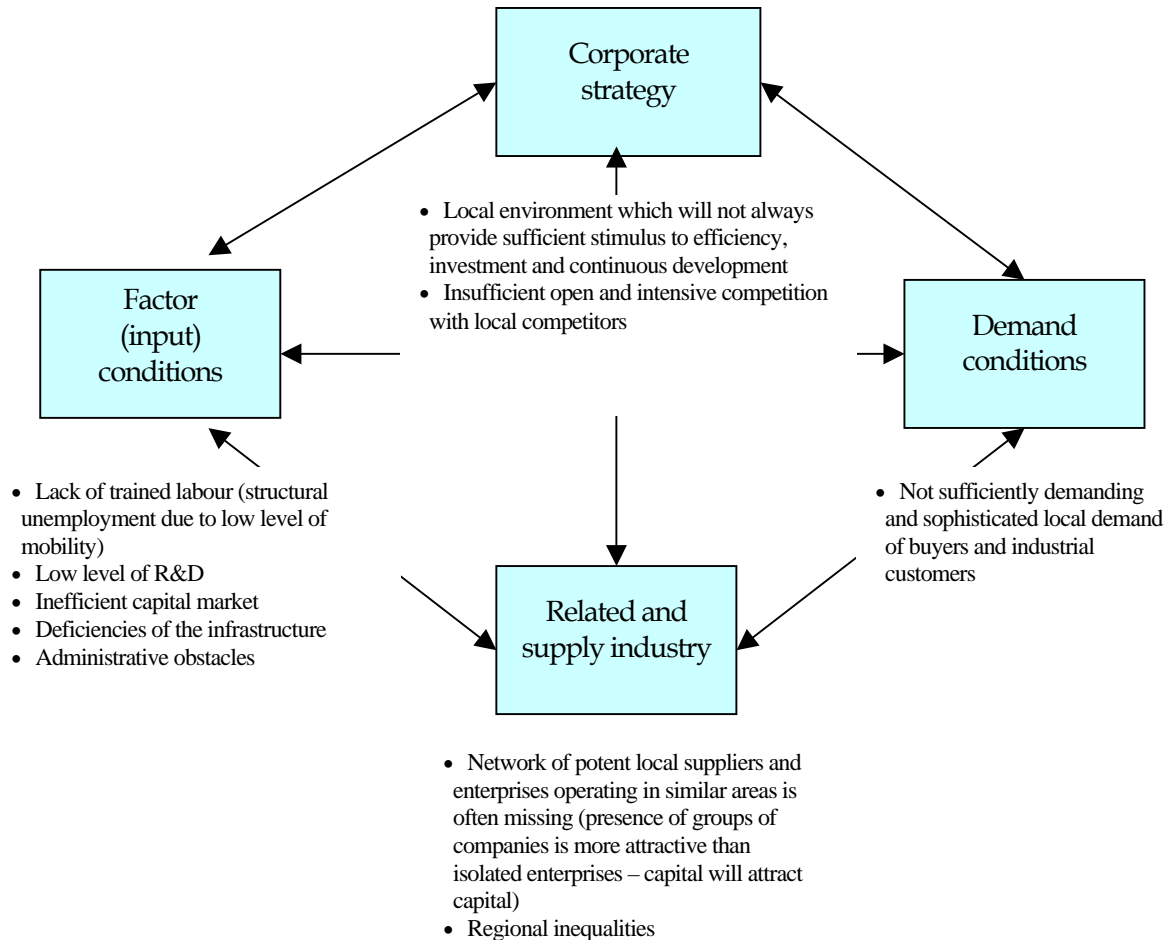
According to Michael E. Porter, professor of Harvard Business School, one of the most frequently cited researchers of the theme (1990) an appropriate macro-economic, political, social and legal environment will create the potential for competitiveness, however, it is *not sufficient* in itself. Efficiency depends, ultimately, on the *improvement of the micro-economic capabilities* of the economy, along with the *quality of local competition*.

Figure 1. Competitiveness and the determinants of its growth



For this reason, M. E. Porter lays emphasis on the key factors of the micro-economic environment as illustrated by the widely known 'diamond shape chart'. The model's application to Hungary is presented in figure 2.

Figure 2. Productivity and micro-economic business environment - application to Hungary



Competitiveness as *growth potential*, therefore depends (1) on the quantity of the available resources and the efficiency of their utilisation, (2) the characteristics of the market and (3) the occurrence of so-called external effects and the related state intervention.

Externalities are often disregarded, in relation to competitiveness, however, the authors hold that this is an important aspect of competitiveness. External effects indicate a market failure i.e. the loss of efficiency occurring in the normal operation of the market. External effects are defined as a situation when an economic actor has an effect on another one but such effect is not the subject of a business transaction. Air pollution, for instance, is a negative externality where the polluter and the population or an entrepreneur living from tourism affected by the externality, do not have a direct economic relationship with one another. In other words, pollution has no market price. In our view, such external effects call for state intervention. An adequate correction of such market failure will result in an improvement of competitiveness.

For this reason, the analysis of the factors influencing competitiveness is centred around the three main themes discussed above.¹:

¹ The categories to be presented below should not be considered as exclusive, because for instance infrastructure may also be considered as a positive external factor. E.g. a motorway is a 'public good' whose

- I. Resources
 - Infrastructure
 - Labour market
 - Foreign direct investment
- II. Operation of the market, regulatory environment
 - Innovation, research and development
 - Enterprise environment
- III External effects
 - Environment protection
 - Social cohesion

The various studies were aimed at carrying out an objective assessment of the current situation and identifying possibilities for state intervention.

Hungary's competitiveness comparing favourably in regional terms

One of the most frequently cited competitiveness ranking is compiled by the International Institute for Management and Development (IMD) and is disclosed in the publication entitled World Competitiveness Report (2003). In compiling the ranking order the IMD takes account of factors such as economic performance, the efficiency of the government and the business sector and infrastructure. ²

Table 1. Order of competitiveness of countries of population up to 20 million

| Country | 1999 | 2000 | 2001 | 2002 | 2003 |
|-----------------|------|------|------|------|------|
| Finland | 5 | 3 | 4 | 2 | 1 |
| Luxembourg | 3 | 6 | 5 | 5 | 6 |
| Sweden | 9 | 7 | 7 | 7 | 7 |
| The Netherlands | 1 | 1 | 1 | 1 | 8 |
| Belgium | 13 | 13 | 12 | 13 | 13 |
| Estonia | 0 | 0 | 16 | 16 | 17 |
| Czech Republic | 20 | 20 | 21 | 19 | 21 |
| Hungary | 18 | 18 | 18 | 18 | 23 |
| Portugal | 17 | 17 | 20 | 20 | 25 |
| Greece | 19 | 19 | 19 | 21 | 26 |
| Slovakia | 0 | 0 | 22 | 23 | 27 |
| Slovenia | 21 | 21 | 23 | 22 | 28 |

Source: World Competitiveness Report (2003)

use is (in the majority of cases) free of charge, providing road users with benefits, whilst they do not directly bear the costs of road construction or road maintenance either.

² The index so compiled combines quantitative as well as qualitative aspects, since it is put together from 127 statistical data and 116 factors derived from questionnaires filled out by business managers.

In the 2003 ranking order Hungary is ahead of Portugal, Greece, Slovakia and Slovenia, but is behind the Czech Republic and that of Estonia. Some of the major changes in the order during recent years have included the overtaking of Hungary by the Czech Republic and Hungary's overtaking of Portugal since the late nineties. On the whole, it may be concluded from the above list that *Hungary is relatively favourably positioned among countries of similar sizes within our region and that no relative deterioration occurred last year.*

The World Economic Forum (WEF) discloses its Global Competitiveness Report (2003) each year presenting a ranking order of countries from the aspect of a variety of factors influencing competitiveness.³ Two key indices are calculated: the Growth Competitiveness Index reflecting growth perspectives and the Micro-economic competitiveness Index showing the efficiency of the utilisation of resources.

The competitiveness *index reflecting growth perspectives* takes account of the medium term sustainable macro-economic growth possibilities in view of the current levels of development. Three key areas are regarded as important from among the factors influencing medium (and long) term economic growth:

- technology,
- institutions,
- macro-economic environment.

The *micro-economic index* is based on data derived from interviews involving business executives and governmental officials. The assessment of the business environment is focused on four aspects including:

- the quality of input factors (human resources, capital resources; physical, administrative, information technology and natural resources)
- business environment and strategy (types of corporate strategies, local competition)
- quality of demand factors (sophistication of domestic demand, consumer pressure promoting constant modernisation of products and services) and
- existence of associated industries and supplier sector.

³ The analyses in 2000, 2001 and 2002 took into account 59, 75 and 80 different countries, respectively.

Table 2 Ranking order of certain selected countries according to the WEF competitiveness index, 2000-2002

| Ranking order according to growth index | | | Ranking order according to micro-economic index* | | |
|---|----------------|----------------|--|----------------|----------------|
| 2000 | 2001 | 2002 | 2000 | 2001 | 2002 |
| Portugal | Spain | Spain | Spain | Spain | Spain |
| <i>Hungary</i> | Portugal | Portugal | Portugal | <i>Hungary</i> | Slovenia |
| Spain | <i>Hungary</i> | Estonia | <i>Hungary</i> | Estonia | <i>Hungary</i> |
| Czech Republic | Estonia | Slovenia | Greece | Slovenia | Estonia |
| Greece | Slovenia | <i>Hungary</i> | Czech Republic | Portugal | Czech Republic |
| Poland | Greece | Greece | Slovakia | Czech Republic | Portugal |
| Slovakia | Czech Republic | Czech Republic | Poland | Slovakia | Slovakia |
| | Slovakia | Slovakia | | Poland | Greece |
| | Poland | Poland | | Greece | Poland |

Comment: Estonia and Slovenia are not included in the year 2000 ranking order

Source: Global Competitiveness Report, 2002-2003 (World Economic Forum, 2002)

Table 2 presents the ranking orders of certain selected countries compiled for the past three years. In terms of the growth index Hungary is ahead of the Czech Republic and Poland as well as Greece while in respect of micro-economic competitiveness Hungary was already ahead not only of the three Central and Eastern European countries but also of Portugal and Greece by year 2002.

The above mentioned international comparisons rely on indices comprised of a large number of particular areas. The compilation of such indices involves a number of questions concerning methodology. Other questions include whether the sustainable growth of the economy and the adaptability of the market actors depend uniformly on the above factors in each country and whether these factors have equal weight in the different countries (as is indicated by the application of equal weighting factors). It should be mentioned - by way of an example - that no consensus has been reached in technical literature concerning even the most essential factors influencing the selection of location for settlement by foreign direct investment (for a study on this theme see a forthcoming edition of the Working Papers), which is only part of the areas of the competitiveness theme discussed herein.

