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SME POLICY AND COMPETITIVENESS IN HUNGARY

Small and medium-sized (SMEs) enterprises in Hungary account for 99.9% of all enterprises and for more than two thirds of employment. Since transformation started in 1989 they have been the only net makers of employment. In spite of such remarkable importance, results have been modest compared to the amount of Hungarian and foreign, mostly EU resources poured into the sector. Less than a sixth of SMEs are fast-growing and only a tiny minority of SMEs make use of bank credit. According to various indicators and in spite of bright spots, the SMEs context is problematic and SMEs features are often unfavourable and hardly competitive. In recent years the goal of upgrading SMEs and strengthening their contribution to the economy has acquired central position among policy goals and activity. Although progress has been made, the results are weak and in some cases drawbacks have happened. The paper starts from analysing the SMEs situation, reviews the main features of the recently implemented policy strategies, assesses whether these strategies are appropriate to address the situation, including the effects of the domestic and international crises, and considers whether the targets pursued are realistic and important, and the instruments considered in line with the targets[1].

Keywords: **Hungary, SMEs, Transformation, Entrepreneurship, Competitiveness, Policies, Crisis, Strategy**

Transformation is about creative destruction: dismantling the old economic, political and social system and fostering a new one. A similar observation holds for economic, political and social actors. The issue of creative destruction has been considered during transformation in Central and Eastern European Countries (CEECs) (Murrell, 1992). Within it the importance of bottom-up processes in general and that of the creation of small and medium-sized enterprises (SMEs) have been debated since the beginning (Kornai, 1990; Dallago, 1991). However, policies have been dominated by the need to stabilise, liberalise, and privatise quickly and on large scale (Sachs, 1993; Frydman – Rapaczynski, 1994) according to the teaching of the Washington Consensus (Williamson, 1994; Rodrik, 2007).

Large scale privatisation has led to remarkable formal success: by the end of the Nineties the economy was dominated by privately owned enterprises in nearly all former socialist countries. In spite of this formal success and improvement in restructuring (Fabrizio et al., 2009),[2] CEEC economies have remained vulnerable and their enterprises hardly competitive. There are important reasons to maintain that SMEs are a fundamental component of the economies competitiveness both in general (Audretsch, 2006; Erixon, 2009a; Gries – Naudé, 2010; Schmitz, 2004) and in the case of transformation economies (MacIntyre – Dallago, 2003; Aidis – Welter, 2008; Dallago – Guglielmetti, 2010). Along with the advantages of diffused entrepreneurship and the favourable consequences for innovation, in transformation economies SMEs can embody market institutions and support their evolution much faster and at lower cost than more bureaucratic and conservative large companies. The latter have anyway to go through costly and lengthy privatisation and restructuring before strengthening their competitiveness.

Enterprises competitiveness is of great importance for modern economies and their management. This importance has increased with the deepening of the transformation process amidst growing integration of world economies ("globalisation"). The global openness and integration of economies have led in fact to deeper coordination of macro-policies, which can now be used by national governments only amidst many limits. Consequently, the differential push to competitiveness has been coming primarily from the institutional and micro-

economic components of the economy. Entrepreneurship and SMEs foundation and upgrading feature prominently among the latter. In view of these developments, international and specialised organisations have tried to assess the factors supporting the innovative and competitive effect of entrepreneurship and SMEs (Doing Business, 2009a; Kauffman Foundation, 2007; OECD, 2008b). For countries in transformation, diffused entrepreneurship, enterprise foundation and upgrading have a particular importance for growth and competitiveness both for the requests of the transformation process and the structural features of those economies. However, policies have been dealing with SMEs as a size category more than for their critical role in the economy.

Among transformation countries Hungary presents perhaps the greatest puzzle. Thanks to the important attempts at reforming her economy since 1968 and again during the Eighties (Kornai, 1986), Hungary was considered to be the frontrunner in transformation. However, since 1989 the country suffered various policy and transformation setbacks that increased the economic, social and political vulnerability and led to spread dissatisfaction.[3] Enterprises entered transformation with important advantages: fundamental laws for large companies were approved in the second part of the Eighties and SMEs boomed since early Eighties (Dallago, 1989). During the Nineties there was a massive inflow of foreign capital and the number of SMEs witnessed an incredible expansion. During this decade one Hungarian out of ten was registered as a businessman. In spite of this success, the Hungarian economy lacked momentum and large part of the enterprises was not competitive and aimed at survival or only existed on statistical paper (Szirmai, 2003). Problems continued through the foll owing decade. Indeed, Hungary' performance is below average among CEECs according to various competitiveness ranking and SMEs are the least efficient by international standards (MNDE, 2009).

It is in this perspective that in recent years the Hungarian government has considered the disappointing situation with entrepreneurship and SMEs as one of the causes of the unsatisfactory performance of the economy. This convincement has but accelerated since the dramatic effects of the international crisis. This paper considers what went wrong with SMEs, which constitutes an important part of the Hungarian transformational drawback. The next sections consider some data and information (Section 1) that depict the unsatisfactory situation of Hungarian SMEs, particularly concerning competitiveness (Section 2). Section 3 deals with the main individual factors that are behind the strategy to foster SMEs and Section 4 examines the effects of the international crisis and the new policy strategy. Section 5 concludes.

Overview of the SME sector

Although large state owned firms dominated the economy during the socialist period, small and medium-sized enterprises (SMEs) were remarkably important particularly since the 1968 economic reform (Dallago, 1989). In the process of transformation many new SMEs were founded, through genuine greenfield investment, spin-offs, foreign direct investments and "spontaneous" privatisation (Dallago, 2003; Laki, 1998). The overwhelming majority (99.9%) of enterprises in Hungary are presently small and medium-sized and they provide more than two thirds of employment *(table 1)* and 80% of GDP (Estrin et al., 2009). Consequently, their competitiveness fundamentally influences the performance of the whole economy. However, a clear dualism appeared between the modern foreign-owned sector and the less dynamic domestic sector. The latter includes most SMEs which do not perform substantial investments and make use of underground economic practices (such as tax evasion) (Szirmai, 2003).

SMEs have been defined in Act XXXIV of 2004, which has confirmed the Hungarian definition and practice to the European Commission recommendation 2003/361/EC of 6 May 2003. Starting from 1 January 2005, SMEs definition became more refined on financial and ownership issues. These concerned particularly the use of consolidated budget and the exclusion from the SME category of those enterprises whose capital is owned for more than 25% by the state, municipalities or large companies, separately or jointly. This criterion does not apply to institutional investors.

