BUSINESS SERVICES IN HUNGARY DURING THE TRANSITION

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Business services in Hungary during the transition

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Executive summary

Thesis: Examples of Western developed economies show a strict correlation between the state of services sector and the level of economic development. Services should be considered as a catalysator in a modern economy.

Services play a key role in macroeconomic development, in reducing unemployment, in relieving economic crisis and a key role in knowledge-based economy.

Efficiencies of service provisions enable the growth of all other sectors which rely on services as inputs, while neglecting of vital service branches doom many other sectors to failure.

Starting from the above thesis a general picture of the state of services, particularly business services is given before and after the transition, in order to pinpoint the effect of the transition process from socialism to capitalism.

1. The state of services before the transition in Hungary

During decades of socialism infrastructure and services can be characterized as not only of low standard, but far lagged behind the general level of the country's economic stage of development. It has been a consequence of a deliberate single-minded economic policy pushing back the development of the service sector as many branches of it was declared as „unproductive".

The low standard of services like telecommunication, banking and financing systems, communication hindered many other sectors of the economy. The situation was aggrevated by the fact, that certain very important business services like auditing and consulting companies, adequate legal background which are fully extended in developed countries simply did not exist. They should have been newly established from the scratch.

2. The development of business services in transitional Hungary

One of the most important milestones of the transition was the enactment of the Company Law January 1, 1989, which made pssible the accelaration of the privatization process.

From 1989, the starting point of free undertaking, the number of firms providing business services has grown about twice as fast as the number of all firms. At the same time foreign participation also grew rapidly.

All in all, privatization had a positive impact on the development of business services. The rapidly expanding private ownership in every sector of the economy boasted the emerge of business services.

Altough the weigh of services has been significantly increased during the transitional years, it can not be stated that the quality and quantity of services is adequate.

3. The role of the state

The extensive experience about the dynamic and evolving nature of services' role in developed economies should force governments in transitional economies to implement equally dynamic and flexible public policy toward services. A well-functioning economy requires a delicate combination of government and markets which should be the heart of a development strategy. In this partnership each partner is assigned certain domaines of responsibilities. The governments of transitional economies should employ crucial instruments as part of the development strategy to promote and boast services underlying the development of the whole economy.

KOVÁCS ILONA

ÜZLETI SZOLGÁLTATÁSOK MAGYARORSZÁGON AZ ÁTALAKULÁS IDEJE ALATT

Összefoglaló

Állítás: A fejlett nyugati országok példái azt igazolják, hogy szoros korreláció mutatható ki a gazdasági fejlettség színvonala és a szolgáltató szektor fejlettségi állapota között. Modern gazdaságokban a szolgáltatások katalizátor szerepet játszanak

A szolgáltatások kulcsszerepet játszanak a makrogazdasági fejlődésben, a munkanélküliség csökkentésében, a gazdasági válságok enyhítésében, valamint a tudományos megalapozottságú gazdaságban.

A hatékonyan működtetett szolgáltatások elősegítik a szolgáltatást felhasználó gazdasági szektorok növekedését, ugyanakkor a szolgáltatások fejlesztésének elhanyagolása más szektorokat is hanyatlásra kárhoztat.

A tanulmány ebből a tételből kiindulva általános képet fest a szolgáltatások helyzetéről, különös tekintettel az üzleti szolgáltatásokra, a gazdasági átmenet előtti és utáni időszakban, s rávilágít az átmenet során bekövetkező változásokra.

1. A szolgáltatások helyzete Magyarországon a rendszerváltás előtt

A szocializmus évtizedei alatt a szolgáltatások és az infrastruktúra nem csak hogy alacsony színvonalú volt, de messze elmaradt még az ország gazdasági fejlettségi szintjétől is. Ez egy szándékosan egyoldalú gazdaságpolitika szükségszerű következménye, amely háttérbe szorította a szolgáltató szektorok fejlesztését, arra hivatkozva, hogy ezek az ágazatok improduktívak.

Olyan szolgáltató ágazatok, mint a telekommunikáció, bank- és pénzügyi rendszer, szállítás és hírközlés elmaradottsága természetesen gátolták számos más gazdasági ágazatnak a fejlődését is. Az átmenet időszakára a helyzetet még súlyosabbá tette az a tény, hogy a nyugati országokban olyan fejlett és kiterjedt szolgáltató ágazatok, mint az auditálás, tanácsadó cégek léte, vagy adekvát jogi háttér Magyarországon egyszerűen nem is léteztek. Ezeket a semmiből kellett megteremteni.

2. Az üzleti szolgáltatások fejlődése az átmeneti Magyarországon

Az átmenet szempontjából az egyik legfontosabb jogi lépés a Társasági törvény törvénybeiktatása 1989. január 1-én, amely lehetővé tette a privatizációs folyamat felgyorsítását.