For these reasons an in-depth analysis of the particular areas relating to economic and business competitiveness seemed a more suitable approach than the production of a comprehensive assessment of the situation as a whole.

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Market Environment, Regulation and Enterprise Promotion

Summary

The Hungarian enterprise structure is characterised by the structural features of an advanced emerging economy. Companies are operating in competitive markets in the majority of the economic branches; concentrated or interim market structures are more frequently found among industrial branches. More intensive competition is usually related to higher level and more rapidly growing productivity.

The 'one-stop-shop' system established as part of the regulation of the foundation of enterprises provides for rapid administration of business, at relatively low costs by international standards. The changes of regulation are closely followed by the number of operational enterprises and their distribution according to legal form, primarily in accordance with the aims of economic actors at minimising their tax burdens. The administrative burdens have been substantially reduced by the integration of tax and contribution returns and the introduction of the simplified enterprise tax.

According to questionnaire based surveys carried out between 1997 and 1999 the growth of small and medium sized enterprises was hindered primarily by the high tax and contribution rates - though this effect declined over time - as well as by market demand and the conditions of competition. The measures introduced with the aim of impeding unfair market practices have resulted in improvements in this respect. Enterprises however, still do not pay adequate attention to consumer protection.

In the international practices of enterprise promotion attention has been shifted from subsidised services to legal regulations and to programmes that can be operated in a medium run even without subsidies. The practices applied in Hungary did not follow this trend. Support programmes do not contain built-in control mechanisms and there is usually no adequate information for the measurement of their impacts. The instruments applied in this field are restricted to the provision of relatively inexpensive funds to small groups of recipients. Enterprise promotion organisations have adopted a rent seeking behaviour; they are more interested in the provision funding than in the accomplishment of results and hardly any sustainable operations have evolved that are capable of integration in the market.

Introduction

The Government may do quite a lot - though not without restrictions - to promote the growth of competitiveness of businesses through appropriately shaping their economic environment. Our paper contains a discussion of the factors influencing competitiveness through the market environment, along with transformation of the institutions in charge of the promotion of economic development that is focused on the enhancement of competitiveness. Our study is comprised of three structural elements: in the first one the authors will describe the sectoral structure of the economy and the existence or lack of competition within the economic branches, i.e. the structural conditions and circumstances of competition on the basis of statistics. The second part will be devoted to the description of the actors of the market and the framework of entering the market as well as those of exiting from the market along with its operation, on the basis of the relevant legal regulations. The third part will discuss the operation of the system of institutions and instruments introduced and operated with the aim of strengthening market actors, along with the possibilities of the elimination of their operational disorders. A proposal will also be made concerning possible improvements to the governmental policy.

Hungarian market structure

The structure of the business sector that had evolved in Hungary by year 2000 showed the structural features of an advanced economy in transition. The economy of Hungary - a small, open economy under pressure to incessantly adapt to external circumstances - was characterised by a large number of relatively small enterprises in domestic ownership, low level of capitalisation as well as intensive and growing presence of foreign capital. Competition is expected to intensify as a result of Hungary's EU accession. Various forms of cooperation in the market, distribution of work and organisation (including network formation) appeared and have been growing stronger, and in some areas even the signs of corporate concentration have been perceived. While the average size of a company in Hungary is not materially different from the average European business size there are still significant differences in respect of income and performance indicators. The basic structural features of small and medium-sized enterprises have hardly changed during recent years, their financial management has been characterised by high labour intensity and low capital intensity. They account for much larger share of employment than of sales revenues or income generation. This is a natural phenomenon in itself, but the differences between small and large enterprises seem to be rather too large by international standards and the gap has been increasing, rather than diminishing.

The centrally planned economy had a distorted sectoral structure, characterised by a large number of monopolies, dominance of large state companies, relative shortage of small and medium-sized enterprises, by lack of imbalance between (state, cooperative, private) forms of ownership and (large and small enterprises) forms of businesses and by restrictions on the freedom to launch businesses. The two equally important pre-requisites for transition to market economy were creation of private ownership and competition. The ownership conditions, actors and rules of a market economy had to be established in the

hope that the creation of the frame conditions would, at the same time, entail the evolution of the behaviour patterns of a market economy.

The establishment of legislative and organisational frameworks was accompanied by the privatisation of the majority of former state owned and cooperative businesses. Former large and medium-sized enterprises were also privatised. Privatisation was often accompanied by decentralisation. The objectives of the actions taken in the course of the dismantling of the large enterprise structure did not always include provision for competition or the increasing of the number of market actors, though decentralisation also resulted in a growing number of market actors.

Concentrated market structures inherited from the previous era continued to function in a number of areas. Distortions of the market, however, tend to distort competition as well, leading to the coordination of behaviour between various economic actors, resulting in economic dominance of various forms, ranging from the enforcement of unfair prices, unjustified advantages and the forced application of conditions disadvantageous for others, through the restriction of production, rejection of business relationship and discrimination against various business partners, to the bundling of products, application of prices set under the competitive level and the impeding of others' market entry. Such forms of behaviour are detrimental to suppliers, competitors or consumers as well as to society as a whole. Among the conditions of competitiveness special attention is therefore to be assigned to the assessment of the structural conditions of the market. The market structures established so far are described in categories without value judgements or normative evaluation, through a statistics-based approach, not taking account of economic differences between the various branches and markets.

The authors have in-depth information on the sectoral structure of enterprises in terms of economic branches. The features of the market are described on the basis of the sectoral features of enterprises. Our simplifying assumption is that an **economic branch - a group of businesses offering mutually substitutive products or groups of products** - is a market at the same time. Accordingly, the terms 'market' and 'economic branch' will be used synonymously.

The structure of an economic branch (market structure) will be described in terms of its **concentration⁴ and the number of actors**. Strong competition is observed in sectors characterised by a large number of entities and a low degree of concentration (deconcentrated structure) while weak competition is characteristic of a sector of high degree of concentration and small number of entities (concentrated structure).

⁴ Concentration is calculated in terms of the so-called Herfindahl index (sum of the corporate sales revenue / total sectoral sales revenue ratios to the power of two). The index is 1 if only one entity is operating in the sector and it is approximating zero in the case of an infinite number of entities, of small sales revenue figures. In the establishment of the types of market structures both the degree of concentration and the numerousness of the entities operating in a given sector are broken down into two groups: higher than average and lower than average concentration sectors and sectors of higher or lower than average numerousness of businesses, producing four categories: (1) sectors of small concentration and large numbers of entities, (2) sectors of small concentration and small numbers of entities, (3) sectors of high concentration and large numbers of entities (4) sectors of high concentration and small numbers of entities. The first category describes the structural conditions of strong competition, the fourth category is that of weak competition. The second and the third categories are combined as a category of medium intensity competition.

The sectors of deconcentrated and concentrated structures account for 18% of the total number of economic branches each, while 64% of the branches are positioned between the two extremes.

Industry and services are the most complex sectors. A total of 272 economic branches are distinguished in industry, 127 in the service provision sector, 77 in trade and 16 in agriculture. In respect of the market structure the largest numbers of economic branches belong to the interim structural category in each sector. Industry is also characterised by numerous concentrated branches while the rest of the sectors have many a deconcentrated branch.

Table 1 Number of branches by sector and by branch structure

| Macro sector | Concentrated | Interim | Deconcentrated | Total |
|--------------|--------------|---------|----------------|-------|
| Agriculture | | 10 | 6 | 16 |
| Industry | 79 | 168 | 25 | 272 |
| Trade | | 50 | 27 | 77 |
| Services | 14 | 82 | 31 | 127 |
| Total | 93 | 310 | 89 | 492 |

Source: calculated from tax returns

Enterprises in the branches

Enterprises are not equally distributed among the different economic branches. The following is a description of the market environment of businesses in terms of regions, main owners and sizes.

A total of 0.3% of enterprises are operating in concentrated economic branches, 29% in intermediate branches while the largest number of enterprises are functioning in deconcentrated branches, under the structural conditions of economic competition.

In terms of territorial distribution, concentrated markets are more characteristic of Central-Transdanubia, the North Hungary, North Great Plain and South Great Plain. A larger than average number of deconcentrated markets is found only in Central Hungary.

Domestic private enterprises are more characteristic of deconcentrated markets, while state owned, domestic corporate businesses and foreign enterprises are more typical of concentrated markets.

Larger than average numbers of businesses without employees and of micro-enterprises are operating in deconcentrated markets, while small and medium-sized enterprises and large enterprises are more characteristic of concentrated and intermediate markets.

Performance and competition

The productivity (per capita sales revenue) of **enterprises** operating in concentrated market structures was larger in 2001 (HUF 17,143,000) and their efficiency (gross added value per one HUF of shareholders' equity) was smaller (HUF 1.57) than the corresponding figures of enterprises operating in deconcentrated markets (HUF 12,001,000 and HUF 2.58, respectively).

The productivity and efficiency of concentrated **economic branches** grew faster between 1998 and 2001 than did those of deconcentrated markets. Average productivity increased from HUF 11,396,000 to HUF 22,418,000, efficiency increased from HUF 0.4 to HUF 0.87 in markets of concentrated structure. The corresponding figures in deconcentrated markets were HUF 10,584,000 and HUF 14,834,000 as well as HUF 0.65 and HUF 0.52, respectively.

Our results were probably also influenced by the fact that enterprises are not operating entirely separately. They belong to groups of enterprises, networks and strategic alliances, consequently the limits of individual businesses are not entirely clear-cut. This factor could not be taken into account in our analyses for our work was based on data derived from tax returns. Another research project, however, has recently shown that the 350 largest companies in terms of sales revenue, all of the large banks and the ministries as well as the State Privatisation and Holding Company (ÁPV Rt.), along with all of the caucuses in Parliament are to be regarded as a single large network, and almost 90% of all enterprises participate in a single system of relationships (Vedres, 1999.) In view of this fact the author of the study (Balázs Vedres) rightly raised the idea that 'it should seem well worth re-thinking the abstract economic concept of free competition based on atomised - separated - participants.'