Table 1

Size distribution of Hungarian registered SMEs

(2005, in percent of all enterprises according to workforce size categories)

	0-1	2-9	10-49	50-249	SME total
Number of enterprises*	75.6	20.2	3.6	0.6	**99.9**
Employees*	6.0	21.9	21.6	19.5	**68.9**
Sales revenues	7.4	14.4	19.7	18.1	**59.6**
Export	5.9	5.5	10.3	13.5	**35.3**
Value added	6.0	10.9	16.4	18.7	**52.0**
Equity	8.9	11.9	14.6	15.8	**51.2**

Notes: * including the financial sector.
Source: HCSO in the case of sales revenues and value added figures, MoET calculations for the rest

The Hungarian Central Statistical Office (HCSO) adopted the new European method in 2005 thus decreasing substantially the number of operating enterprises. An enterprise is now considered to be operating in a given year if it had sales revenues or had at least one employee. In 2004 the number of operating enterprises was 871,956 and 708,307 according respectively to the old and the new methodology (MoET, 2007a: p.129-131.; Strategy, 2007; Völfinger, 2005).

While microenterprises (with less than 10 employees) employ a higher share than in other transformation countries, except Poland, and EU-15 countries, the employment share of small (20-49 employees) and medium sized enterprises (50-249 employees) is lower than in other countries. Overall, the number of SMEs compared to the inhabitants and the employment share of SMEs remains higher in Hungary and other transformation countries (with the relevant exception of Slovakia and Romania) than in EU-27 on average and is similar to the structure in the Southern EU member countries (Eurostat, 2008; OECD, 2008c).[4]

Both sales revenue per enterprise and value added per employee are a fraction of the EU average in both relative *(Table 2)* and absolute terms (Table 3), with somewhat better performance only for small enterprises in sales revenue. Therefore, it is inevitable that labour cost per value added is higher in Hungary, except in the case of microenterprises. However, the spread of the underground economy may influence the explanatory value of these data.

Table 3

Hungarian enterprises compared to EU-25 (absolute values, EU=100)

	Micro	Small	Medium	SME total	Large
Number of enterprises	1,03	0,60	0,64	1,00	1,00
Number of employees	1,20	0,89	0,98	1,05	0,89
Sales revenues	1,09	0,98	0,97	1,01	0,98
Added value	0,84	0,85	1,03	0,90	1,13

Source: SMEs and Entrepreneurship in the EU, Statistics in focus 24/2006 (Strategy, 2007)

A MoET (2007a) survey distinguishes three different groups of SMEs in terms of performance and this pattern has been stable since the late 1990s: a) *fast-growing enterprises:* this group includes some 15% of SMEs whose yearly growth exceeds 20%, are often part of groups or value chains and networks, produce intermediate goods or business services, are active in public procurement tenders and innovative and active in foreign markets, are endowed with important human and intellectual capital, make intensive use of specialized professional services, and of bank credit for their investments; b) *stable enterprises:* they represent 65-70% of the SME population, have low but positive performance and low qualification of their entrepreneurs/managers and employees, and produce mainly for the retail market without using bank credit, except microcredit and mutual guarantees; c) *laggard enterprises* include the 15-20% of isolated small enterprises and enterprises run by marginal businessmen (elderly, social and minority businessmen) with negative and declining performance, selling their products to the final consumers and making no use of external finance and services.

Table 2

Enterprises in Hungary (2005) compared to the EU-19 (2003) *(*EU-19=100*)*

		Micro	Small	Medium-sized	SME together	Large	Total
Average size	HU/EU-19	59	107	102	61	83	58
Sales revenue per enterprise	HU/EU-19	17	47	31	21	30	19
Value added per employee	HU/EU-19	17	19	15	17	20	17
Labour cost per added value	HU/EU-19	71	111	135	103	119	109
Proportion of export in sales revenues (%)	HU/EU-19	122	92	106	108	178	135

Note: EU-19: 15 Member States + Iceland, Liechtenstein, Norway and Switzerland
Source: SMEs in Europe, 2003, Observatory of European SMEs, No. 7, calculations based on data provided by APEH

More than looking at comparisons with richer market economies, for countries still undergoing some relevant transformation it may be important to look at developments. The data show that a substantial part of Hungarian SMEs is weak also under this heading.

Problematic issues

Policies outcomes have been modest so far due to various reasons. First, programmes are usually episodic and uncoordinated. Second, they have failed in fostering the entrepreneurs' interest (particularly young and educated ones) to specialise, modernise and promote the growth of their enterprise. Third, nearly all programmes show time inconsistency and they are discontinued after relatively short time. Fourth, many programmes depend upon donors and do not involve the beneficiaries' responsibility, e.g. by means of co-financing. Fifth, the donor typically is not involved in following the outcome of the investment after the support is over: the relation between the donor and the beneficiary is usually formal and short-lived.

A sixth general problem is the lack of evaluation culture. Evaluation of policy programmes is important in order to assess their efficacy and adjust them to goals and possibilities. Evaluation should follow a standardised approach in order to provide policy-makers, experts and the public with technically grounded and comparable data (OECD, 2008a) and should avoid the well-known self-selection and committee selection problems[5]. Evaluation in Hungary is only moving through the first steps, an evaluation culture is still lacking, and the insufficient continuity of the programmes prevents assessing themselves: time is not enough for seeing the impact of the programmes on the beneficiaries. Evaluation at the level of policy makers is still more formal than substantial, and only few programmes have been evaluated. Existing evaluation is more an assessment done in terms of number of interventions (typically: how many enterprises – possibly distinguished by size class – applied to and received funds from individual programs), jobs created and funds spent (possibly broken down by size class of enterprises and aim of the application). Typically the results of the programmes are not analysed against what would have happened without the programme.