1989-től kezdődően teljesen zöld utat kapott a szabad vállalkozás. Üzleti szolgáltatásokat nyújtó cégek száma kétszer olyan gyorsan növekedett, mint általában a vállalkozások száma. Ezzel egyidőben jelentős növekedésnek indult a külföldi tőkebeáramlás.

Mindent egybevetve megállapíthatjuk, hogy a privatizációnak pozitív hatása volt az üzleti szolgáltatások fejlődésére. A gyorsan expandáló magánvállalkozások erjesztő hatással voltak az üzleti szolgáltatások fejlődésére és súlyuk növekedésére. Mindezek ellenére sem állíthatjuk, hogy a szolgáltatások minősége és mennyisége adekvát lenne.

3. Az állam szerepe

A fejlett gazdaságok dinamikus és fejlődő szolgáltatási ágazatairól szerzett sokirányú tapasztalathalmaz kincsesbánya lehetne az átmeneti gazdaságok kormányai, gazdaságpolitikusai számára hasonlóan dinamikus és rugalmas gazdaságpolitika folytatásához a szolgáltatások területén. Egy jól működő gazdaság az államnak és a piacnak egy nagyon kényes egyensúlyát kívánná meg, amelyben mindegyik szereplőnek meglenne a saját felelőssége.

TABLE OF CONTENTS

I. INTRODUCTION AND OBJECT OF THE RESEARCH

The aim of our research is to acquire an insight and a better understanding in/about the role of business services in a economy where society is striving to be transformed into a market economy and democratic state of law. This type of transformation process has never occurred in history, there is no experience, no paved path, the work still should be done. Behind these simply composed words tremendeous political and social changes lie and they brought out unforeseen economic crisis and social tensions.

It was a widely accepted view in 1990 that, there is no ideal transition to a market economy with little pain, but hoped that once political and economic reforms would be working, a sensible rise in national income would follow. To give an example of that is the World Bank projection of per capita output for Hungary, Poland and Czechoslovakia over the decade 1990-2000. Per capita output was projected to attain its 1989 level until 1996. By the year 2000, output per capita is projected to be 20 percent higher than in 1989. Regretfully this projection did not come true. In Hungary the transformation crisis is protracting including more than 20 per cent fall in Gross Domestic Product (GDP) from the year of 1989 to 1997, near 15 per cent fall in consumption and in real income, and more than 20 per cent in real wages, accompanied by a never seen high unemployment (13 percent) and inflation rate, a huge amount of foreign debt, increasing pauperism at a fearful rate, depreciation of pensions, what more, bankruptcy of the whole pension system, health care and education system.

Western developed economies' examples show that there is a strict correlation between the general state of infrastructure and services in a country and the level economic development, standard of living, quality of life. Experiences about Western economies based on earlier research, considerations about the role of infrasrtucture and services can be summarized as the following.

– Key player in macroeconomic development

Services, within this, business services is a key branch contributing greatly to economic development in Western developed countries. The rapid growth of services increased their share within gross national product. The service sector accounts for approximately 70 per cent of the GDP of most developed

countries and an even larger proportion of employment .compared to the data for Hungary - as of 40 to 50 per cent - between 1980 and 1993.

Efficiencies of service provisions enable the growth of all other sectors which rely on services as inputs, while neglecting of vital service branches will doom many other sectors to failure (*Rask* and *Rask* [1994]).

– Key player in reducing unemployment

The development of services greatly affects employment firstly, because newly established activities create new jobs, secondly, it is more labour-intensive.

The expansion of services less sensible for technological development, like retail trade, finance and banking, business and personal services in the developed countries was accompanied by a significant rise in the number of persons employed in these branches. By the early seventies the number of employees in industry has reached a peak and from that time on the increasing service sector gained its labor force not only from agriculture but from industry.

The development of the business service sector can be considered as a very important factor to decrease the rate of unemployment.

– Key role of services in relieving economic crisis

Experiences of developed countries show how big role services play in economic upturns and downturns. The unelastic nature of the increased bulk of services prevents from great cyclicality and helps to relieve the deepness of an economic crisis.

– Key role in knowledge-based economy

If it was told that services are of great importance in the seventies and the eighties in the developed countries, then now in the light of the events taking place in the nineties, it should be stated that their role has been multiplied. The latest findings show that the novel in the nineties is **the knowledge-based or knowledge-driven economy resulting basic changes in the quantity and quality of employed people.** As all sectors of the economy rely increasingly on **knowledge, research and development (R&D)** enhancing the skills of the labour force becomes a prerequisite to better economic performance. "In the knowledge-based economy, the service sector is taking on a new role, emphasizing the value of technology and the

quality of human capital" – asserted Jean-Claude Paye, Secretary General of the OECD recognizing the importance of encouraging more efficient and equitable strategies for skills development, including enterprise-based training and formulating more flexible transitions between education, training and work. (*Paye* [1996])