Legal and regulatory environment

The document entitled '**European Charter for Small Enterprises**' as a basis of the activities aimed at supporting and promoting the development of small enterprises, may be considered as the fundamental document of enterprise development policies in the European Union. The Charter declares that small enterprises should be regarded as the key drive of innovation, employment as well as social and local integration within Europe, therefore, the **best possible environment** should be provided for the operation of small and medium-sized enterprises and entrepreneurial activities. Rather than direct state subsidies and artificial reduction of the prices of financial services, emphasis should be laid on areas such as

1. Education and training for entrepreneurship
2. Cheaper and faster start-up.
3. Better legislation and regulation
4. Availability of skills
5. Improving online access
6. More out of the Single Market
7. Taxation and financial matters
8. Strengthen the technological capacity of small enterprises.
9. Successful e-business models and top-class small business support
10. Develop stronger, more effective representation of small enterprises' interests at Union and national level

A new SME development programme has been elaborated in line with the Charter for the period between 2001 and 2005 and the new set of objectives also appears in the structure of the organs implementing the SME policy. Hungary - together with other candidate countries - signed the Charter in Maribor (Slovenia) in late April 2002, assuming a commitment concerning the development of the domestic SME development policy and

business environment in accordance with the established action programme and in view of the requirements of small enterprises.

Start-up conditions for businesses

Substantial progress has been made in Hungary in enabling cheaper and faster start-up of businesses during the recent period and more progress will be made in the near future in the development of corporation and business law. Efforts should continue to be made in the area of legislation and IT development in order to render the system of reporting for registration as fast, convenient, simple and inexpensive as possible.

Entrepreneurial card

The conditions and requisites of the establishment, operation and disestablishment of sole proprietorships have been regulated since 1 April 1990 by Act No. V of 1990 (as amended). Up to 30 June 1998 entrepreneurial cards were issued by the local governments, from 1 July 1998 applications for cards had to be submitted to the relevant chambers of economy. This amendment implemented the long awaited 'one-stop-shop' system since after receipt of the applications the chambers obtained - through a computer system established for this purpose - the tax administration number from the competent authorities, the tax identification codes and the statistical codes where necessary, along with the social security account numbers.

With effect from 1 November 2000 the provisions of the Act No. CXXI of 1999 delegated the tasks relating to the reporting of sole proprietors for registration as well as those of their registration, to the municipal (in Budapest: district) local governments carrying out district centre tasks with competency in respect of the head offices of such businesses. Administration of business is carried out by the document offices of the Ministry of the Interior. The change did not alter the 'one-stop-shop' system of reporting for registration. The local governmental document offices - the number of which has increased from 253 at the time of the delegation of this task to 274 to date - bear substantial workloads, which is increased by the mandatory replacement of entrepreneurial cards, and the situation was made even more complicated by the fact that the sole proprietors opting for the system of simplified enterprise tax also had to change their cards again owing to the change of their tax administration numbers.

Replacement necessitated by the expiry of the cards issued prior to the entry into force of the new regulations was exempt from the relevant duty within the deadline of validity (the original date of which was 30 June 2002). Under pressure by chambers and other interest representing organisations the provisions of Act No. XII of 2002 extended the validity of the entrepreneurial cards issue before 1 November 2000 up to 15 February 2003. The provisions of Government Decree No. 129/2000. (VII. 11.) on entrepreneurial cards were also amended accordingly. An entrepreneur who failed to submit an application for the replacement of his old type entrepreneurial card and operating licence by 15 February 2003 is now conducting economic activities holding an invalid card. Quite typically, according to data on early January 2003 a total of 66,224 sole proprietors had not replaced their entrepreneurial cards.

The replacement of the entrepreneurial cards was necessitated by the establishment of the central register of sole proprietors holding entrepreneurial cards managed by the Central Data Processing, Registration and Election Office of the Ministry of the Interior.

With the exception of telephone and telefax numbers the data held in the register are available for anyone, in order to increase the security of economic transactions. For a fee the Office provides data from its register on individuals and groups of entrepreneurs (pursuant to Decree No. 28/2000. (X. 27.) BM, issued by the Ministry of the Interior). Data of businesses are entered in the sole proprietors' registers and tax registers as a result of the data reconciliation exercise involved in the mandatory replacement of the cards. The entire process of data reconciliation is automated. Data are provided on one person in one procedure for a fee of HUF 1,200. No substantial information is available on the degree of utilisation of the data supply service but local governments have reported that data have not often been requested on entrepreneurs in order to ensure the security of economic transactions.

Asking for the entrepreneurial card of the entrepreneur for a check would already be an easier solution in practice for this purpose.

Applications submitted by the deadline are currently processed at the Central Office of the Ministry of the Internal Affairs, final data are expected to be available by the end of June. According to data as of mid-May:

- a total of 516,327 businesses were recorded during the registration period (between 1 November 2000 and 15 February 2003).
- the number of businesses currently in operation is 404,408 (of which new businesses launched after 1 November 2000: 105,957, those recorded during the registration period: 298,451).
- enterprises disestablished during the course of the registration procedure: 111,919.

In addition to the official certificate of no criminal record the documents in proof of the holding of qualifications required by law where the applicant intends to pursue operations necessitating qualifications, other official licences where licensing obligation is imposed by law on the performance of the operation, document in proof of the way of the performance of work where the individual does not intend to perform such activities on a full time basis, the documents in proof of the legality of the use of the head office, premises, branch unit and, of course, the documents that are suitable for the proof of his identity and place of residence have to be attached to the application for an entrepreneurial card. The document office will issue the entrepreneurial card in possession of the tax number, it may only be taken over personally - unlike before - and the taxable operations may be launched from the date of the receipt of the card.

The data pertaining to taxation - registered exclusively by the Tax Administration - and their changes, however, have to be reported to the Tax Administration within 15 days by the sole proprietor. In the new system the set of data subject to the reporting obligation has been reduced, and - as enabled by the one-stop-shop system - data may be reported via the post office. Data reported outside the scope of reporting for registration include, for instance, bank account numbers. Within 15 days of receipt of the entrepreneurial card the entrepreneur also has to report to the local authority for the purposes of registration for local enterprise taxation. (Exceptions to this rule may include some municipalities where the local government has decided not to collect local enterprise tax. In the territory of Budapest every entrepreneur has to report for registration for taxation purposes.) An

entrepreneur should expect a call from the Central Statistics Office as well, requesting for data for their purposes.

Pursuant to Article 7 of the Act on sole proprietorships the notary of the relevant municipal (in Budapest: district) government is to check whether the operations of the sole proprietor meet the requirements and criteria specified in the relevant legal regulations and the card of the sole proprietor, and communicates the findings of the check to the notary of the district centre having competency concerning the issuing of the entrepreneurial cards. Based on this opportunity a practice has evolved in the capital city under which - in order to reduce the workload of document offices - the notary of the competent municipal (in Budapest: district) local government who is at the same time in charge of various official permits, such as the operating licence of a business or a plant licence, provides information and assistance to applicants concerning the processes involved and the tasks to be carried out. Thereafter the document offices only have to issue the cards. An entrepreneur will normally receive his/her entrepreneurial card within a week or two (the maximum permitted processing time is 30 days). In this case the *launching of a sole proprietorship may cost up to HUF 15,000* which includes the procedure fee and the costs of the printed forms involved. If the operation is subject to the licensing of the plant where the operation is to be pursued the procedure may take substantially longer and may cost much more, especially if other authorities also have to be involved. In practice this has been causing most of the problems for entrepreneurs.

Founding of enterprises

In respect of the legal regulations governing the foundation of businesses Act No. 1997 CXLIV on the establishment of new economic associations and the closely related Act No. CXLV of 1997 on the registration of businesses, the publicity of corporate data and corporate court procedures entered into force on 16 June 1998, bringing about significant changes in the foundation and operation of economic associations. This was followed by the introduction of the so-called 'one-stop-shop system' for economic associations on a mandatory basis, which is a system functioning practically in the same way as does the system providing for the issuing of entrepreneurial cards, as well as the submission of the data required for taxation to the tax administration system within a maximum of 15 days. Enterprises established without preliminaries may be operating as pre-enterprises from the day of the counter-signature of the articles of association and/or laying out of such in a public document, however, they may pursue economic activities as regular business operations only from the date of submission of the application for recording in the trade registry, but they may not carry out operations subject to licensing by the competent authorities.

The businesses concerned - limited liability companies /*Kft.*/ and shareholding companies /*Rt.*/ - were affected in June 2000 by the mandatory capital increase requirement the importance of which is indicated by the fact that by the end of May over 73,000 (72,500 *Kft.* and 600 *Rt.* type) additional entities had to fulfil such statutory obligation. The enterprises concerned had three options to choose from: increasing the equity to the statutory minimum amount; transformation; winding up through the final settlement of accounts and liquidation. From the same date economic working associations as well as economic working associations with the involvement of legal persons may continue operating as unlimited partnerships after transforming their charters or they have to transform into different economic associations. Without such

transformation these organisations are declared by the Court of Registration wound up, for the new Company Act terminated such types of economic organisations. At the end of May the CSO register held a total of 7,456 business organisations of the categories terminated by the new act, from among which only 3,680 were registered as active organisations. At the end of February 2003 the corresponding figures were 1,359 and 96, respectively.

Since 16 June 1998 the law distinguishes between the procedures to be applied in the case of organisations without legal personality those applicable in the case of legal entities. The time and cost requirements of registration of such entities also depend on this distinction.

In the case of *organisations without legal personality* the Court of Registration carries out only format type checks *in the case of which the processing time may not exceed 30 days* (not including the time required for the supplying of details not submitted with the original application). *In the case of legal entities* besides content review the total processing time may be *up to 60 days*. Legal representation is a mandatory requirement in the trade registration process, the entities are legally established from the day of their recording in the trade register. In addition to making available the minimum equity required for the foundation of the business the fee for publication and the procedural charge also have to be paid. Their amounts are specified as percentages of the founding equity. For instance, the *costs of the foundation of a limited partnership may*, depending on the costs charged by the lawyer for his services, *vary between HUF 50,000 and 100,000* including duties and the costs of the forms to be used.

A study disclosed by the OECD in year 2000 (OECD, 2000) enables international comparison of the obligations relating to the foundation of an enterprise, through a review of the administrative obligations, time and cost requirements of the foundation of businesses.

Table 2 *Procedural requirements of the establishment of businesses in the late nineties*

| | Number of procedures | Time (weeks) | Estimated costs (ECU) |
|--------------------------|-----------------------------|---------------------|------------------------------|
| Australia | 1 | 1 | 340 |
| France | 10 | 6 | 3 400 |
| Germany | 6 | 16 | 1 400 |
| Italy | 18 | 10 | 2 200 |
| Japan | 6 | 3 | 4 000 |
| the Netherlands | 2 | 12 | 1 000 |
| Spain | 7 | 24 | 330 |
| Sweden | 3 | 3 | 1 130 |
| Great Britain | 1 | 1 | 420 |
| United States of America | 1 | 1 | 500 |

Source: OECD Small and Medium-Sized Enterprise Outlook 2000

Accordingly, Hungary does not compare unfavourably: establishing a business is neither a complex, nor a lengthy process. The establishment of a sole proprietorship is an inexpensive procedure, other forms of businesses may be established at acceptable costs.