To address this situation the government approved, on 10 October 2007, *the Strategy for the Development of Small and Medium-sized Enterprises (2007-2013)* (Strategy, 2007) to pursue "the improvement of the economic performance of small and medium-sized enterprises" as part of the implementation of the National Strategic Reference Framework of Hungary for the period 2007-2013. Another important milestone in the development of a national SME strategy has been the approval by the European Commission of the *Economic Development Operational Programme 2007-2013* (MoET, 2008), a programme under the Convergence Objective providing for important financial support (€2.9 billion, of which some €2.5 billion are contributed by the EU) among other things to upgrade the SMEs competitiveness. The main objective of the Programme is to increase the value added and the jobs created by SMEs and their productivity by, among other things, facilitating SMEs access to finance and promoting the development of the business environment.

SME policy and programmes are designed with a long term perspective, aimed at ensuring entrepreneurs a more stable and predictable regulatory and policy framework. However, while the *Strategy* pays attention to the supply side, i.e. actions and services provided to SMEs, it devotes less effort to the demand side, where many of SME's problems originate and subsist. For instance, emphasis is put on the various instruments to ease SMEs' financing constraints, but much less so to the critical issue of how to increase the willingness and opportunities of entrepreneurs to ask for and use efficiently financial resources. Regional differences in SME characteristics and constraints are also a crucial component that should be considered when assessing the proper policy design. With the exception of EU funded projects, SME policy remains centralised in Hungary.

The 2007 SMEs Strategy promises to initiate a new phase of evaluation in SME policies in Hungary: it includes monitoring and takes commitment for an interim assessment of the outcome of the Strategy (Strategy, 2007) by quantifying a set of targets and distinguishing them according to their nature and relevance (strategic targets, comprehensive objectives, horizontal targets). However, objectives are not always clearly and precisely specified. For instance, the strategic target "increasing the economic performance of small and medium-sized enterprises" is expressed as the increase of the ratio of gross value added produced by SMEs from the current 52% to 55% by 2013, without specifying the conditions, e.g. whether this will be the outcome of growing numbers of SMEs or growth of individual SMEs. This incompleteness makes it impossible to assess whether a certain outcome (or failure) may be attributed to the policy or some other unobserved event. Further, the Strategy may lack time continuity due to the implementation of new policy priorities and instruments since late 2008.

Fostering SME Competitiveness

Many SMEs policy programmes focus on the size of enterprises, thus failing to consider whether their activity has the potential to increase the competitiveness of enterprises and consequently generate economic growth. Hungarian policy-makers are apparently aware of this problem and have become attentive to policies supporting SMEs competitiveness. However, various flaws still remain in policies. I shall consider the following critical aspects: a) the business environment; b) human resources; c) access to financing; d) barriers to SMEs access to international markets.

a. The business environment. Entrepreneurs in Hungary continue to identify high tax and social security burdens as the single most important factor impeding firms operations (Table 5, MoET, 2007a), although this rating has declined between 1997 and 2007 as the tax system has been repeatedly reformed. Considerable improvements include lowering corporate tax to 16%, with additional easing for lower tax base, and the introduction of the simplified entrepreneurial tax. Social security payments[6] remain particularly high for labour-intensive SMEs, which find it more difficult than large firms to make use of tax allowance. The fiscal burden represents 38.6% of Hungary's GDP, a rate lower than the EU-25 average (40.9%), but significantly higher than in Visegrád countries. The tax system compares with low tax moral, which places Hungary at a low 111th in the overall ranking of World Bank – Doing Business (WB-DB) 2009 and 11th in EECA region *(Table 4).*

Table 4.

The Hungarian economy in the World Bank Doing Business Rankings, 2009 (2008 in parenthesis)

Ease of...	Doing Business 2009 (2008), total rank*	Doing Business 2009 EECA rank**
Doing Business	41 (50)	7
Starting a Business	27 (72)	6
Dealing with Construction Permits	89 (90)	12
Employing Workers	84 (83)	12
Registering Property	57 (98)	13
Getting Credit	28 (25)	10
Protecting Investors	113 (110)	23
Paying Taxes	111 (109)	11
Trading Across Borders	68 (49)	10
Enforcing Contracts	12 (13)	2
Closing a Business	55 (56)	6

Note: Doing Business 2008 rankings have been recalculated to reflect changes to the methodology and the addition of three new countries.
* 181 countries
** Eastern Europe & Central Asia, 27 countries
Source: The World Bank Group, Doing Business

Variability and unpredictability of economic regulation are perceived to be the second main obstacle to the operation of enterprises. They are particularly problematic for small enterprises, which lack internal capacities to deal with it and may have to use costly external support services. Change of regulation has been in part the result of compliance with the *acquis communautaire,* in that regulation regarding the SME sector was harmonised following EU membership. However, unpredictability has been primarily the outcome of domestic changes.

According to the European Commission, in the EU-25 administrative burdens of entrepreneurs make up on average 3.5% of GDP (Strategy, 2007). MoET estimates that direct burdens to Hungarian entrepreneurs (comprising data provision to the public administration and other burdens related to public administration procedures) may amount to 4.5–6.7% of the GDP. About 1.5% of these stem from EU obligations, while a larger part is generated by the Hungarian regulatory and public administration environment.

According to WB-DB (2009) rankings, Hungary scores 41st-out of 181 countries as concerns "ease of doing business", and 7th in Eastern Europe & Central Asia (EECA) *(Table 2).* However, while starting a business witnessed an impressive improvement in 2009, dealing with construction permits remains a serious obstacle to SME formation. Closing a business is somewhat less problematic although not satisfactory. Efficient bankruptcy laws and procedures are important factors for a conductive business environment. Although according to WB-DB Hungary ranks 12th in enforcing contracts and 2nd in the EECA region, bankruptcy procedure is harsh for both debtors and creditors, and does not facilitate recovery particularly for small enterprises. Companies in trouble have maximum 150 days to negotiate with their creditors and recover. As a consequence, only 8 enterprises restructured in 2006 out of 14 933 enterprises which went through bankruptcy procedures, and 9439 came under liquidation. This outcome can be ascribed to various factors including: increasing defaults on payments from clients and contractors, limited use of credit insurance, lack of professional management and evaluation culture in domestic SMEs. The new Bankruptcy Act should unify to one procedure the presently separate bankruptcy and liquidation procedures and shorten the time needed for liquidation (Strategy, 2007; FBD, 2007; Simon – Turóczi, 2007).[7]

Although property rights are in general well-defined and protected, other aspects related to this issue need to be clearly set. Registering property has been substantially improving but is still problematic (WB-DB scores are 57 on 181 and 13 on 27 respectively in the overall and the EECA indexes), and even more problematic is the protection of investors (scores are respectively 113 and 23). Only 65% of Hungarian enterprises are aware of industrial property rights protection issues and 40% are involved in their protection through means such as trademarks, patents, and licences.