The widespread new technic and development of information technologies, are central to the evolution of the knowledge-based economy, and have revolutionized the whole sphere of economy: new type of infrastructures, services, information networks, data transferring networks and other activities emerged based on microelectronics and computer technic. "The OECD economies are increasingly based on knowledge and information. Knowledge is now recognized as the driver of productivity and economic growth, leading to a new focus on the role of information, technology and learning in economic performance. It has also brought about calls for more emphasis on research and innovation.... The OECD economies are more strongly dependent on production, distribution and use of knowledge than ever before. ....In the past decade, the high technology share of OECD manufacturing production and exports has more than doubled, to reach 20–25 %. Knowledge-intensive service sectors, such as education, communication and information, are growing even faster. Indeed, it is estimated that more than 50 % of GDP in the major OECD economies is now knowledge-based." (*Stevens*, [1996], *Wyckoff*, [1996]).

The old saying that "information is power" gets a greater actuality than ever. The accessibility of spiralling number of information on the Internet is a driving force of economic growth.

The overwhelming shift toward knowledge-driven economy based on rapid changes in technological progress and the development of human resources force governments and firms as well to rethink the role of services. Effective governments should make effective policies creating incentives for expanded investment in human resources, technology, innovation and information networks.

A critical lesson from developed market economies is that producing goods and strategic services with high value-added is at the core of improving economic performance and international competitiveness. If services are adequately developed they are helping well functioning the economy, if they are less developed than the general level of the economy they are hindering development .

Starting out from the above thesises, we should give a general picture of the state of services, particularly business services before and after the

transition in order to pinpoint the effect of transition process. First, however, it is necessary to present service statistics we are working with.

II. BUSINESS SERVICE STATISTICS AND METHODOLOGY

1. Working definition

We have aggreed that our working definition on **business services** based upon **NACE classification** of the Statistical Office of the European Community would include:

Financial intermediation, Code J

65 Financial intermediation, except insurance and pension funding
66 Insurance and pension funding
67 Activities auxiliary to financial intermediation

Real estate, renting and business activities, Code K

70 Real estate activities
71 Renting of machinery and equipment without operator
72 Computer and related service
73 Research and development
74 Other business activities

2. Modernization of the statistical system

Likewise in other areas of statistics, the year of 1990 has indicated a turning point in service statistics. Up to this time statistical observation comprised service statistics related to the branches of the national economy and the so called state prioritized consumption services being part of household consumption. The fundamental political and economic changes made basic modifications necessary in the observation system of service statistics.

The main steps of restructuring the Hungarian statistical system can be characterized as follows.

Mandatory regulation and recommendation of EU are of highest priority. The Hungarian Central Statistical Office (HCSO) has had outstanding achievements in the modernization of classification. The new sectorial classification system of activities was set forth in 1992. The first two digits is equal to that of NACE Rev. 1, and consequently to the appropriate levels of ISIC Rev. 3. To reflect domestic pecularities a third

and fourth level of the classification is available. Hungarian statistics are aimed at switching to the total NACE Rev. 1 by the end of 1998.

Another important task was the modernization of the list of services in order to express service structure characteristics of a developed market economy and of domestic features, and to serve as a basis for an up-to-date, detailed service statistics. With the list of services Hungarian statistics are ahead also in international relation.

The list contains five levels. The first level consists of 20 main groups, the lowest of 652 service types. According to our experiences, more detailed division is needed for the 14 (business) services assisting economic, social activities. The shift to the international classification system has changed the place of service activities in the classification system of economic activities.

After the modification of TEAOR (former Hungarian classification system) observation of services linked to branches of the national economy is carried out in the framework of sectorial statistics. The grey areas are especially where there was no observation before, because new special branches have emerged in services, and in areas where sectorial re-classifications occured and there was no tradition of statistical observation of services.

Economic organizations operating in Hungary are recorded fully - though with a little time lag - by the business register of the HCSO (Hungarian Central Statistical Office). This is made possible by the obligation of registration of newly started enterprises at the HCSO and of economic organizations with the status of non-corporate body at the state revenue directorates (APEH).

Regarding the size of enterprises new definitions were accepted for small and medium size enterprises in accordance with the recommendation of European Union. **Mediumsize enterprise:** number of employed people is less than 250. **Small enterprise** is where less than 50 persons are employed, and inside this latter enterprises are taken into account as **micro-enterprises**, if less than 10 people are employed.

3. Main indicators for the development of business services

At this stage of our investigation we set up a kind of an inventory of statistical indicators which will be applied in our work for analysis of business services in Hungary for the period of 1991–1997. Indicators are as follows:

– **Output of business services** (dynamics and percentage share)

– **Gross value added of business services** (dynamics and percentage share)

– **Subscribed capital** of enterprises **with FDI**

– Employment and unemployment rate

In the next section (Section III.) we are going to analyze business services development on the basis of the above indicators.