The European Union has issued directives on harmonisation and has created a Community enterprise form to coordinate national regulations in the area of the establishment of businesses.

Most of the Hungarian regulations pertaining to the establishment of businesses are in line with the Community regulations, however, owing to differences some of the corporate and company regulations will have to be amended to create a more favourable domestic economic legal environment for small enterprises and foreign investors. Effective and flexible cross-border cooperation within the Union particularly between small and medium-sized enterprises should be promoted by the European economic interest representation association to be introduced as a new form of enterprise. In a longer run the introduction of electronic trade registry procedures - a long awaited improvement in the relevant procedures - may also be implemented in Hungary through the amendment to the No. 1 Community Directive on the legal regulation of businesses. In view of the expectations of the European Charter for Small Enterprises as well, changes are expected in the current detailed regulation of smaller businesses - primarily those without legal personality - through the possible termination of the statutory obligation to retain lawyers' services or the simplification of the registration process.

Effect of the change of the legal and regulatory environment on the number of enterprises and changes of the taxation rules specifically applicable to the SME sector

The change of the legal and regulatory environment will have a major influence on the development of the number of enterprises. The tables attached provide an insight in the development of the number of registered and the active businesses (the latter category has been separately covered by statistics only since 1995).

In the category of **corporate businesses** the limited liability company and the limited partnership form are the most popular ones. Besides these two types of businesses which account for the largest numbers of businesses in Hungary, the categories of unlimited partnerships, shareholding companies and cooperatives make up very modest percentages of all businesses. The number and composition of corporate entities has been changing steadily and in a variety of directions since the entry into force of No. VI Act of 1988 on economic associations, and since its re-drafting in 1997. The initial rapid increase was followed by a period of lower - and fluctuating - growth rates. Since 16 June 1998 - the entry into force of the new Company Act - the number of businesses without legal personality has increased by 32% in four years, within which the number of limited partnerships has increased by 40%. The rate of the growth of the number of enterprises with legal personality - limited liability companies /Kft./ in particular - was not even half as high as that of entities without legal personality. These trends have been motivated primarily by the tighter requirements contained in the new Company Act and the increased minimum equity requirements, but the significant increase of duties payable with respect to the foundation of businesses - which had been widely known in the second half of 1998 already - must also have contributed to the above trend since it probably accelerated the implementation of the intents concerning the foundation and

transformation of businesses. A third factor may have been a rule in the new Accounting Act according to which economic associations established by the end of 2000 were permitted to continue the application of single entry book keeping practices for an interim period of time up to 31 December 2003, which was no longer possible for entities launched after the entry into force of the law. Consequently, the number of functioning limited partnerships increased almost twice as fast between January and December 2000 than that of limited liability companies. In year 2001 only 21,500 and 17,000 limited partnerships and limited liability companies were established, respectively.

The growth of the number of **sole proprietorships** that began in the early 90's peaked in 1995. This was the year when the **flat rate tax** option was made available for such businesses with annual net sales revenues not exceeding HUF 3 million in 1994. For businesses engaged exclusively in retail trading activities the corresponding limit was HUF 15 million. The mode of the introduction of this option made it possible for many entities to minimise their taxes, for instance a lot of employees adopted a strategy of retaining their employees as contractors (entrepreneurs themselves). A total of 10.4% of all sole proprietors operating in 1994 (64,000 individuals) shifted to flat rate taxation in 1995. Besides highly profitable sole proprietors loss making ones also chose this favourable type of taxation. The latter category of businesses made up 18%. Together with those earning below the taxable level they represented over two thirds of those having opted for flat rate taxation. In response to the above trends, the provisions of No. XXXV Act of 1995 amending the rules on personal income taxation with effect from 15 May 1995 altered the conditions of flat rate taxation, substantially reducing the range of taxpayers entitled to this option. Those who had reported for registration as taxpayers under the flat rate taxation scheme were permitted to pay their taxes under the previous rules. Since then the relevant regulations have been supplemented by the introduction of a variety of elements, for instance, from 1997 it was available for agricultural prime producers, from year 2000 VAT exemption was also available for those meeting certain conditions, without having to apply for such exemption specifically. In 1999 a total of 26,500 persons paid their taxes in accordance with the rules on flat rate taxation, and their number increased in 2000 and 2001 to 30,500 and 31,500, respectively. This is where mention should be made of the failure of the fixed amount flat rate taxation form which was introduced by the law for a two year period on an experimental basis, and which was adopted only by a total of 904 persons providing accommodation services, 118 hairdressers, beauticians and cab drivers. In year 2000 similar numbers of taxpayers chose this form of taxation, after an amendment to the rules on the termination and re-launching of businesses. In year 2001 this form of taxation was available only for providers of accommodation services.

After the peak in 1995 the number of registered sole proprietorships declined until 1998 at varying annual rates. The most substantial decline was observed in 1996 and 1997, when legal regulations on social security contribution payments were modified. Since 1999 the number of sole proprietorships has been increasing at modest rates.

The number of small and medium-sized enterprises per 1,000 residents (63.4, in contrast to the average of 52.4 registered in the European Union) reflects a high rate of entrepreneurial activities in Hungary. The high level of business undertaking propensity, however, is not accompanied by the knowledge and skills required for the successful operation of businesses, which is one of the reasons for the fact that the *survival rate of businesses is substantially lower than it is in the European Union* (it was 53.8% between 1995

and 1997). Consequently, the development of the number of enterprises hides a high rate of fluctuation. The fluctuation of the number of sole proprietorships and corporate businesses without legal personality is somewhat reduced by the mandatory audit - since 1994 - by the Tax and Financial Control Administration (APEH) of all businesses that are closed down. Therefore, a large number of businesses do not formally wind up such operations. This breach of administrative obligations - the smaller the business the more frequent the breach is - explains the difference of an average rate of almost 30% between the number of registered entities and those actually operating.

The fluctuation of sole proprietors declined somewhat during the recent two years: in 2000 and 2001 some 52,000 new sole proprietorships were launched each year. Some 43,000 and 52,000 were closed down in 2000 and in 2001, respectively. In addition to the change of the regulations the high rate of fluctuation is also driven by selection in the market and the fluctuation caused by seasonal type businesses. The amendment to the Labour Code in effect since 1 July 2003 may contribute to a reduction of the number of businesses as a result of the increase of the controlling possibilities aiming at identifying 'forced enterprises'.

Among **taxation rules** specifically applicable to the SME sector mention should first be made of two major preferential conditions introduced in 2001 to reduce the tax burdens of small and medium-sized enterprises - particularly micro- and small enterprises - both in respect of the personal income tax and the corporate income tax, which resulted in major improvements in the income positions of enterprises and their liquidity. One such improvement was the **investment tax base allowance for micro- and small enterprises** enabling a reduction of the pre-tax profit if certain conditions are met, to the extent of the amount of the tax base, in 2001 and 2002 not exceeding HUF 10 million and HUF 30 million, respectively. On the one hand this rule stimulates the statement of profits, while on the other hand the investments promoted by the new rules may improve the chances of Hungary's economy to catch up. The other such preferential regulation is **tax allowance for small and medium-sized enterprises attached to interest rates on credits** enabling businesses to deduct the lower of 40% of the interest paid on loans taken out for the purchasing of tangible assets or HUF 5 million per tax year from the amount of the tax payable by the enterprise. According to tax returns filed in 2001 the preferential rules were applied by almost 8 times as many entities (persons) than the number of recipients - of the same size category - of financial support under the Széchenyi Plan. (The investment tax base allowance provided for small and medium-sized enterprises were used by a total of 43,181 businesses (sole proprietorships and corporate businesses) in a total amount of HUF 83,404 million while the tax allowance on investment loans were used by a total of 2,955 businesses in an amount of HUF 1,013 million.)

In order to promote research and development in the sector, both corporate businesses and sole proprietorships may - since 2001 - deduct 200% of their R&D costs from their tax base. Some improvement was provided for entities operating in the tourism sector by the termination of the duty called 'tourism contribution' from 2002. From year 2003 the increased rate of depreciation write-off and the introduction of tax-free development reserve provided further improvements to the conditions applicable to businesses. The burdens borne by enterprises was substantially reduced by the reduction of the fixed amount health contribution from the HUF 4,500 paid in 2002, to HUF 3,450 in 2003.

In the year 2003 regulations, however, the largest change pertaining to the smallest businesses was brought about by the introduction of a new type of tax called **simplified enterprise tax (SET)**. A total of 66,737 businesses applied for the adoption of this type of taxation, of which a total of 63,340 businesses were registered as payers of this type of tax. From among those adopting the SET a large number of entities were loss-making businesses according to the analysis of the year 2001 tax returns, in contrast to the prior expectations. According to data as of 6 January 2003 one in five of the total of 32,432 sole proprietorships and one in four of the total of 20,795 corporate businesses closed fiscal year 2001 with losses. Their average loss was also relatively substantial - HUF 300,000 - along with a unit sales revenue figure of HUF 2.9 million. Furthermore, an amount of HUF 8.4 billion - far in excess of the expected sum - was paid as tax advance on the first quarter, by those opting for the payment of SET. This shows that the budget should expect more revenue from this type of tax than had been estimated and the total amount will probably exceed the amounts by which the personal income tax, the corporate income tax and VAT will diminish owing to the introduction of the new tax type.

Payers of the SET may fix their local enterprise tax base at 50% of the SET base, sparing them the administrative burden entailed by the detailed calculation of the basis of the local enterprise tax. The need for the resolving of the problems relating to local taxes is growing increasingly urgent as a result of Hungary's EU accession particularly with respect to the local enterprise tax which also has a substantial impact on competitiveness. This is considered as one of the most sensitive issues among the challenges pertaining to the system of public burden sharing, and it may be resolved only through the transformation financing of local governments.

Administrative burdens

The need for the reduction of the taxation, contribution and administrative burdens of small and medium-sized enterprises has been on the agenda practically ever since the system-change. Its necessity has been proven by findings of surveys on businesses. The findings of our surveys on entrepreneurs carried out in four phases between years 1997 and 2000 on a representative sample of 2000 businesses reflected that small and medium-sized enterprises considered the heavy public burdens and the lack of predictable economic regulations as the major hindrances to the growth of their businesses. This factor was assigned the highest weight factor (63%) though in comparison to the rest of the categories it was slowly declining (KVFI, 1997, 1998a, 1998b, 2000).