Over the last decade, information and communication technologies (ICTs) have opened up ever increasing opportunities for SMEs, allowing the advantages of small scale to be combined with economies of scale and scope through networking among firms and with other actors such as universities and research institutions. In recent years the use of ICTs increased considerably among Hungarian SMEs, but remains at relatively low levels of technical sophistication (i.e. using a computer and holding an internet connection). Hungary falls behind the European average with respect to: i) the use of more sophisticated technologies (broadband access), although not behind most new EU member countries; ii) the weight of security in business decisions; iii) the share of companies using digital signatures; and iv) the use of electronic commerce by Hungarian enterprises (less than half the EU average, the last position in the EU). Even worse is the gap in the use of more sophisticated IT and e-business solutions, in which Hungary ranks very low in the EU, at a considerable distance from the best performers. The performance is very weak in the share of enterprises having internal company processes and external integrated company processes. In all these aspects SMEs fare considerably worse than large firms (e.g. in broadband internet penetration, the gap is close to 50% – MoET, 2007a), with the partial exception of medium-sized companies.

Further development of E-government is important because it can substantially improve the productivity of the public administration, significantly decrease transaction costs of enterprises, and reduce the discretionality of public administrations, thus improving the quality of compliance with rules and accountability. This contributes to create a more predictable environment for enterprises. E-government services completely accessible electronically for the general public (50%) are higher than the EU average (36%), due to the substantial improvement during the past few years. However, in the case of enterprises, Hungary ranks only 21st, significantly behind the European average (MoET, 2007a; UN, 2005).

b. Human resources, motivation, and networking. Managerial weaknesses are a key cause of (small) business failure and a shortage of skilled workers is a barrier to innovation. Together with regulation, human resources are apparently and important weakness of Hungarian SMEs. Traditional formal education is good, but the country ranks below European average concerning life-long learning and the share of students in the technical and natural sciences. Most non-corporate R&D personnel is employed in higher education institutions. Training, education to entrepreneurship, e-learning and distance learning and R&D human resources are all at rather low levels in SMEs. Along with being at low level, R&D also has excessive concentration at (mostly large) enterprises with foreign ownership: these concentrate nearly 80% of corporate research, while only 2-3% of SMEs are innovative pioneers and 20-22% are imitators (Strategy, 2007).

The willingness to start-up companies has significantly deteriorated in the population (CSO, 2006; GEM, 2008).[8] There may be different reasons for this trend, including that the post-transition years of enthusiasm and great opportunities are over. However, this could also be related to the fact that the best motivated, skilled and educated people are attracted by the working conditions and salaries offered by multinational subsidiaries operating in Hungary. Existing SMEs show high concentration in more traditional branches, in particular real estate trading and renting, traditional business support services, trade, construction industry. Although this may be an answer to market demand, Hungarian entrepreneurs apparently tend to avoid high risk, knowledge and technology-based competitive industries and prefer those that require lower capital intensity, guarantee rapid returns and do not require particular technical skills.

As in many OECD countries, there is also an increasing trend in SMEs to specialise in their core business and subcontract some operating functions (accounting, marketing, legal, technical, IT and other services) to other specialised SMEs. This trend may be associated to the labour market regulation and lack of flexibility, which can have the detrimental effect of raising the risk associated with increasing employment: according to WB-DB employing workers is ranked a low 84 and 12 overall and in EECA respectively.

There is also an increasing trend to networking that by now involves more than half of SMEs, (MoET, 2007a). About 57% of all enterprises participated in 2005 in some form of formal or informal cooperation with other enterprises (counselling, borrowing tools, machines or money, acquiring business, etc.). Of these 17% are engaged in formal cooperation (joint purchase, sales, production). However, most of these are soft forms of networking and production networking is scarce. A promising although limited development is the increase of ownership cross-holding, which is pulling cross-investment. This is leading to greater corporate concentration and may strengthen the enterprises resource base and performance.

A considerable effort was performed in the past years to set up a network of industrial parks and other infrastructural devices such as regional university knowledge centres, which by now have a fair situation. Although they may be important tools for solving the enterprises location problems and facilitate business cooperation, their effect is modest: there have been few spin-offs and the infrastructure supporting innovation has remained weak in general (Strategy, 2007).

c. Access to financing. Although Hungarian SMEs have been the only net job creators over the past 15 years, their performance has been modest in relation with the growing amount of resources, including foreign and EU resources, spent to support this sector. Moreover, less than 4% of SMEs benefited from development programmes, with the lowest rate in the smallest size classes. Before the 2008 crisis financial needs were ranked low among the impediments to the growth of enterprises *(Table 5).* This may be due to both credit aversion by entrepreneurs and to banks targeting more developed clients, together with the absence of significant programmes for potential entrepreneurs (JEREMIE, 2007).

The Hungarian experience – similar to that of other former transformation countries – is that lack of financing is not an important obstacle to the creation of small firms, which rely on informal sources or, for some firms, parent companies. However, the inability or unwillingness to access external finance is critical for the development of these SMEs (McIntyre – Dallago, 2003). Since 1999 financing issues have become increasingly less problematic, reflecting the fact that commercial banks and savings cooperatives increasingly served SMEs with new loan products and services. In the WB-DB ranking Hungary gets a fair 28 in the overall ranking and 10 in that referring to EECA for getting credit. The EBRD index of banking sector reform is in fact 4.0 in 2008, as it was in 2001, and that of non-bank financial institutions improved in the same period from 3.7 to 4.0. This puts Hungary on top of other central European new member countries. Domestic credit to the private sector compared to GDP improved from 30.9% to 54.6% leaving the other central European countries at distance. Also, the government took positive steps to ease the traditional SME aversion of large banks, particularly with the multi-pillar special credit system set up in 2003 and jointly operated by various credit institutions and organisations.[9]

The limited financial penetration is due to different factors: ignorance or worry of many entrepreneurs of the existing possibilities and their features and fear or inability of growing; insufficiently developed guarantee and insurance system; weak reputation and trust preventing the matching of demand and supply; fear to weaken or jeopardise the owners' control over the enterprise. These problems require a broad spectrum of financing solutions and education of entrepreneurs.

