Major Stakeholders in the Transformation of the Hungarian Enterprise Sector between 1987 and 2007*

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The authors have been researching the enterprise sector in Hungary for more than two decades. In 2009, a new analysis was launched with a long-term approach to study this field based on a special statistical database of ECOSTAT. This database contains data on all enterprises that filed a corporate tax return with the Tax and Financial Control Administration. The present article features the following three aspects of the multiple processes taken place in Hungary in the last two decades: the way that led from the centralized system to the "country of micro enterprises"; the characteristic differences of enterprises by domestic or foreign owners; and the degree of export concentration.

KEYWORDS:
Enterprise.
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Since the end of the 1980s, Hungary has experienced a growth in the number of enterprises, unprecedented in its history. However, the impetus of the rapid increase broke in the middle of the 1990s as a consequence of, inter alia, foreseeable saturation, and then self-correction as well as market-based selection of enterprises started. In other words, a clarification process began as a result of which only active enterprises having stabile market position "stay alive". The rapid changes were followed by slower transformation processes, in which – instead of volume increase – replacement of enterprises, structural changes and shifting of positions can be witnessed. These processes are also underpinned by the improved total effectiveness of enterprises.

1. The way that led from the centralized system to the "country of micro enterprises"

Of the Eastern European countries, Hungary was all but unique in that the mixed economy's political conditions had been established by the end of 1987, under which the self-dependent state corporate-cooperative sphere, the "socialist sector" could be organically complemented with the private sector. This concept was also embodied in legislation: in the course of 1988–1989, a new tax system was introduced; essential laws were made on liquidation, commercial enterprises, the transformation of enterprises, corporations and cooperatives, as well as on foreign investments. As a combined effect of the established legislative framework, the political changes and the unfolding economic processes, a rapid transformation started in the organizational structure of the economy following 1990–91. The Law of Business Associations, which entered into force on 1 January 1989, became a platform to processes proved to be irreversible in the composition of economic stakeholders. The fact that the economic regime change preceded the political regime change by two years, retrospectively, is of inestimable importance to the future.

In 1989–90, a number of laws/regulations were elaborated in business legislation, which opened up a road towards a multi-sector economy as well as were suitable, ahead of the political changes or in line with them, to ensure a return for the Hungarian economy to the Western European capitalist way. At the end of 1989 and at the beginning of 1990, overall deregulation was implemented in the legal system: the administrative barriers to the market economy were removed and economic legislation provided a new foundation for the Hungarian economy. The establishment of the complete economic legal system was of longer duration than the first election term (Antall–Boross Government (1990–1994)) and it ended in 1995–1996. The adoption of the essential laws of the Hungarian market economy was an advantage for the country in the course of EU accession and legal harmonization.

The right to privatise was in the centre of the economic regime change: the country turned from a structure based on the absolute superiority of socialist state property to a system resting on the dominance of private property. Hungary as the earliest of the former socialist countries started the privatization process in 1989. The Law of Business Associations served as its legislative basis. The first stage of privatisation ("spontaneous privatisation") roughly lasted for a three-quarter year period and it affected a maximum of two percent of the state sector.

Later, spontaneous privatisation was replaced by state-managed compulsory privatisation. Ordered by the acts of 1992, 99 percent of the state-owned companies were compulsorily transformed into joint-stock companies (90%) or limited liability companies. The legal form of state-owned companies ceased to exist; its place was taken over by the trading company form of state companies. Mass privatisation, the market-based sale of state property was implemented in 1995–97 under the Privatisation Law.

The national wealth, which had been nearly completely nationalized after 1945, became privately owned over a decade and half, that is, historically during a very short period. Privatisation played a determining role in the establishment and revivification of the market economy: while the proportion of state property exceeded 85 percent at the beginning of the process, nearly four-fifths of the Hungarian economy was in private hands in the middle of the first decade of the 21st century.