Table 3. The ranking of factors hindering the growth of businesses in respect of the four groups of factors (%)

| Factors* | Average value, December 1997 | Average value, December 1998 | Average value, December 1999 |
|--------------------|---|---|---|
| Regulation | 73 | 68 | 63 |
| Market environment | 49 | 49 | 52 |
| Financing | 32 | 31 | 37 |
| Inputs | 13 | 15 | 14 |

**'Regulation' includes taxation and social security burdens and the unpredictability of economic regulations; 'Market environment': strong, unfair competition, shortage of orders; 'Financing': shortage of capital shortage of credit, delays of payment; 'Inputs': obsolete capacities, procurement difficulties, labour shortage.*

A lot of the resources of enterprises are absorbed by administrative procedural tasks and reporting obligations imposed on businesses by the tax authority. This is also true where external accountants are retained to carry out accounting tasks for which 1.5-2.0% of the sales revenues are usually paid by businesses. For instance, in 1999 a total of almost 70 different types of forms were in use for the fulfilling of obligations, along with some 20 different types of forms used in the registration of contribution payments for the purposes of reporting for registration, reporting of changes of data as well as the contribution return forms in line with the amended statutory regulations. Together with the terminations of businesses and the fusions/mergers of businesses the state tax authority kept a total of 46 budgetary accounts supplemented by four additional accounts created in 1999 (previously related to the social security system) in relation to which taxpayers could generate cash flows. One major change was that *since 1 January 2000 the same rules apply to the filing of tax and contribution returns, substantially reducing the administrative burdens.*

Each of the surveys on businesses showed that the largest reduction of the administrative burdens would be granted for businesses by the possibility to submit the necessary tax/contribution returns electronically. The possibility of downloading of the necessary forms from the APEH home page was a substantial contribution to the first step of the accomplishment of the above goal and the receipt of the returns and the control data (9 million and 15 million processed in 2002, respectively) on time and with precise contents. This option was introduced in year 2000 in respect of the No. 9928 and 9929 corporate income tax returns on year 1999. In 2003 a total of 49 of the forms introduced by APEH are available online together with the aspects of the analyses of inter-relationships and the relevant checking and execution program, accompanied by a total of 38 forms in the form of document images. In year 2003 almost twice as many personal income tax returns (more than 617,000 forms) were generated with the aid of the Internet based program than in 2002. Accordingly, almost a third of all personal income tax returns were produced electronically. In year 2002 and 2001 the corresponding figures were 6.9% and 1.6%, respectively. In the case of sole proprietors the ratio of returns downloaded from and submitted through the Internet increased from 2.8% in 2001 to 13.8% in 2002. The corresponding figures in the case of corporate income tax returns were 18.5 and 44.5%, respectively. The growth is significant, but it should also be taken into account that according to the survey conducted by our Institute (KFI, Small Enterprise Promotion Institute) 75% of businesses retain external auditors, which shows that this growth should be even faster and accountant businesses should be utilising this opportunity in even higher proportions.

The electronic form of filing tax returns also makes the work of the tax authority a lot easier, for example, by significantly reducing the number of calculation and logical errors made by taxpayers in the case of each type of tax return: e.g. in the case of corporate income tax returns the rate of errors dropped by about fifty percent.

The second stage of the development of an electronic tax administration comprises the electronic filing of tax returns.

The introduction of the simplified enterprise tax (SET) resulted in a substantial reduction of administrative burdens. From January 2003 limited partnerships and

unlimited partnerships paying their taxes under the simplified enterprise tax scheme may save substantial accounting costs by continuing to pay their taxes according to the SET rules for they can fulfil their registration obligation through the registration of revenues as well according to their choice made upon entering the scheme, just like sole proprietors. Limited liability companies (Kfts), cooperatives, forest owners' associations, executor offices, law offices, patent administration offices are under obligation to apply double entry book keeping according to the Accounting Act. A lot of accountants have reduced the fees charged to their clients with simplified record keeping: in general they charge the same amount for a quarter as they used to charge for a month, i.e. between HUF 10 and 15,000 + VAT.

In the wake of Hungary's EU accession a growth of the administrative burdens should be expected in the areas of certain technical and security requirements, or in respect of employment, taxation or the increasing complexity of the system of state supports.

Administration of justice, security in law

Our above mentioned surveys on enterprises (KVFI, 1997, 1998a, 1998b, 2000) have also provided information concerning security in law for economic actors in Hungary and unfair competition practices as a factor influencing the growth of businesses. Unfair practices in competition - not restricted to behaviour violating the provisions of the Act on competition - were ranked fifth, with similar values assigned in each of the surveys, following the high rates of public burdens, the intensity of competition, the unpredictability of economic regulations and the insufficient stocks of orders.

Similar surveys carried out on small and medium-sized enterprises of East European countries have also shown that instead of financial type limitations business managers consider factors restricting infrastructure promoting undertakings and the operation of the market economy, such as corruption or the restriction of competition as the main obstacles to economic growth (Viszt, 2000).

'GKI' Economic Research Institute carried out comprehensive research in 1999 concerning the 'regular' forms of unfair practices - such as business behaviour violating rights relating to ownership and contracts - along with the frequency of occurrence of such practices and the amounts of the damage and losses caused (Papanek, 1999). The survey was based on the assumption that many companies are forced to assume excessive risks or bear large losses owing to other businesses' corrupt practices promoting business acquisition and the administrative processes, breach of contract, late or non-payment, fraudulent bankruptcy and liquidation or the dumping prices enabled by tax evasion. The social losses and damage caused by this situation - although not materially larger, indeed, smaller on the whole than in the Central and Eastern European region in general - are not acceptable. In respect of the frequency of the various forms of violations of the law the survey reveals particularly serious problems in the areas of late and non-payment, competition on the part of the black economy, deficient or non-performance by sub-contractors and suppliers. The problems of deficient, negligent or corrupt behaviour on the part of public institutions and assumed corruption in the granting of orders in public procurement procedures are considered to be somewhat less dramatic. In some cases business partners suffer damage as a result of others' taking advantage of the unreliability of the trade register and the land register entries or of the violation of rights relating to

intellectual property. The causes of the above include for instance the unreliability of the land registers and the trade registers, the deficiencies and internal contradictions of the acts on the regime of financial management, amended many times, along with the deficiency or lack of knowledge of the law on the part of the enterprises that have suffered losses, the low standards of business moral and the shortage of appropriately qualified experts in institutions in charge of sanctioning unfair competition. The extent of employment in the black economy is a result of the excessively heavy public burdens.

A variety of positive changes have taken place since the survey in almost each of the above areas in respect of the restriction of unfair competition and non-compliant business practices. Progress has been made in the area of legislation - through legal harmonisation as well - in the area of the trade registers and the registration of sole proprietorships, in education and extension training, and mention should be made of the slight reduction of public burdens and the increasing of controls and inspections. Nevertheless, substantial efforts will still have to be made to develop sound and compliant business practices and to reduce the burdens borne by the courts as well. Some improvement is indicated in this area by a review of the number of cases dealt with by local and county courts. In 1997 almost 20,000 economic cases were submitted to local courts the number of which then gradually declined to about 14,000 by year 2000 while the number of cases of first instance and of appeals submitted to the county courts increased somewhat within the 2000-3000 range. Within the court cases the share of economic cases made up a declining share: in a period of four years under review they dropped from 6.9% to 6%, while the share of labour and criminal cases increased. The number of economic court cases still in progress - which turned out to take several years for some reasons according to the summary of a review of cases by the Economic College of the Budapest Metropolitan Court - also diminished. Categorisation of the litigations according to subject showed in 1998 that businesses submitted cases to court on account of loss or damage to their assets only in a smaller number of cases. Litigations on account of breach of contract were more frequently encountered.

Besides the Office of Economic Competition faster administration of matters in court is promoted by the *Permanent Court of Arbitration* operating alongside the Hungarian Chamber of Commerce and Industry (MKIK) both in respect of domestic and international cases, as an alternative forum of the settlement of disputes over economic matters. This forum is *becoming increasingly popular with businesses*, which is also proven by the fact that the number of cases submitted to the court of arbitration has been increasing year by year and last year it exceeded 200. The Chamber of Commerce and Industry elaborates the codes of ethic concerning fair market practices in order to ensure security of business transactions and to create, safeguard and enhance the fairness and compliance in market behaviour, with the involvement of interest representing organisations of economic actors. To this end the Chamber has issued its Code of Ethics, accompanied by other specific codes of ethics for an increasing number of branches (drivers' schools, travel agencies, catering businesses, taxi drivers etc.) issued with the involvement of the relevant trade unions.

One of the most important issues of security in law is fight against corruption declared both by the World Bank and by the IMF as the main obstacle to economic and social development. Quite a number of measures will be necessary for Hungary to get

advanced in the corruption ranking published on a regular basis by Transparency International.

In 1995 Hungary was ranked 28th among 41 countries, with a score of 4.12, while in 2002 Hungary stood at the 33rd position - after the 31st place in 2001 - out of a total of 102 countries, with a score of 4.9. (The maximum 10 point score is assigned to the country with the lowest level of bribery.) A general observation of the study was that the accessing countries - where *Hungary* is rather favourably ranked being second after Slovenia - *had introduced EU conform anti-corruption laws but no material progress had been made in their application in legal practices.* Legislative and law enforcement efforts may bring about favourable results through tight controls over the flows of public moneys, compliance with the rules on publicity and transparency as well as those on the granting and use of financial assistance (aids, grants) but any major improvement may be expected only through an improvement of the political and business moral evolving within the framework of the law.

Consumer protection

The application of the rules of consumer protection is one of the most important elements of competition for businesses. The entities that comply with the requirements of consumer protection improve their market positions together with competitiveness, while those that fail to comply with the rules find themselves in a disadvantaged position and may even find themselves forced out of the market. During its decades of development consumer protection has always been treated as a priority policy area. The standards of consumer protection in the European Union are among the most important results of the gradual development of the single internal market, where after the enlargement high level protection will have to be provided for some 470 million consumers. Based on the Amsterdam treaty the regulations on consumer protection will have to be treated as a separate set of requirements, providing for the priority of the protection of consumers in the areas of other policies as well, enabling the Member States at the same time to apply tighter consumer protection regulations than those applied by the European Union.

At present it is a general problem that *enterprises do not recognise the importance of consumer protection.* Many of them do not know the rules of consumer protection or consider them as something necessary but rather unpleasant. Manufacturers do not recognise their responsibilities under the acts on product liability and consumer protection. Information on the entire range of requirements to be met by enterprises (from product safety and product liability regulations through areas of guarantee and warranty as well as consumer complaints to the regulation of advertising) is provided by the publication entitled 'Consumer protection in the European Union and Hungary - for Enterprises' (*Fogyasztóvédelem az Európai Unióban és Magyarországon - vállalkozóknak*) issued in the 'Europe booklets' series published by the ITDH Euro Info Centre.