Table 5

Factors impeding enterprise growth in Hungary

	1997	1998	1999	2003	2005	2007
High tax and social contribution liabilities	84	78	73	74	72	77
Unpredictability of economic regulation	62	58	53	58	55	63
Strong competition	53	57	61	61	61	56
Shortage of orders	48	45	52	45	48	45
Unfair competition	46	44	44	47	48	45
Delayed payments of customers	30	31	30	32	34	35
Shortage of capital	40	37	37	34	32	31
Other inhibiting factors	19	20	17	16	13	19
Procurement difficulties	14	16	16	17	16	13
Obsoleteness of existing capacities	17	19	17	17	13	12
Shortage of loans	27	26	26	20	15	12
Shortage of labour	9	9	9	12	8	9

Source: MNDE (2008), p. 159.

Other financing instruments show a similar pattern: rapid development, inability to attract the most enterprises, and overall modest effect (JEREMIE, 2007; MoET, 2007b). The importance of microfinance has been rapidly decreasing, while banks have preferred to target stronger clients. There is currently no significant programme targeting potential entrepreneurs. Perhaps the most successful among financial instruments has been leasing, whose amount has increased threefold between 2000 and 2005 reaching 5.4% of GDP. However, 80% of transactions are related to vehicles. Factoring is still highly underdeveloped, similarly to business angels and venture capital: the latter concentrates on expanding businesses and is nearly absent in the seed stage and weak in the start-up stage. Credit guarantee for SMEs is improving but still insufficient and the majority of guarantee operations relate to loans extended to microenterprises.

d. Access to international markets. Although nearly two thirds of exports come from large enterprises *(table 1),* primarily from the subsidiaries of multinational companies, the propensity to international trade of Hungarian SMEs is generally high in international comparison, particularly in the case of microenterprises (Table 2). In most countries barriers involve critical SMEs aspects: capabilities, finance and access (OECD, 2007). Increasing export is prominent among the Strategy objectives, which foresees a 2% increase over 2005 of the SMEs export participation, although other forms of internationalisation do not receive attention. Increasing SMEs international activity will be possible only if Hungary is able to remove part of the barriers to foreign trade that for the time being rank the country only 68th in the WB-DB general index of trading across borders and 10th in the EECA index.

Top barriers include inadequate quantity of, and untrained personnel for internationalisation, and limited or problematic access to foreign markets. The latter includes limited information to locate and analyse markets, and identifying foreign business opportunities and barriers belonging in the business environment, like unfamiliar exporting procedures and paperwork. Working capital to finance exports is apparently sufficient for high-growth SMEs, but is an important barrier for more traditional enterprises.

It is interesting to notice that in addition to the advantages deriving from EU integration, Hungary has an information, knowledge and relational advantage in the neighbouring countries in regions inhabited by Hungarians. This is apparently a factor easing also capabilities barriers, particularly those related to the inability to contact potential foreign costumers.

The international crisis: A watershed?

SMEs are found to be important in cyclical downturns and recessions (Erixon, 2009a, 2009b; Vandenberg, 2009). In fact and while crises are usually caused by the financial sector or large enterprises, SMEs are more resilient since they are more flexible, more oriented toward the domestic economy and to services, more family based and less prone to downsize employment. However, this greater dependence upon domestic demand and the limited amount of internal resources make SMEs more sensitive to the events in the domestic economy in both downturns and recovery. Since countercyclical measures tend to support domestic demand, these have a disproportionate effect on SMEs.

The international financial crisis is rooted in a combination of factors common to previous financial crises and some new factors, including deficiencies in financial regulation and architecture. Of relevance is the fact that financially integrated markets, while offering many benefits, can also pose significant risks, with large real economic consequences (Claessens, 2010). The crisis, which has had important direct budgetary costs, has been particularly aggressive in Hungary: the country was the first EU member country to request an urgent loan package to the IMF, the European Union and the World Bank to avoid sovereign default and currency collapse in October 2008. Reasons for this vulnerability include irresponsible and inconsistent fiscal policy stance in particular since 2001, high debt, domestic monetary policy and the nature of the country integration into the international financial system (Andor, 2009).

Poor fiscal policy quality (Staehr, 2010; Winkler, 2010), policy mistakes and the lack of structural reform in Hungary led to a record deficit, rapidly increasing debt[10] and a serious drop in competitiveness by 2006. The 2006 reform programme, including the Strategy discussed herewith, reached some success and avoided the immediate crisis, but could not solve most of the structural problems. Particularly problematic are the structural features and weaknesses of the economy: considerable foreign trade exposure, weak export structure and performance, particularly by the domestic sector, significant external debt. Foreign ownership of banks, that was found to contribute to financial vulnerability (Popov – Udell, 2010), represents a slight advantage for Hungary, thanks to the stronger position and higher capitalisation of domestic banks (particularly OTP). However, the tendency of foreign banks to lend in foreign currency (Stein, 2010) has been particularly great in Hungary, which increased financial instability of consumers and local SMEs in the wake of the forint rapid devaluation (by 40% against the Euro between August 2008 and March 2009).

Even more important have been the crisis indirect effects on the real economy through depressed revenues and spending, lower economic growth and increased unemployment (Staehr, 2010). Consequences for SMEs have been consequently important. The international crisis has thus been particularly severe, as reflected in the depressed mood of the business community that continues through 2010.[11] The crisis has put a stop to a growth process that was based on flow of external funds and internal consumption largely funded through loans. The drop of the value of real estate, by far the most important asset in households' portfolio (Horváth – Körmendi, 2009) has significantly weakened the value of the most typical collateral that SMEs use, thus adding a further debilitating effect.[12]

The effect of the crisis on SMEs has been generally harsh (Hodorogel, 2009). In most of the 29 countries reviewed by the OECD, including Hungary (OECD, 2009; OECD-Intesa, 2009) SMEs report a severe decline in demand for their goods and services, although the magnitude of the shock differs from country to country. Increase in reported defaults, insolvencies and bankruptcies and increased payment delays – which add to the endemic shortage of SMEs' working capital and their decreased liquidity – further strengthen fall in sales. SMEs adaptation to the crisis has been apparently contrasted by the banks' policy. Indeed, the conditions on access to bank credit have generally and significantly worsened, thus exposing SMEs to two mutually reinforcing shocks: a demand slump and a financial shock. In fact, evidence suggests that credit has decreased as a source for financing SMEs investment projects and SMEs' demand for working capital and short-term loans has been reduced, although not as dramatically as for investment purposes. Banks have tightened lending policies in terms of guarantees, collateral and amounts, although not exclusively towards SMEs, and in some countries have substantially increased the cost (and spreads) of credit to all their clients.