4. Methodology of the research

- Economic analysis on the basis of macroeconomic indicators and business services indicators;
- Analysis based on Input-Output Tables;
- Analysis based on publications in literature foreign and domestic as well;
- Analysis on the basis of extra-statistical information sources.

III. THE DEVELOPMENT OF BUSINESS SERVICES IN TRANSITIONAL HUNGARY

1. Business services newly emerged

To build up a market economy requires numerous institutional conditions that a socialist economy did not have. The establishment of these institutions is urgently needed and experiences of developed Western countries can be utilized even if with limited validity for Central and Eastern European countries.

As it is well-known, transition economies are short of foreign direct investment capital. To lure foreign capital basically requires an adequate infrastructural background in the country. The urgent task is therefore to develop the service sector, meaning not only attraction for foreign capital

investors, but also an approachment to the level of services in more developed countries.

The core of transformation process is the privatization going paralell with fundamental structural changes in the economy. As the process of transition in Central and Eastern European countries is without example, it goes without saying that certain institutions needed to the privatization process have never existed in socialist countries.

The lack of important business services like auditing and consulting companies, adequate banking and financing system, adequate legal background, which are fully extended in developed countries, slowed down the privatization process. First of all a legal and organizational type of framework should be set up from infancy with all the necessary institutions through the process of "learning by doing".

One of the most important milestones of the transition was the enactment of the Company Law January 1, 1989, which made possible the acceleration of the privatization process.

The main types of business services established newly can be summarized as follows:

1. **At macroeconomic level** unique state bodies, like **the Hungarian State Property Agency (SPA) and the State Holding Company** have been established to handle, prepare and regulate the privatization of state owned enterprises. **The Small Venture Development Office and Found for Small Entrepreneurs** are providing advice about financing and market possibilities, and Employment Offices belonging to The Ministry of Labor offering labour market services for the unemployed.

2. **At firm level** the "**externalization**" of business services has been apparent. This meant that for activities formerly performed inside the firm - like legal advising, book-keeping, maintenance, training, market research, graphic design – independent private small firms were organized as satellite companies around the big state enterprise to be privatized. (*Vanyai,* [1996].) Of course, manufacturers have a choice between "making" or "buying" such services, except where regulations prescribe that external firms should be hired for example for auditing.

Management consulting firms, among them numerous Western management consulting firms have been set up with their high professional standards but often with the lack of knowledge and understanding of the

special conditions of the Hungarian economy at the beginning. "Learning by doing" process has been most characteristic for all.

The degree of internationalization has been overwhelmingly large in certain branches of services. A large share of foreign direct investment went to the service sector, particularly to areas like management consulting, real estate and asset valuation, banking, telecommunication, and information network. The U.S., the U.K. and Germany have the lion's share in management consulting firms established in Hungary. In 1993, about 70 per cent of the USD 2 billion inflow was absorbed by the tertiary sector (*Vanyai,* [1996].)

Hungarian companies and institutions to be privatized preferred to choose rather Western consulting firms because of their higher expertise in professional practice in a given field. Their main advantages over the domestic counterpart are the sophisticated technology and proved methodology, flexibility, and efficiency (*Hovanyi*, [1996]).

In the midst of dense tasks of privatization, especially in 1989–1993, excess demand has been prevailed for consulting firms and also a strong price competition. This upheaval, however, will get a downturn by the time the privatization process will be over in Hungary. Strong signs have been already shown up for the reversal of this tendency.

Hungarian experts in management consulting strengthened their theoretical knowledge and practical expertise during the past years. "Their most valuable competitive advantage is their detailed knowledge of the legal, technical, economic, financial, etc. peculiarities of the Hungarian scene." (*Hovanyi*, [1996]).

The widespread privatization process triggered mushrooming the small- and medium-sized enterprises, corporations, limited companies which have been explosively evoluted almost from the sracth. On the other hand, in the frenzied attempt to privatize the state sector, huge state enterprises have been partitioned into many smaller specialized units, which became in some cases service firms themselves. Establishing new businesses, small and medium-size enterprises was supported by significant favors from the government , particularly through taxes.

2. What do economic indicators show? Changing role of business services in the economy

During decades of socialism infrastructure and services can be characterized as not only of low standard, but far lagged behind the general level of the country's economic stage of development.

Much research has been done in Hungarian economic literature in the seventies and the eighties to call government's attention to implement policies to reduce the backwardness of domestic infrastructure and services in Hungary. Instead, economic policy very single-mindedly - pushed back the development of the service sector as many service branches were marked as "unproductive" leading to their exclusion even from GNP accounting.

Before the transformation process Hungarian economy can be characterized by a structure which has been biased towards low share of service sector and high share of industry and agriculture. The service sector accounts for more than 70 per cent of the GDP in most developed countries and an even larger proportion of employment, while in Hungary it is about 40 to 50 per cent between 1980 and 1993.