In order to enhance their competitiveness businesses

- have to be familiar with the legal regulations and laws on consumer protection;
- have to comply with the legal regulations on consumer protection;
- may produce and distribute only safe products and services;
- have to establish proper relationships with the authorities and the civil organisations representing consumers;

- have to strengthen consumer protection attitudes within the business (among managers and employees);
- have to participate in training and extension training in respect of consumer protection related fields.

The Government's *No. II Medium Term Consumer Protection Policy* also contains the state measures considered necessary for the promotion of the implementation of the above tasks. The policy has been developed on the basis of the EU's current - No. V - consumer protection strategy and is accompanied by a concrete action programme for the period between 2003 and 2006. Special attention needs to be paid according to Government Decree No. 1012/2003. (II. 25.) to the protection of the life, health and safety of consumers, to the promotion of the operation of social organisations performing tasks of the representation of rights of consumers and the continued EU-conform development of the institution system of consumer protection and market supervision, the operation of the reconciliation bodies and training of consumer protection. Further tasks in the area of electronic trade are aimed at the improvement of the security of consumers. The conditions and requisites of the accomplishment of the objectives include:

- uniform high standard consumer protection;
- efficient performance of consumer protection regulations and
- involvement of consumer protection organisations in the EU policies and the enforcement of the policy.

A single harmonised system of high standard consumer protection involves the continuous adoption and adaptation of the EU regulations (at present a total of 15 directives and three recommendations deal with consumer protection); increased controlling of compliance with the legal regulations; continued development of the consumer protection and market supervision system.

Hungary has already adopted a large part of the legislation on consumer protection: in the course of the introduction of the relevant regulations a number of directives and statutes of the EU concerning consumer protection have been adopted and/or harmonised, and they apply to enterprises on a mandatory basis. No. X Act of 1993 on product liability was promulgated first, and was followed by the introduction of the No. LVII Act of 1996 on the prohibition of unfair market practices and the restriction of competition. Besides the essential consumer protection related provisions of the Act on foodstuffs and the Act on credit institutions and financial enterprises the No. LVIII Act of 1997 on economic advertising activities was followed by the adoption of No. CXV Act of 1997 on consumer protection, which is a comprehensive piece of legislation covering all major aspects of consumer protection. The latter was accompanied and later followed by a number of legal regulations adopting EU directives, increasing the number of consumer protection related legal regulations to about a hundred. Such legislation included, for instance, the rules on door-to-door sales activities, the safety of goods and services and the related market supervision procedures as well as the decree issued by the Ministry of Economic Affairs on the display of the prices of goods and services offered to consumers.

The rules on consumer protection were most recently influenced by the No. XXXVI Act of 2002 comprising a package of amendments to the No. IV Act of 1959 on the Civil

Code of the Republic of Hungary along with amendments to certain acts in order to promote legal harmonisation in the area of consumer protection. The package covered a total of five areas. The establishment of a market supervision system on the state borders from 1 January 2003 in conformity to EU rules was enabled by the complementation of Government Decree No. 79/1998. (IV. 29.) on the security of goods and services and the related market supervision procedures, with a new chapter on the controlling of bonded goods by the market supervision authority. The official and surveillance tasks relating to consumer protection are carried out by the Consumer Protection Authority and the territorial units of the consumer protection authority. Some 200,000 commercial entities are currently controlled by a total of 430 individuals, therefore, the headcount of the Consumer Protection Authority will be increased by 75 persons (of whom 50 will be hired this year) while the number of county supervisory officers under the scope of the Ministry of the Interior will be increased by 200 by year 2006. This will be accompanied by the modernisation of the IT background.

In the field of the effective implementation of the rules on consumer protection the government resolution highlights the strengthening of the security of consumers in relation to electronic commerce, along with the maintenance of the alternative forum for the settlement of legal disputes in the field of consumer protection and the creation of the requisites for ongoing operation. The roles played by the local governments are also emphasised.

The conciliatory bodies commissioned to enable the settlement of disputes between consumers and businesses and, where such settlement is not achieved, to make decisions on such disputes are functioning - in line with European practices - are functioning alongside chambers of commerce and industry (in some counties there are no such bodies, unfortunately). Their competence covers the settlement disputes relating to the quality and safety of goods and services, the conclusion and performance of contracts and to product liability. Such procedures are initiated on request by consumers who have to pay HUF 1,000 as a procedural fee. The council is to resolve a dispute in 30 - in complex cases in 60 - days. The system has been operating since 1 January 1999 but businesses are hardly aware of this and, what is even more of a problem, enterprises fail to fully recognise its benefits. The work of local governments in consumer protection needs to be strengthened for they have more in-depth knowledge of local conditions.

The main tasks in the area of the involvement of consumer organisations in EU related policies and the application and implementation of the policies include enhancement of the roles and scopes of responsibilities of the social organisations performing the representation of consumers' rights, improvement of the conditions of their operations, extension of consumer protection training to consumers and businesses as well as the application of the consumer protection policies and its objective in other policies.

An amount of HUF 60 million was made available in 2003 at the Ministry of Economic Affairs and Transports for the promotion of the operation of civil consumer protection organisations. This was supplemented by part of the amount collected in fines. Consequently, some HUF 80-90 million may be spent on supporting such organisations

this year. Civil organisations have to play an increasing role in the administration of complaints, provision of assistance, advice and information.

Support for small businesses - state actions

Fact finding

The tools of the support of (small) enterprises by the state have been identified by a series of government resolutions (in 1990, 1992, 1994, 1996, 1997, 2002), acts (1998 on venture capital, 1999 on development of small and medium-sized enterprises) and other documents not qualifying as statutes of law (1998: government strategy, description of the various programmes of the Széchenyi Plan).

In terms of an international *context* the most important conclusion is that *during the recent decade or two* a series of increasingly clear-cut and substantial reforms have been introduced in the field of enterprise promotion. International organisations and the governments of advanced countries have been *reducing the scope and frequency of the application of the tools of subsidised (financial or business development) services* both in the case of foreign (aid type) programmes and domestic programmes. Instead, they have been laying increasing emphasis on the legal regulatory environment and on *programmes that can be operated after a short interim period even without financial assistance*. The latest trend⁵ is focusing on the coordination and harmonisation of the two areas (legal, regulatory, business environment on the one hand and the enterprise development programmes on the other hand) recognising that positive changes in the first area are a pre-requisite for the effective operation of the programmes providing concrete services.

Very modest efforts have - and only recently - been made in Hungary concerning the introduction of a more effective reform, despite the fact that a smoothly operating enterprise development system is one of the key factors of competitiveness.

The policies applied so far during the transition period have not been efficient enough in accomplishing their objectives as declared in the official documents. The governments in office so far have definitely formulated and implemented their small enterprise development programmes on the basis of the old paradigm. The programmes do not include the built-in control mechanisms that are already familiar from international recommendations, consequently, the sets of information required for the measurement of the impacts are not complete in the majority of cases.

The consequences are clearly observable in a variety of areas:

- The enterprise development policy has made hardly any contribution to the evolution of financial and/or business development service markets that can

⁵ In the assistance policy applied by the United States of America funding is provided under the programme called 'Millennium Challenge Account' for enterprise development actions in developing countries if the reform of the local regulatory environment is also making satisfactory progress. The application of this rule was motivated by the fact that according to prior experience the programmes carried out in legal environments not suitable for this purpose usually failed to promote the enterprise sector of the recipient country.

operate without assistance. The development of such particular markets is a spontaneous process which is not a problem in itself but some stimulus could substantially accelerate this process in a number of areas.

- The enterprise development system has provided only a small percentage of Hungarian small enterprises with appreciable assistance so far.
- The tools applied have had little positive impact on the development of competitiveness even in the above small number of cases; they were limited to the provision of relatively cheap funding sources for a handful of businesses.
- As a result of the rather limited accessibility the majority of the enterprise development tools did not meet the criterion of having to deliver its impacts without distorting competition.
- The criteria of assistance and programmes under preferential terms were met by a much larger number of entities than could actually benefit from them. Consequently, a large number of the entrepreneurs are dissatisfied with the decisions on allocation.
- Enterprise development organisations have developed a rent seeking type of behaviour and there is little interest in accomplishing actual results. Much of the efforts are absorbed by the securing of funding sources.
- Sustainable and self-regulating sub-systems and activities integrated or able to be integrated in the market have hardly evolved.

The past year brought about a variety of contradictory developments in the area of enterprise promotion. On the one hand, government documents declared the necessity of political change along with the most important principles, on the other hand, practical measures do not follow significantly new trends. The most important examples are as follows:

The Europe Loan, which is aimed on the one hand at (artificially) rendering funding sources cheaper, moreover, applying a reversed financial logic for the smaller the loan amount of the loan the lower the interest rate is. On the other hand, it assigns a role to the governmental policy in financial intermediation that does not seem to be well-grounded for the 'securing' of funds accompanied by a price guarantee will not resolve material questions in the financial sector. In other words, the government is trying to provide help where there are actually no problems. One of the questions encountered in this area is whether there is real actual demand for very long term loans - extended for longer than 10 year periods - in the target group of enterprises.

No material change has taken place in micro-lending despite fact that it will never be possible to achieve a significant improvement in the modest results recorded so far, without a substantial reform.

The organisation structure of the Economic Competitiveness Operative Programme within the National Development Plan has been created with the aim of providing the subsidised services.

Instead of gradually lowering the interest subsidy rates the Széchenyi Card continues to provide high rates of interest subsidies.

Accordingly, there are no definite enough signs of the necessary changes.

Causal explanation

The application of the direct instruments of enterprise promotion means that the Government (and/or other donor) provides financial or business services for enterprises through an intermediating organisation. The underlying consideration is that the development of specialisation and task sharing is the key source of the improvement of the efficiency of small enterprises. International experience built up during the past two decades has, however, definitely shown that the provision of services will not - in itself - provide a solution: any material effect may be accomplished only by turning the relevant programmes sustainable and suitable for integration in the market within a short period of time.

The problems currently faced in the area of enterprise promotion stem from the governmental policy. Domestic practices have not actually responded to the anomalies generated by programmes subsidised in a longer run: during the recent decade only a variety of personal and organisational changes have taken place that have not led to material solutions.

It should be noted that under the current structure the operation of the enterprise promotion systems cannot be improved through increasing the budgetary input for the problems arise from the low level of efficiency. This is also indicated by the fact that resources that have been unutilised for quite some time are laying around in a variety of areas (e.g. SME Development Fund / *Kisvállalkozás-fejlesztő Pénzügyi Rt.*) and there are large accumulated funds in some of the programmes (E.g. Micro Loan Programme).

The main cause of the current problems lies in the dogma influencing decision makers, according to which the government's tasks in the field of enterprise promotion consist of providing cheap funding and business services for enterprises. This concept is being increasingly rapidly eliminated from the policies of international organisations owing to the definitely negative experiences of the programmes that have been aiming to resolve problems based on this approach.