SMEs response include: a. cost-cutting, particularly of the wage bill, to restore profitability and adjust production to lower demand; b. search for additional sources of liquidity (e.g. extending own payment delays and reducing or suppressing dividends); and c. postponing investment and expansion plans. The governments' anti-crisis packages have tried to ease SMEs' financing problems. These packages include: a. supporting sales and working capital through export credit and insurance, tax reductions and deferrals, better payment discipline by governments; b. enhancing SME's access to liquidity through bank recapitalisation and most often expansion of existing loan and credit guarantee schemes; and c. helping SMEs investments by means of grants and credits, accelerated depreciation, and R&D financing.

In Hungary, the oversized state and internal consumption generated sustained external financing needs and demand for credit. Growing exposure and increasing real interest rates in the domestic market led the majority of companies and households to incur their debts in foreign currencies: retail loans in foreign currencies increased from 0% in 1997 to 18% in 2003 and 70% in 2008. In a 2009 World Bank cross-country survey, in Hungary 52.4 percent of firms – mostly domestic oriented – were found to have an average of 67.3% of foreign-currency denominated debt (Correa – Iootty, 2010). In spite of marked improvement of the financial situation since 2006, the external vulnerability of the economy remained acute and the crisis further exacerbated it (MEH, 2009; MNB, 2009).

The crisis has impacted on a country in difficult situation, including low employment rates and prolonged recession, high dependence on exports and high external debt, being a substantial part of the latter in foreign currencies. In the effort of adjusting to the crisis the government implemented a set of crisis management measures at the end of 2008. These measures eased the pressure upon the economy and laid the ground for implementing a new comprehensive and long-term strategy pursuing short term mitigation of the crisis, including assuring budget equilibrium and supporting employment, and long term reforms (MEH, 2009; OECD-Intesa, 2009). This new strategy addresses four mutually reinforcing structural problems, which reduce significantly the growth potential. These are: a) the obsolete state with high expenditures, and excessive level and inadequate structure of redistribution; b) low employment; c) the weak structure of the real economy; and d) high financing needs.

The government took determined policy measures in April 2009 to decrease the economy's vulnerability and restore the country's credibility (CEC, 2009). These included export-guarantee and -insurance to firms as well as state-backed and subsidised loans plus a set of measures for fiscal stabilization (including shortened maternity leave, increased pension age, changes in the tax system and social security contribution, public works programmes, job protection measures and reform of unemployment benefits). However, in spite of determined action and the success in reaching greater stability of the domestic banking sector (MNBb), "Hungarian economic recovery is likely to lag behind that of developed countries and the economies of Central and Eastern Europe on account of persistently weak domestic demand" (MNB, 2010a).

The 2009 economic strategy (MEH, 2009) is implemented in two phases: a) managing the consequences of the world economic crisis and preserving a balanced budget on the short term together with increasing the level of employment and creating the basis for economic growth; and b) restructuring public finances, improving the supply of and access to public services and various structural measures in the longer term. The first phase comprises five aims, including the support to developing the economy and infrastructure, which is highly relevant for SMEs. An important aim is establishing a work friendly tax regime by substantially decreasing taxes and social security contributions on wages (by 7% in two years). Fiscal balance is pursued through transferring taxation to other items, including increasing value added taxes, excise taxes, property taxes and fighting tax evasion and avoidance. Other aims include developing a targeted social net encouraging work; a stable and predictable pension system; and establishing a cheaper state and a new policy making.

International action, the international financial support package to Hungary, and the measures taken by the Hungarian authorities have reduced the country's vulnerability (IMF, 2009, MNB, 2009). However, the economy is in serious recession (MNDE, 2010a), and this jeopardises the financial stability and solvency of the economy (Barrell – Holland, 2010). In fact, banks liquidity and solvency risks are still high. Measures supporting bank lending have therefore received attention and authorities' and parent banks' interventions have reduced liquidity risks.

The deteriorating macroeconomic environment and the increasing risk aversion of banks are diminishing credit demand from and supply to the corporate and household sector. The reduction is more pronounced for SMEs than for large corporations and SMEs situation is particularly fragile, since they have a higher-than-average proportion of short-term loans. However, SMEs benefit the most from domestic and European refinancing programmes.

Taxation of enterprises changed and became more favourable to SMEs that invest and increase employment and less favourable to larger enterprises (APEH, 2010). Indeed, while corporate (profit) tax rate increased to 19% effective from January 2010 and foreign associations have a corporate tax rate of 30%, up from the previous reduction to 16%, most credits and allowances reducing the corporate tax base were cancelled, except investment benefits (development reserve, investment benefit for SMEs, accelerated depreciation). Contributions payable by employers were reduced from 32% to 27%. The government foresees that taxation of enterprises will decrease overall by some HUF 40 billion (approximately €135 million).

The government has introduced four new programmes since November 2008 and has eased the conditions of some existing ones in order to mitigate the funding problems faced by SMEs (MNB, 2009). The new support is in two forms: three new programmes supporting the banking system in refinancing corporate loans, financed mainly from EU sources (Új Magyarország Working Capital Credit Program, SME Credit Program, Venture Capital Program), and measures providing subsidies on interest or guarantee scheme through the state budget. The overall short-term support is HUF 140 billion (€480 million) corresponding to 10% of the total volume of SME loans maturing within a year. The overall provision of new funds amounts to HUF 225 billion (€780 million).[13]

The new economic policy aims also at introducing some important structural measures aimed at strengthening the Hungarian economy so to support post-crisis development. Among these structural measures the development of SMEs is prominent. The main aim is upgrading the large part of SMEs that is presently stagnant and serving primarily the domestic market. The objective is not new in that it consists of making these SMEs competitive players also in the international market, particularly in the branches where Hungary has a comparative advantage and where jobs can be created.