According to data of the Hungarian Statistical Office the Hungarian business community extended by more than half a million (mainly new) private businesses from less than 400 000 in the post-socialist period of 1989–1997. The number of corporations and unincorporated enterprises altogether exceeded one million in January 1996. As regards the **two business service sectors, J and K**, from 1989, the starting point of free undertaking, the number of firms has grown about twice as fast as the number of all firms. The number of registered enterprises mushroomed, in 1993 it reached 223 thousand from much less than 100 thousand in 1989, than a further 100 thousand of increase was experienced until 1996, and by 1997 a significant , about 70 thousand decrease is apparent. This latter phenomenon has signaled already the saturation in that market. The number and the share of enterprises employing less than 20 persons has shown the fastest growth since 1989. Hungarian markets of business services are dominated by private firms in about 75-80 per cent.

Foreign participation also grew rapidly. While in 1990 the number of organizations with Hungarian and foreign (mixed) participation has been 5 693 and merely 231 pure foreign participation, in 1995 the corresponding numbers are 13 986 and 10 964.

Looking at the statistics of employment, we experience significant increase in the number of people employed in the service sector, while there

was decrease in industry and agriculture. (See Table in the Annex.) The most remarkable increase in employment can be traced just in business services: the number of employees in the sector of financial intermediation and other financial activities has grown 13 per cent in 1995, in real estate and renting 4 per cent, in transport, storage, post and telecommunication 2 per cent. All these facts justify our strong suggestion that the service sector plays a great role in relieving unemployment. It is even more remarkable how the share of capital invesrments has been changed between industries: in 1996 3,1% of all investments was realised in agriculture, 31,7% in industry and 65,2% in the services sector, while in 1990 the respecting numbers are:

Out of all investment 25,9% in K, and 2,8% in J sectors has been realised.

Parallel with this process a great ammount of foreign direct investment has flown in the country. Data in Table in the Annex speak about the involvment of domestic and foreign direct investment in the field of services, especially business services.

The most spectacular development has occurred most probably in **telecommunication** between 1989 and 1997. Hungary was considered as one of the countries with lowest density figures of connected telephone lines in Europe. The number of connected lines almost tripled during this period, it increased from 996 thousand in 1990 to near 3 000 thousand in 1997. The number of private subscribers has grown from 705 thousand in 1990 to 2 500 thousand in 1997. New telecommunications services were introduced at a remarkable high speed. The progress in that sector has been fantastic, nevertheless it is still not adequate with the population of 10 million of Hungary.

"Regulatory and organizational measures preparing the takeoff period of the Hungarian telecommunications sector started with the splitting up of the Hungarian Post into Hungarian Mail performing traditional postal services with a low level of technology intensity, the Hungarian Broadcasting Company (late Antenna Hungaria Ltd.) and the Hungarian Telecommunications Company (MATAV). This organizational reform carried out in 1990 stopped the cross-subsidization of other postal services from revenues earn in the telecommunications services for the modernization of this sector itself." (*Vanyai*, [1996]).

The marked improvement of telecommunications, a sine qua non for economic progress, accompanied by the development of telecommunications technologies and regulations has a positive impact on every segment of the

economy, among them the industry of telecommunication equipments, which strongly attracted foreign capital. It has been a large step towards conformity with European standards.

Although the reform of **the financial system** has started as early as in 1987 in Hungary, by 1994 it became obvious that the existing banking system has formed an obstacle in the transformation process. There was a tremendous need for more liberalization and deregulation. The deregulation of the banking system opened way for foreign banking investors to the Hungarian market, bringing not only their experiences in modern banking technic, but also the modern technic itself to the area. In spite of successful initial steps, the Hungarian banking conditions are still inadequate. Hungarian banks don't fulfill the tasks what can be expected from a western counterpart.

Although banking, insurance and real estate agencies have mushroomed, there is no adequate demand from the side of the population for these services, first of all because of the low income level of households, secondly, the Hungarian population is not very familiar with all these modern banking and insurance technic.

Demand from manufacturing firms for business services like **market research, advertising, consulting, computer software, graphic design** has recently grown considerably in developed Western economies. As manufacturers tend to move away toward more customized production a greater input of strategic services is required to their functioning (*O'Farrell*, [1995]). This tendency has started to prevail in Hungary as well at a remarkably great speed.

An enterprise survey among Hungarian enterprises shows that foreign advertisement agencies massively contributed to the modernization of practically oriented marketing and sales promotion skills in Hungary. Hungarian enterprises "are aware that their marketing should be improved but they are much less sure about how this should be done. This is reflected by their week demand for the services of marketing information systems, their low level of interest toward commission market research and their less than 2 % average share of advertisement expenditure". (*Vanyai*, [1996]).