Future objectives, possible measures

Accordingly, enterprise development policy needs fundamental reform in practically all of the relevant fields if positive changes are to be accomplished, as described below:

Functional approach: In the formulation of policies functions rather than organisations should be taken as a point of departure. This will open a materially broader perspective of possible measures.

Sustainability: The currently almost 100% donor dependence of the programmes should be reduced. Instead of saving budgetary resources the primary reason for the necessity of this change is that the *incentive and measure of customer oriented and useful services is self-sustaining capability*. Without meeting this requirement the donor will continue to be the most important customer instead of the entrepreneur.

Institution development, capacity building. Rather than the financing of operations the development of structures capable of self-sustaining operation should be defined as the main aim of the policy. This should be accomplished through institution development - which could create the legal and other regulatory conditions enabling self-sustaining operations along with capacity building which constitutes the creation of the

required instruments (such as organisations that are capable of performing the task of extending micro-loans in an efficient and effective way).

Coordination based on market mechanisms

The current means of the controlling and regulation of implementation are primarily of an administrative type, which - together with the scarcity of the resources available for the purposes in question - demands coordination of the type applied in the centrally planned economy. The result of the reform would be a system in which market coordination would be functioning through competition and the necessity of efficiency, where success would be measured in terms of the growth of the generation of added value.

The policy aiming at the promotion of the development of small and medium-sized enterprises may be effective if instead of seeking for *target groups* it aims to identify *areas of intervention* where no market of the services improving the competitiveness of small enterprises is functioning or where it is not functioning effectively enough. In other words, if instead of a structural approach it applies a functional approach and instead of aiming at the substitution of the market, it aims at building a market. Some elements of the functional approach are present in part of the domestic programmes, these need to be strengthened, while structural features should be gradually phased out.

Small and medium-sized enterprises in Hungary are growing increasingly mature in responding to the challenges of economic competition which involves the evolution and development of the markets of financial and business services. Enterprise development policy may create efficient instruments if it recognises such trends in the market and cooperates with them.

There is a market difference between market substituting and market building economic development in terms of their impacts as well. The first approach will preserve market failure while the second one offers a chance for the resolving of the problem. In order to see macro-economic growth resulting from the reduction of transaction costs such reduction needs to be real, i.e. it needs to be based on improved efficiency. Programmes where high costs are accepted and are made to be borne by others instead of the enterprises will have no real impact on the economy as a whole.

Venture capital financing

Regulatory role

The state may apply direct and indirect instruments in order to improve the equity position of small enterprises. The indirect instruments involve the development of the institutions that will operate as a framework of the investment activities.

Its key areas include the regulation of organisations involved in investment, the creation of special exchanges promoting the listing of successfully growing enterprises in the exchange and the regulation of the taxation of investments. Hungary has adopted a specific law regulating venture capital investments which deserves special attention.

The Act on venture capital was adopted by Parliament in 1998 (No. XXXIV Act of 1998 on venture capital investments, venture capital enterprises and venture capital funds).

The Act regulates activities of venture capital investment and their stimulation by providing preferential tax treatment. The Act was criticised by a number of experts already during its preparation, considering it unsuitable for regulation as well as for operation as a stimulant. Such criticism seems to have been at least partly confirmed by experience built up so far in relation to the application of the law. The most important fund managers and funds have not reported for registration under the scope of the law and only one organisation has so far commenced the process of its registration. Accordingly, the law has had no significant impact to date.

A review of the Act seems to be necessary now along with the introduction of a regulation as may provide real assistance for investment activities. This needs not necessarily be a separate Act. The authors consider that the solution would be provided by aiming at the implementation of the proposal - made by a variety of persons on several occasions - that the regulation should introduce an investment organisation of a more general nature than what is defined by the currently effective act: an investment organisation that would be transparent from the aspect of taxation. This would mean that invested amounts would not be taxed as long as they are not taken out of the entity in which they are invested. This solution is being increasingly widely applied across the world, following successful examples observed in the US.

Role as capital investor

The state enters the capital market in many countries in cases when it intends to influence spontaneous market processes for some reason.

The place and role of capital financing in the financing of enterprises

An entity's own funds play the decisive role in its financing. At the same time the involvement of external funding sources is also generally applied in modern market economies. From the aspect of an enterprise the question is generally raised in the form of what the optimum structure of internal and external funds may be in a given situation.

Investment is the only external source the application of which provides ownership rights for the financing entity, whereby it has a share not only of the profits but also of the governance of the business. From the aspect of the business receiving the financing the risk is smaller than in the case of a loan for there is no payment obligation while from the aspect of the investor this is the solution where returns, indeed, even the maintenance of the value of the capital, is least reliably guaranteed.

Capital may be raised by issuing shares through the stock exchange or through transactions outside the exchange, this latter being of particular relevance in respect of our topic. Investment through arrangements outside the stock exchange is often identified with venture capital operations.

The various phases of investment share different proportions of the value of the invested capital. The proportions that are characteristic of West Europe are presented in the following table, aggregated in five categories:

Table 4. Breakdown by phase of investment, in the West European venture capital industry

| Investment phase | Share (%) |
|------------------|-----------|
| Sowing of seeds | 0.6 |
| Launching | 5.2 |
| Growth * | 41.4 |
| Substitution | 6.4 |
| Buy-out** | 46.4 |
| Total | 100.0 |

*Together with other early phases, bridge-financing and reorganisation.

** Including management buy-in.

It has been experienced by a variety of countries that the financing of technology-intensive businesses is less attractive for venture capital in the seed sowing and the launching period therefore state programmes are often focused on these areas.

Venture capital is suitable for the financing of practically any economic branch, if the financial conditions of financing can be provided for.

Information is available on the breakdown by size of less than half of the venture capital investments effected in Europe. The available data shows that the most favourable category is made up of businesses employing between 200 and 499 persons. Most of the invested capital landed in relatively larger small enterprises and medium sized enterprises. At the same time the available data on average investment amounts also show that instead of 'average' small enterprises venture capital seeks for entities that are capable of absorbing more substantial amounts of investment.

Table 5 Share of enterprises of investments in a breakdown by size

| Size category | Share of investments,% | Average investment, HUF million |
|---------------|------------------------|------------------------------------|
| 0-9 | 5.0 | 66 |
| 10-19 | 4.3 | 74 |
| 20-99 | 28.8 | 168 |
| 100-199 | 16.3 | 361 |
| 200-499 | 29.7 | 720 |
| 500-999 | 4.8 | 409 |
| 1000-4999 | 9.7 | 709 |
| 5000+ | 1.3 | 1357 |

Source: European Venture Capital Association yearbooks
EVCA, Zaventem, Belgium

State instruments applied

In the advanced countries the state usually plays a very limited role in the market of investments outside the stock exchange, as is illustrated in the following table:

Table 6 Share of state in venture capital funds

| Country | Share of state in new assets of venture capital funds |
|--|---|
| United Kingdom | 1.1 |
| France | 1.8 |
| Germany | 7.9 |
| Belgium | 7.4 |
| Finland | 6.6 |
| Denmark | 22.4 |
| The Netherlands | 0.0 |
| Italy | 13.1 |
| Spain | 11.4 |
| Europe, total (not only the above countries) | 3.1 |

According to experts' estimates state funds account for less than 1% of venture capital funds in the United States of America. It should be noted that the most important new source of funding is made up of reinvested yields generated by the operation of venture capital.

The reason for the limited participation of the state is that in the majority of the countries (like in Hungary) there is a very substantial supply of venture capital, permanently in excess of the actual investment possibilities in any given period of time.

In a number of West European countries there are organisations/agencies participating in the supply of small enterprises with capital. These differ from clearly market based actors in that they make their investment decisions in pursuit of certain social objectives. Most of them are targeting regional development, job creation and technology development, and besides capital they provide additional services for businesses.

In some of the advanced countries⁶ efforts are made to with the aim of rendering state participation market conform also by stipulating that state funds may be invested in a business if there is a leading private investment as well or if there is one that invests an amount equalling the investment to be effected by the state.

Successful state venture capital programmes⁷ are implemented in cooperation with organisations financing the pre-competitive phase as well and they stimulate market-oriented activities already during the research and development phase.

In one model the role undertaken by the state is limited to providing funds for investment enterprises or investment funds assisting the development of small enterprises carrying out such investment operations fully in line with the rules governing the market. Such programmes are functioning primarily in Anglo-Saxon countries.

⁶ See the operation of investment enterprises in Germany with financial assistance by the state or the capital programmes operating in the USA and the UK.

⁷ E.g. the Israeli YOZMA capital fund is successfully managing the whole process of getting results of research and development to the market.

The other model sets more clear-cut structure political objectives (primarily the financing of the initial phase of innovative enterprises) extending the role played by the state to several areas, incorporating a variety of elements to guarantee the satisfaction of the efficiency requirement.

It should be noted that the market of capital investments outside the exchange has evolved and is functioning in Hungary. Some EUR 120 million was invested in this market in 2002, followed by the investment of EUR 100 million in the first quarter of 2003, the entire amount of which was invested outside the scope of the Act on venture capital.

Proposals

In highly concentrated markets of modest competition state instruments should be applied to create and stimulate competition.

The key principle to be taken into account by the state in the shaping of the enterprise environment is that transaction costs should be reduced to and kept at the lowest possible level between government and enterprises. Any growth of the burdens (measured in money, time, efforts or risks) will reduce the international competitiveness of Hungarian enterprises, therefore, changes entailing such consequences may be introduced only if the expected yields exceed the costs.

Corporate and company regulations need to be amended in a number of aspects in order to make the domestic environment of legal regulations on the economy provide better conditions for small enterprises and foreign investors. The introduction of electronic trade registry procedures - a long awaited improvement - has been put on the agenda and is part of the current development of the legal regulation of companies. In view of the requirements of the European Charter for Small Enterprises as well, changes will need to be introduced to the currently highly detailed regulation of small enterprises - primarily those without legal personality - by the possible elimination of the obligation to use lawyers' services and by the simplification of the registration process.

In respect of the process of obtaining entrepreneurial cards the efforts of chambers aiming at full registration of economic associations through an amendment to the Act on chambers is considered neither a good idea, nor a reasonable endeavour.

In addition to the possibilities of further simplification of the administrative tasks relating to the foundation and termination of businesses and of the reduction of the time and cost of such procedures the following should be regularly reviewed with the aim of alleviating administrative burdens:

- possibilities for the ongoing simplification of the tasks relating to the fulfilment of reporting (return filing), data supply, accounting and registry obligations, re-directing these to electronic channels,
- burdens relating to labour,
- forms of the systems of internal market relations, administrative provisions involved in the relationships between businesses,
- conditions of access to funding sources and credit, administrative and cost implications,
- compliance with environmental and other obligations.