To this end, the government intends to use two main sets of instruments: assisting financially the enterprises' market entry and reducing administrative burdens. Instruments span from action aimed at improving the context (e.g. international diplomatic effort to promote exports, cutting bureaucracy and regulation, faster procedures in lawsuits, electronic payment of orders, support to research and development, security of energy supply, development of infrastructure) through financial support (credit programmes, state-backed export credit insurance) to real services (public procurement programme, export promotion, electronic registration of companies in one hour, simplification of site authorisation). Noteworthy are public procurement programmes and reduction of administrative burdens. As to the former and in compliance with the EU Small Business Act, SMEs with less than net HUF 1 billion revenues a year (€3,4 million) use a simplified procedure supported by the contracting authority starting from 1 July 2009. The government also decided to reduce the administrative burden of the enterprises arising from national regulation by at least 25% by 2012. The Government also worked out and is implementing programmes aimed at fostering both vertical and horizontal integration of SMEs. A programme supporting SMEs suppliers to large companies in the processing industry has started in February 2008 with EU funds. A competitiveness pole programme encouraging networking and cluster formation and development has also been launched.

Firms in general and SMEs in particular have responded fairly to these measures. Indeed, according to a World Bank cross-country business survey in Eastern Europe[14] released at the end of 2009 Hungarian firms appear to be among the least affected by the financial crisis (Fodor – Poór, 2009; Ramalho et al., 2009; WB, 2009; Correa – Iootty, 2010). The survey found that the major effect of the crisis is a drop in demand (lower in Hungary than elsewhere) which has caused a drop in employment[15] affecting mostly permanent employees and has pushed firms to use more internal funds to finance their working capital and postpone investments. The latter effect has been important particularly in Hungary (+4%), evenly spread across all firm sizes and industries. Supply-side effects, and particularly so access to credit, have appeared to be generally less relevant than during previous crises, but less so for a larger number of companies in Hungary (29.1 percent). Also household and corporate debt – particularly the former including SMEs debt – has fallen back to 2008 level up to mid-2009 and then stagnated thanks to the significant appreciation of the forint (MNDE, 2010b).

Although in general the percentage change in sales is inversely related with the size of the firm, in Hungary medium-size firms has shown a slightly smaller drop in sales than large firms and also capacity utilisation has witnessed little change (–5%). An important idiosyncrasy also exists in employment: while large firms significantly reduced permanent employment (particularly so firms in domestic ownership), SMEs increased their permanent employment although freezed wages. Overall, fewer firms are really in financial distress compared to the other countries.

Conclusions

SMEs have great potential in Hungary and have reached fair results. Their importance in the economy, their job creation and innovation potential justify special attention and care. The perspectives of the Hungarian economy depend to large extent upon the competitiveness of SMEs, which account for much of employment and important parts of production and exports. In spite of internal and external constraints, progress has been made in recent years in policy-making and achievements related to SMEs. The goal of upgrading SMEs and strengthening their contribution to the economy has acquired important position in the government agenda and policy goals. While progress took place, there are also problematic areas and in some cases drawbacks have happened. The international crisis has exacerbated drawbacks.

SME policies have been neither cost-effective nor sufficiently stable in time or appropriate to foster Hungarian SMEs' competitiveness in the globalised economy. Policies have been so far more targeted to existing SMEs and are lacking the full entrepreneurial dimension necessary to foster innovative and internationally competitive SMEs. Important issues such as awareness and capacity building, opportunity recognition and utilization have been overlooked. As a consequence, most SMEs have created jobs but hardly innovated and become competitive. This is the challenge for the years to come.

The pre-crisis Strategy denotes a serious effort in overcoming the main problems afflicting the sector. It affords a detailed and realistic situation analysis and builds upon it the detailed formulation of a new strategy for the development of small and medium-sized enterprises. Yet it fails to tackle the critical issue of entrepreneurship satisfactorily. Through the Strategy the government placed SMEs policies in a perspective that is broader, more detailed, better defined and better coordinated both internally and with other policy areas. It also avoided in its design the danger of interfering with the market by pursuing healthier cooperation between the public and private sectors. However, problems remain open and questions remain unanswered or the answer is short to the reality.

The new post-crisis development strategy is apparently wise in that it does not concentrate exclusively on crisis management and advances further in a balanced direction. Indeed, it aims at making the establishment and management of new enterprises easier and cheaper, thus hopefully reviving Hungarian entrepreneurial attitudes and making existing SMEs stronger and more competitive. However, two caveats are worth stressing.

First, although the strategy includes several wise and sound aspects, it still requires more precise priorities. It includes too many goals, although these are desirable in themselves. Second, the danger is still up that the new strategy can be a new chapter in the old problem of policy instability and unpredictability: although motivated by sharable and desirable aims, it also in-

cluded components (e.g. in taxation policy) that invert previous goals. Whether it will actually result in an important step forward will depend upon the long-run consistency of its implementation, the careful definition of priorities and the effective cooperation between government and the business sector.

The international crisis has made the heavy indebtedness in foreign currencies and the budget deficit difficult to manage. Therefore, macroeconomic policies have taken the lead in the government's concern and priorities. However, the forint depreciation – particularly until raw materials remained relatively cheap, had some advantage primarily for SMEs, supporting their export. This period was short, and was followed soon by substantial forint appreciation, that has had the merit of decreasing the burden of debt in foreign currencies.

The country has been recovering from a serious financial crisis with fair results, including the comparatively fair resilience of SMEs, overcoming a potentially very risky situation, and is now confronting the real effect of the crisis. The government has been inevitably led to pay absolute priority to the macro-stabilisation of the economy. Amidst these urgent and pressing goals the SME strategy implementation and even the issue of weak SMEs competitiveness has been lost of sight. This is understandable, although it may have negative long-run consequences. It is to be seen whether this neglect has been a short-term price paid to more urgent needs that will be overcome soon with stronger determination. The country serious vulnerability, that the crisis revealed beyond doubt, requires that the issue of SMEs competitiveness is placed again and with stronger determination at the centre of the policy stage.

Footnote

[1] This research was funded by the Autonomous Province of Trento, as the sponsor of the OPENLOC research project under the call for proposals "Major Projects 2006". I thank Jacopo Sforzi for support in the research.

[2] The share of high-tech and medium-high-tech exports increased remarkably in various countries, including Hungary. However, this was primarily the effect of foreign investment.

[3] Presently Hungarians are the most dissatisfied among Central and Eastern Europeans (Pew Research Center, quoted in HVG, 26 December 2009: p. 7.).