While foreign capital undeniably accelerates the development of particular branches of business services, it generated some anomalies and imbalances as well.

All in all, privatization had a positive impact on the development of business services. The rapidly expanding private ownership in every sector of the economy boasted the emerge of business services.

The extensive experience about the dynamic and evolving nature of services' role in developed economies should force governments in transitional economies to implement equally dynamic and flexible public policy towards services.

There is, however, **a serius warning sign** in the sectoral structure of business services. **Tendencies and trends in research and development is more than alarming**. Between 1991 and 1996 the share of both output and gross value added devoted to research and development has declined from year to year. During the long protracting crisis the bad situation has even worsened. A significant drop - 25% -has occurred in R&D spending from the year of 1991 until 1996. The ratio of R&D spending to GDP has decreased from 2.3 per cent in 1989 to 0.7 per cent in 1996 which is extremely low both by international and domestic standard. Spending in real value has decreased by 56 per cent in research institutes of the Hungarian Academy of Sciences, 17 per cent in universities and colleges, and 65 per cent in research divisions of enterprises. The number of researchers dropped dramatically between 1989 and 1996, by 53 per cent. The share of basic and applied research somewhat increased, 3 percentage points, from 60 to 63 per cent, while experimental research and development decreased from 40 to 37 per cent. Foreign direct investment has been very weekly involved in Hungarian R&D, therefore it could not have any positive influence on it.

Government committed a serious mistake by cutting back investments in that subsector, and not encouraging foreign investment either. It destroyed the basis for increasing international competitiveness that should get a greater significance in the transitional process of the Hungarian economy . A real long term strategy is needed and the government should be aware of the real picture of domestic technical standard, how the efficiency of innovation and research an development (R&D) enhances economic development.

Lessons drawn from developed economies show that the period of a downturn or crisis in the economy is a period for technical revival, for more intensive research and development and innovative activities. As it has been already pinpointed earlier the knowledge-based economic development became deceisive by the end of the nineties.

IV. POLICY CONCLUSIONS

Hungarian government should be aware that services should be considered as a catalysator in a modern economy.

Western developed economies' examples show that there is a strict correlation between the general state of infrastructure and services in a country and the level economic development, standard of living, quality of life.

A critical lesson from developed market economies is that producing goods and strategic services with high value-added is at the core of improving economic performance and international competitiveness. If they are adequately developed they are helping well functioning the economy, if they are less developed than the general level of the economy they are hindering the development of the economy.

Efficiencies of service provisions enable the growth of all other sectors which rely on services as inputs, while neglecting of vital service branches doom many other sectors to failure.

Services play a key role in macroeconomic development, in reducing unemployment, in relieving economic crisis and a key role in knowledge-based economy. I would like to emphasize this last mentioned role of services: **key role in knowledge-based economy.**

The widespread new technic and development of information technologies are central to the evolution of the knowledge-based economy, and have revolutionized the whole sphere of economy: new type of infrastructures, services, information networks, data transferring networks and other activities emerged based on microelectronics and computer technic. It is estimated that more than 50 % of GDP in the major OECD economies is now knowledge-based."

The overwhelming shift toward knowledge-driven economy based on rapid changes in technological progress and the development of human resources in developed Western countries should force Hungarian government and firms as well to rethink the role of services. Effective governments should make effective policies creating incentives for expanded investment in human resources, technology, innovation and information networks.

The development of business services in transitional Hungary is unavoidable. The extensive experience about the dynamic and evolving nature of services' role in developed economies should force governments in transitional economies to implement equally dynamic and flexible public policy toward services. A well-functioning economy requires a delicate combination of government and markets which should be the heart of a development strategy.

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VI. ANNEX: Statistical variables of business services' development in Hungary 1991–1996[1]

Table 1. **Output in the Hungarian business services sector 1991–1996** (at 1991 prices)

1991=100

Code	*Industries*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*
J	***Financial Intermediation***	100	86	95	115	99	101
65	Financial intermediadiation, except insurance and pensions funding	100	81	84	100	85	83
66	Insurance and pensions funding	100	712	1319	1375	1240	1245
K	***Real Estate, Renting and Business Activities***	100	101	103	112	112	123
70	Real estate activities	100	87	90	93	96	98
71	Renting of machinery & equipment without operator	100	75	69	77	87	89
72	Computer and related services	100	96	89	101	99	100
73	Research and development	100	94	87	81	73	71
74	Other business activities	100	136	144	165	162	171
	J and K	100	97	101	113	109	117
	Economy Total	100	95	94	98	100	103

Source: Author's own computations on the basis of data published in „**National Accounts of Hungary**", Central Statistical Office, 1997 and Input-Output Tables

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Table 2. **Gross value added in the Hungarian business services sector 1991–1996 (at 1991 prices)**