In the area of enterprise development the following concrete changes are proposed:

Micro loan programme

Accomplishment of financial and organisational sustainability after an interim period of 3-4 years.

Financial responsibility of lending organisations, creating more flexible operation in relation to this.

Permitting of autonomous lending activities of non-profit oriented organisations, from their own funds and through financing by donors.

Abandoning of dogma of 'low interest rates'.

Development of adequate risk management capacity, thereafter raising of funds from the money market.

Allocation of central funds based on efficiency criteria.

Guarantee programmes

Guarantee of the loans for businesses, with involvement of the state, as one of the most market-conform method, should be maintained in order to promote access to loans.

Guarantee fee subsidies should be phased out.

Guarantee cooperatives should be possible to be launched only if they can operate in a self-sustaining way without ongoing state subsidy.

Széchenyi Card

Withdrawal of state interest subsidy in 2-3 years.

Respecting of limits of overdraft credit extension by banks for which even a HUF 5 million loan is too much.

Review of soundness of programme in a year.

Venture capital

Winding up of the direct investment activities of funds established from state funds.

Development of co-financing role of state, cooperation with private funds based on joint risk sharing.

Transformation of the Act on venture capital, improvement of the legislative environment of investors using the current channels, primarily through protection of rights of minority shareholders.

Encouraging of investor side by permitting venture capital investment by pension funds (as a matter of course, up to a very small percentage of their funds).

Non-financial services

Programmes should be launched only in areas where the market does not function or where it is functioning deficiently but there is real demand for certain services.

A requirement of self-sustaining should be imposed on services right at inception.

Bidding schemes

The system of non-repayable grants to enterprises based on individual decisions should be dismantled as soon as possible.

Appendix

Table 1 Development of number of registered businesses by legal form, 1990 - 2002

| Period | Sole | Unlimited partner ship (Kkt.) | Limited partners hip (Bt.) | Limited liability company (Kft.) | Shareholding (Rt.) | Cooperative | Total* |
|---------------|-------------|--|---|---|-------------------------------|--------------------|---------------|
| 1990 | 393 450 | 418 | 5 789 | 18 317 | 646 | 7 132 | 457 015 |
| 1991 | 510 459 | 463 | 22 977 | 41 206 | 1 072 | 7 232 | 615 351 |
| 1992 | 606 207 | 1 187 | 41 218 | 57 262 | 1 712 | 7 694 | 746 190 |
| 1993 | 688 843 | 2 492 | 67 301 | 72 897 | 2 375 | 8 175 | 872 517 |
| 1994 | 778 036 | 3 287 | 89 001 | 87 957 | 2 896 | 8 252 | 001 973 |
| 1995 | 791 496 | 3 685 | 102 560 | 102 697 | 3 186 | 8 321 | 1 053 257 |
| 1996 | 745 247 | 4 394 | 127 725 | 122 044 | 3 536 | 8 362 | 1 049 590 |
| 1997 | 659 690 | 4 509 | 140 043 | 143 109 | 3 929 | 8 330 | 998 264 |
| 1998 | 648 701 | 5 006 | 161 857 | 157 990 | 4 251 | 8 230 | 1 026 642 |
| 1999 | 660 139 | 5 217 | 170 762 | 160 647 | 4 350 | 8 191 | 1 049 410 |
| 2000 | 682 925 | 7 873 | 188 136 | 167 033 | 4 372 | 7 516 | 1 094 446 |
| 2001 | 698 001 | 8 213 | 199 152 | 172 919 | 4 423 | 7 074 | 1 124 835 |
| 2002 | 708 513 | 8 113 | 208 454 | 182 242 | 4 425 | 6 768 | 1 152 221 |
| 02 2003 | 708 375 | 8 072 | 209 310 | 183 669 | 4 411 | 6 795 | 1 153 553 |

Source: CSO Monthly Bulletins. Comments: * This column contains other forms of businesses as well, therefore the total figures of the lines of the table are not equal to the data contained in the column of total figures (at end 1989 the number of private artisans was 174 837.) A large proportion of registered enterprises (almost 30% on average) were not active. The share of inactive businesses is largest among cooperatives and sole proprietorships and smallest in the case of shareholding companies and limited partnerships.

Table. 2 Number of operating businesses by legal form, 1990 - 2002

| Period | Sole | Unlimited partnership (Kkt.) | Limited partnership (Bt.) | Limited liability company (Kft.) | Sharehol ding (Rt.) | Coope rative | Total* |
|---------------|-------------|---|--|---|--------------------------------|-------------------------|---------------|
| 31 12 1995 | 417 587 | 2 935 | 80 950 | 85 349 | 2 903 | 4 879 | 605 794 |
| 01 01 1996 | 413 673 | 2 935 | 82 378 | 86 046 | 2 880 | 4 718 | 604 053 |
| 31 12 1996 | 460 163 | 3 558 | 107 782 | 104 166 | 3 232 | 4 858 | 698 045 |
| 01 01 1997 | 498 197 | 3 416 | 104 708 | 97 870 | 3 069 | 4 424 | 724 911 |
| 31 12 1997 | 465 049 | 3 565 | 118 419 | 124 192 | 3 573 | 4 989 | 734 236 |
| 01 01 1998 | 432 925 | 3 367 | 112 807 | 114 294 | 3 317 | 5 531 | 702 641 |
| 31 12 1998 | 458 355 | 4 063 | 140 449 | 134 107 | 3 736 | 5 668 | 779 470 |
| 01 01 1999 | 425 966 | 3 760 | 133 355 | 125 627 | 3 549 | 5 409 | 729 990 |
| 31 12 1999 | 467 513 | 4 386 | 150 637 | 136 777 | 3 853 | 5 892 | 802 215 |
| 01 01 2000 | 432 603 | 4 015 | 139 694 | 126 633 | 3 538 | 5 643 | 744 346 |
| 31 12 2000 | 487 699 | 7 052 | 167 434 | 144 656 | 3 800 | 5 922 | 847 024 |
| 01 01 2001 | 430 031 | 6 561 | 152 958 | 133 080 | 3 659 | 5 680 | 761 634 |
| 31 12 2001 | 468 797 | 7 230 | 174 542 | 150 194 | 3 926 | 5 715 | 840 575 |
| 01 01 2002 | 442 900 | 6 776 | 161 208 | 138 478 | 3 696 | 5 442 | 787 800 |
| 31 12 2002 | 474 678 | 7 020 | 180 534 | 158 342 | 3 857 | 5 392 | 860 022 |
| 01 01 2003 | 441 445 | 6 855 | 173 884 | 151 580 | 3 764 | 5 275 | 812 642 |
| 02 2003 | 447 054 | 6 888 | 177 402 | 155 504 | 3 797 | 5 348 | 826 085 |

Source: CSO Monthly Bulletins.

Comments: The number of functioning enterprises is significantly smaller at the beginning of January than the closing number at the end of the preceding December. This is a result of the fact that data of part of the businesses terminated during the year is taken into account by the Central Statistics Office only once, in the opening figures at the beginning of January.

Table 3 Development of numbers of main groups of taxpayers, by region, 1 January 2003 (No. of persons)

| | Central Hungary | of which Budapest | North Hungary | North Great Plain | South Great Plain | West Transdanubia | Central Transdanubia | South Transdanubia | Total |
|---|-----------------|-------------------|---------------|-------------------|-------------------|-------------------|----------------------|--------------------|---------|
| Individual entrepreneurs | 153 183 | 101 422 | 47 882 | 60 811 | 61 757 | 50 531 | 54 083 | 45 283 | 473 530 |
| Private individuals with tax number, performing autonomous operations | 81 096 | 63 366 | 15 171 | 20 466 | 23 846 | 25 096 | 24 672 | 30 942 | 221 289 |
| Business organisations of which | 238 016 | 186 824 | 37 959 | 46 530 | 44 227 | 39 491 | 41 651 | 37 709 | 485 583 |
| Legal entities | 96 064 | 76 894 | 11 230 | 14 748 | 14 826 | 13 264 | 14 011 | 12 065 | 176 208 |
| Of previous: limited liability companies | 90 818 | 72 458 | 9 886 | 13 373 | 13 395 | 12 089 | 12 788 | 10 662 | 163 011 |
| Economic organisations without legal personality | 117 477 | 91 326 | 16 930 | 22 093 | 20 151 | 17 304 | 19 332 | 16 991 | 230 278 |
| Of previous: limited partnerships | 100 486 | 75 763 | 14 349 | 19 806 | 17 803 | 14 074 | 15 994 | 14 349 | 196 861 |

Source: Adóvilág (taxation review) 2003/5

Table 4 Number of newly established businesses (thousand)

| | 1995 | 1996 | 1997 | 1998 |
|----------------|-------|-------|-------|-------|
| Albania | 7.2 | 4.7 | 2.3 | 3.2 |
| Bulgaria | 55.7 | 68.7 | 41.4 | 50.2 |
| Czech Republic | 123.1 | 85.6 | 85.8 | 101.3 |
| Estonia | 6.0 | 3.4 | 5.1 | 5.8 |
| Poland | 259.6 | 232.1 | 305.8 | 307.9 |
| Latvia | 6.7 | 5.3 | 4.8 | 6.1 |
| Lithuania | 20.7 | 8.1 | 12.3 | 11.2 |
| Hungary | 81.9 | 60.4 | 49.3 | 67.2 |
| Romania | 94.5 | 45.9 | 53.1 | 75.9 |
| Slovakia | 37.3 | 25.9 | 32.3 | 32.1 |
| Slovenia | 8.4 | 6.4 | 6.2 | 6.6 |

Source: Román (2000)

Comment: The demography of small and medium-sized enterprises is assessed by a study of the Central Statistics Office produced in 2000 (Román, 2000) in international comparison, providing information on the features and life cycles of newly established businesses. According to data presented in the study the freedom of enterprise and unemployment has triggered similar effects in neighbouring countries in respect of the establishment of businesses. The above table shows the number of newly founded businesses in Central and Eastern European countries that have shifted to a market economy.

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Table of contents

| | |
|---|-----------|
| Minister's Foreword | 3 |
| Editor's foreword to the research project 'Economic competitiveness: recent trends and options for state intervention' | 4 |
| Market Environment, Regulation and Enterprise Promotion | 10 |
| Summary | 10 |
| Introduction | 11 |
| Hungarian market structure | 11 |
| Legal and regulatory environment | 14 |
| Support for small businesses - state actions | 29 |
| Venture capital financing | 32 |
| Proposals | 36 |
| Appendix | 38 |