[4] http://www.simondyda.net/2009/05/sme-week.html (May 7, 2009)

[5] In case of self-selection, programmes seeking, e.g., to provide support for rapidly growing businesses may see greater participation by growth-propense businesses than by growth-averse or unambitious businesses and this is only partly reflected in "observable" factors. Committee selection refers to programmes where the committee is effective in selecting those firms likely to perform superiorly. Even if the programme did not exist, the selected firms would be expected to have outperformed the other firms and observed differences in performance between programme participants and matched firms cannot be attributed solely to programme participation.

[6] The overall rate of burdens on wages (including social security, vocational training and employer's contributions) was planned to decreased from 33.5% in 2006 to 28.5% in 2007 (Strategy, 2007).

[7] See also: http://ec.europa.eu/youreurope/business/deciding-to-stop/handling-bankruptcy-and-starting-afresh/hungary/index_en.htm, http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/LAWANDJUSTICE/GILD/GILDCOUNTRIES/GILDHUNGARY/0,,contentMDK:20113725~menuPK:262473~pagePK:157658~piPK:157731~theSitePK:262467,00.html#_Toc40673749

[8] Hungary is among the countries in which the perceived opportunities to start a business have witnesses a sharp decline in 2008 (GEM, 2008).

[9] The programme included a Micro Credit Programme, a Midi Credit, the Europe Technological Catching-up Investment Credit Programme and the Széchenyi Card, by far the most successful program offering access to a maximum of EUR 40 000 credit (increased to EUR 100 000 in QI 2006) for unlimited use, to manage liquidity problems, subject to a simplified procedure, with the state budget providing a 50% guarantee fee subsidy for every card issued and with a state interest subsidy of 2%.

[10] Government gross consolidated debt, which was 87.4% in 1995 went down to 52.1% by 2001. it increased again to 65.9% in 2007 and 72.9% in 2008, by far the highest among the new EU member countries (Staehr, 2010) (Eurostat data).

[11] The Economic Sentiment Indicator (ESI) is the lowest in Hungary among the EU-27. ESI is a composite indicator made up of five sectoral confidence indicators with different weights: Industrial confidence indicator, Services confidence indicator, Consumer confidence indicator, Construction confidence indicator, Retail trade confidence indicator. Source: http://epp.eurostat.ec.europa.eu/tgm/printTable.do?tab=table&plugin=0&language=en&pcode=teibs010&printPreview=true# (22 March 2010). On the current situation and prospects of the Hungarian economy see MNDE 2010a.

[12] Home prices are expected to drop 9% in 2010 after adjusting for inflation, according to mortgage bank FHB. Prices fell an inflation-adjusted 7.5% in 2009. http://www.xpatloop.com/news/home_values_in_hungary__to_decline_this_year (22 March 2010). According to the Hungarian Central Bank (MNB), inflation-adjusted house prices fell by an average of 4.2% in 2008, 5.7% in 2007, 5.3% in 2006 and 2.7% in 2005.

[13] Financial (credit and capital programmes) and support schemes for enterprises have been increased as a result of the crisis. Their overall amount will be approximately HUF 1,400 billion (approximately €4.8 billion) in 2009 and 2010 (approximately 5% of the GDP and 35% of the total banking SME credit portfolio). To this HUF 900 billion (€3.1 billion) loans guarantee should be added (MEH 2009).

[14] The Financial Crisis Survey, implemented in June and July 2009, measures the effects of this crisis on 1,686 firms in six countries in Eastern Europe and Central Asia: Bulgaria, Hungary, Latvia, Lithuania, Romania, and Turkey.

[15] Registered unemployment is considerably higher than before the crisis and rising (particularly among foreign workers, less educated workers and minorities), although not as high as at the

decade beginning. A significant part of the adjustment has come in the form of a shorter workweek, short-term contracts and increased regional labor mobility: employment has consequently contracted less than aggregate economic activity but underemployment has risen. Higher labour mobility and greater willingness to accept offered position can also be observed. (Svejnar – Semerak, 2009).

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Közgazdász-vándorgyűlés
Eger, 2012. szeptember 27–29.

50. KÖZGAZDÁSZ-VÁNDORGYŰLÉS

Fontos és kerek évfordulóhoz érkezett 2012-ben a Magyar Közgazdasági Társaság:

Átalakulás és konszolidáció a magyar gazdaságban és gazdaságirányításban

címmel immár az 50. Közgazdász-vándorgyűlést rendezzük meg 2012. szeptember 27. és 29. között Egerben. A jubileumi közgazdász-vándorgyűlés programtervezete és jelentkezési lapja már letölthető a honlapunkon, és várhatóan augusztus első napjaiban elindul az on-line regisztráció is (http://www.mkt.hu/hirek.php?w=368).

A közgazdász-vándorgyűlések a hazai közgazdász szakma legrangosabb és legnagyobb éves összejövetelei: a háromnapos tanácskozások plenáris és szekcióülésein vezető gazdaságpolitikusok – jelenlegi és volt kormánytagok, szakpolitikusok –, a pénzügyi és üzleti élet kulcsszereplői, gazdaságkutatók, akadémikusok és egyetemi tanárok tartanak előadásokat a mintegy 400–700 fős, hazai és határainkon túli magyar közgazdászokból álló hallgatóság előtt. A vándorgyűlés szeptember 27-én, csütörtökön délután – hagyományainkhoz híven – *egy plenáris üléssel veszi kezdetét.* A rendezvény második napja a *szekcióüléseké lesz:* délelőtt öt szekcióban (tervezés és államháztartás; vállalati gazdálkodás; bankok és finanszírozás; külkereskedelem és tőkekapcsolatok; informatika) vitathatják meg az egyes területek kérdéseit a résztvevők. Pénteken délután *gazdaságpolitikai plenáris üléssel folytatódik* a program. A zárónapon, szombaton délelőtt pedig a *Költségvetési Tanács tart* majd *„rendkívüli nyílt ülést”* a plenáris ülés hallgatósága előtt.

Meggyőződésünk, hogy a jubileumi, **50. Közgazdász-vándorgyűlés** méltó helyszínen, az **egri Park Hotelben,** a Magyar Közgazdasági Társaság hagyományaihoz híven tartalmas vitákkal járul majd hozzá ahhoz, hogy minél szélesebb körű szakmai párbeszéd övezze a magyar gazdaságpolitika alakítását.