1991=100

Code	*Industries*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*
J	***Financial Intermediation***	100	85	98	125	103	103
65	Financial intermediadiation, except insurance and pensions funding	100	79	84	106	88	89
66	Insurance and pensions funding	100	533	523	467	291	278
K	***Real Estate, Renting and Business Activities***	100	104	108	113	110	119
70	Real estate activities	100	94	96	97	100	105
71	Renting of machinery & equipment without operator	100	88	86	90	91	92
72	Computer and related services	100	100	97	124	114	116
73	Research and development	100	92	88	84	75	73
74	Other business activities	100	138	152	162	148	152
	J and K	100	98	105	116	108	114
	Economy Total	100	97	96	99	101	102

Source: Author's own computations on the basis of data published in „**National Accounts of Hungary**", Central Statistical Office, 1997

Table 3. **Shares of business services in economy** (Economy total = 100)

	Output				Gross value added			
	J	**K**	**R+D**	**J+K**	**J**	**K**	**R+D**	**J+K**
1991	2,7	6,8	2,5	9,5	4,1	9,4	2,8	13,5
1992	2,6	7,8	2,3	10,4	3,7	10,8	2,5	14,5
1993	2,9	8,6	2,0	11,5	4,1	11,6	2,0	15,7
1994	3,7	9,0	1,6	12,7	5,6	12,0	1,7	17,6
1995	3,2	8,9	1,0	12,1	4,7	12,0	1,2	16,7
1996	3,2	11,0	0,7	14,2	4,8	14,3	0,8	19,2

Source: Author's own computations on the basis of data published in „National Accounts of Hungary", Central Statistical Office, 1997

Table 4. **Employment in the Hungarian business services sector 1992–1996** (Number of employees)

Code	**Industries**	**1992**	**1993**	**1994**	**1995**	**1996**
J	*Financial Intermediation*	57.058	61.192	63.829	64.584	61.246
65	Financial Intermediation, except insurance and pensions funding	42.918	45.226	46.775	47.132	44.150
66	Insurance and pensions funding	13.432	15.250	16.554	17.056	16.625
67	Activities auxiliary to financial intermediation	708	716	500	396	471
K	*Real Estate, Renting and Business Activities*	105.462	90.095	79.580	77.972	79.517
70	Real estate activities	23.940	17.668	13.900	13.267	12.690
71	Renting of machinery & equipment without operator	3.156	2.556	2.045	2.761	2.612
72	Computer and related services	8.723	6.932	5.317	4.971	5.432
73	Research and development	17.789	15.861	13.746	11.939	10.529
74	Other business activities	51.854	47.078	44.572	45.034	48.250
	J and K	162.520	151.287	143.409	142.556	140.763
	Total Economy	4.241.800	3.888.900	3.820.900	3.752.900	3.685.150

Source: On the basis of Hungarian Statistical Yearbook, Hungarian Central Statistical Office

Table 5. **Dynamics in employment of the Hungarian business services sector 1992–1996**
(Number of employees in 1992=100)

Code	Industries	1993	1994	1995	1996
J	***Financial Intermediation***	1,07	1,12	1,13	1,07
65	Financial Intermediation, except insurance and pensions funding	1,05	1,09	1,10	1,03
66	Insurance and pensions funding	1,14	1,23	1,27	1,24
67	Activities auxiliary to financial intermediation	1,01	0,71	0,56	0,67
K	***Real Estate, Renting and Business Activities***	0,85	0,76	0,74	0,75
70	Real estate activities	0,74	0,58	0,55	0,53
71	Renting of machinery & equipment without operator	0,81	0,65	0,87	0,83
72	Computer and related services	0,79	0,61	0,57	0,62
73	Research and development	0,89	0,77	0,67	0,59
74	Other business activities	0,91	0,86	0,87	0,93
	J and K	0,93	0,88	0,88	0,87
	Total Economy	0,92	0,90	0,88	0,87

Source: On the basis of Hungarian Statistical Yearbook, Hungarian Central Statistical Office

Table 6. **Structure of employment in the Hungarian business services sector 1992–1996**
(Economy as a whole=100)

Code	Industries	1992	1993	1994	1995	1996
J	***Financial Intermediation***	1,35	1,57	1,67	1,72	1,66
65	Financial Intermediation, except insurance and pensions funding	1,01	1,16	1,22	1,26	1,20
66	Insurance and pensions funding	0,32	0,39	0,43	0,45	0,45
67	Activities auxiliary to financial intermediation	0,02	0,02	0,01	0,01	0,01
K	***Real Estate, Renting and Business Activities***	2,49	2,32	2,08	2,08	2,16
70	Real estate activities	0,56	0,45	0,36	0,35	0,34
71	Renting of machinery & equipment without operator	0,07	0,07	0,05	0,07	0,07
72	Computer and related services	0,21	0,18	0,14	0,13	0,15
73	Research and development	0,42	0,41	0,36	0,32	0,29
74	Other business activities	1,22	1,21	1,17	1,20	1,31
	J and K	3,83	3,89	3,75	3,80	3,82
	Total Economy	100,00	100,00	100,00	100,00	100,00

Source: On the basis of Hungarian Statistical Yearbook, Hungarian Central Statistical Office

Table 7. **Number of enterprises in the Hungarian business services sector 1996–1997**

Code	Industries	1996		1997	
		Number of enterprises	Number of enterprises in J and K=100	Number of enterprises	Number of enterprises in J and K=100
J	***Financial Intermediation***	2.510	0,74	11.065	3,97
65	Financial Intermediation, except insurance and pensions funding	894	0,26	973	0,35
66	Insurance and pensions funding	344	0,10	387	0,14
67	Activities auxiliary to financial intermediation	1.272	0,37	9.705	3,48
K	***Real Estate, Renting and Business Activities***	338.373	99,26	267.794	96,03
70	Real estate activities	133.680	39,22	98.930	35,48
71	Renting of machinery & equipment without operator	6.907	2,03	7.192	2,58
72	Computer and related services	8.267	2,43	15.686	5,63
73	Research and development	2.991	0,88	3.060	1,10
74	Other business activities	186.528	54,72	142.926	51,25
	J and K	340.883	100,00	278.859	100,00

Source: On the basis of Hungarian Statistical Yearbook, Hungarian Central Statistical Office

Table 8. **Small and medium sized enterprises in the Hungarian busines services sector 1996–1997** (Number and structural shar of enterprises)

Code	Industries 1996	Small sized enterprises up to 11 persons		Medium sized enterprises from 11 to 20 persons	
		Number of enterprises	Total enterprises to the subsector=100	Number of enterprises	Total enterprises to the subsector=100
J	*Financial Intermediation*	2.137	85,14	119	4,74
65	Financial Intermediation, except insurance and pensions funding	580	64,88	91	10,18
66	Insurance and pensions funding	327	95,06	2	0,58
67	Activities auxiliary to financial intermediation	1.230	96,70	26	2,04
K	*Real Estate, Renting and Business Activities*	334.553	98,87	2.369	0,70
70	Real estate activities	133.291	99,71	207	0,15
71	Renting of machinery & equipment without operator	6.723	97,34	114	1,65
72	Computer and related service	7.867	95,16	253	3,06
73	Research and develpoment	2.713	90,71	124	4,15
74	Other business activities	183.959	98,62	1.671	0,90
	J and K	336.690	98,77	2.488	0,73

Code	**Industries 1997**	**Small sized enterprises up to 11 persons**		**Medium sized enterprises from 11 to 20 persons**	
		Number of enterprises	Total enterprises to the subsector=100	Number of enterprises	Total enterprises to the subsector=100
J	*Financial Intermediation*	10.681	96,42	130	1,17
65	Financial Intermediation, except insurance and pensions funding	662	67,14	94	9,53
66	Insurance and pensions funding	370	95,61	2	0,52
67	Activities auxiliary to financial intermediation	9.645	99,38	34	0,35
K	*Real Estate, Renting and Business Activities*	264.086	98,61	2.345	0,88
70	Real estate activities	98.526	99,59	200	0,20
71	Renting of machinery & equipment without operator	7.031	97,73	112	1,56
72	Computer and related service	15.295	97,49	259	1,65
73	Research and development	2.798	91,35	125	4,08
74	Other business activities	140.436	98,24	1.649	1,15
	J and K	274.767	98,52	2.475	0,89

Source: On the basis of Hungarian Statistical Yearbook, Hungarian Central Statistical Office

Table 9. **Basic statistics on the business services sector in Hungary, 1995-1997** (Economy total=100)

Code	Industries	Output 1995	Gross value added 1995	Subscribed capital of enterprises with FDI 1996	Employment 1996	Unemployment 1996
J	***Financial Intermediation***	3,17	4,15	9,47	1,66	1,07
65	Financial Intermediation, except insurance and pensions funding	2,74	4,60	..	1,20	..
66	Insurance and pensions funding	0,33	0,37	..	0,45	..
67	Activities auxiliary to financial intermediation	0,10	0,15	..	0,01	..
K	***Real Estate, Renting and Business Activities***	7,74	10,66	6,56	2,16	2,80
70	Real estate activities	3,28	5,33	..	0,34	..
71	Renting of machinery & equipment without operator	0,38	0,58	..	0,07	..
72	Computer and related services	0,51	0,63	..	0,15	..
73	Research and development	0,36	0,50	..	0,29	..
74	Other business activities	3,21	0,36	..	1,31	..
	J and K	10,91	15,78	16,01	3,82	3,87

Source: On the basis of Hungarian Statistical Yearbook, Hungarian Central Statistical Office