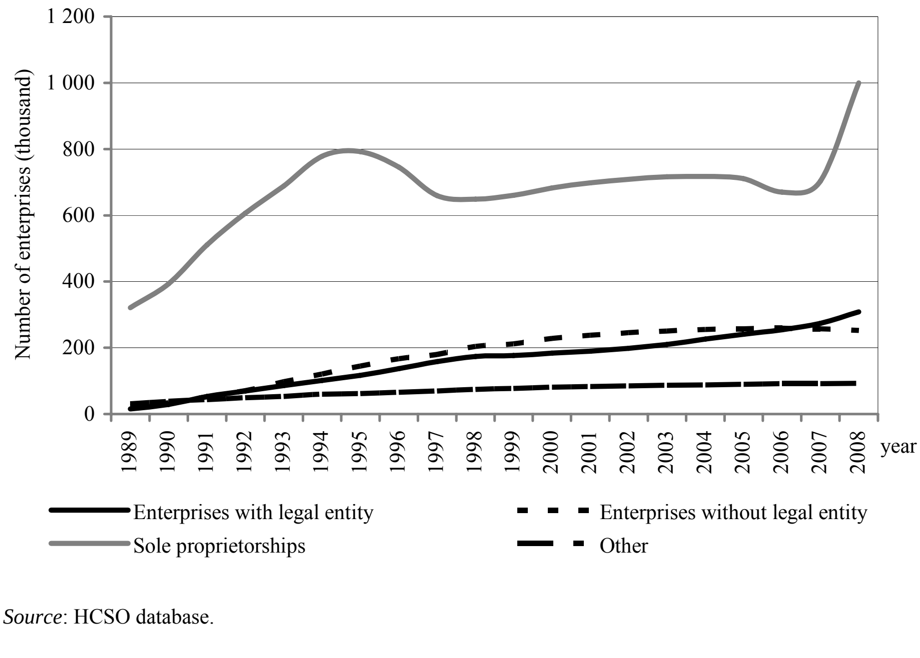
The pillars of the economic organizational structure of the one-party system, the state-owned companies and the cooperatives were transformed, privatised, dissolved, or they ceased to exist. Between 1989 and 1994, the number of state-owned companies decreased to one-fifth–one-fourth, their total turnover of HUF 3 117 billion, at current prices, lessened to HUF 230 billion. Meanwhile, the number of limited liability companies increased 175-fold, their total turnover 45-fold, the number of joint-stock companies 11-fold, their total turnover twenty-fold, and the number of other enterprises 62-fold and their total turnover seventy-fold. The number of cooperatives grew by 80 percent, but their total turnover, at current prices, decreased by a third.

At the end of these processes (by 1995), a new property, economic organizational structure came into existence, which showed smaller changes in its internal proportions until 2000 and no significant changes later. Thus, in its main lines, this structure meant the new Hungarian economy.

Between 1985 and 1991, with respect to their number, medium-sized enterprises with a statistical staff of 50–1 000 formed the largest volume. They were followed by large enterprises; the micro and small enterprises constituted only a tiny proportion. The actual structural change took place between 1992 and 1994: the number of enterprises with 1–9 employees increased eighty-fold, that of enterprises with "0" person forty-fold, with 10–19 employees fourteen-fold, while the number of enterprises with 50–299 persons grew only 1.7-fold from 1991 to 1994. The number of enterprises employing 300–1 000 persons decreased by nearly forty percent and that of even larger ones by forty-five percent. By the middle of the decade, the centralized structure of large companies completely disintegrated, and, as for the number of enterprises, Hungary became the country of micro and small enterprises.

However, in general, not an increase at different rates but as a whole, an ongoing decrease was the common feature of the structural changes observed in different dimensions, which aggravated the necessary transformation. Around at the end of the mid-third of the 1990s, the outcome of stronger recession and slower development reached that threshold, where the result of the structural transformation became positive. In any case, it seems quite certain that the great structural changes, with regard to property relations, economic branches, legal forms, the emergence of new enterprises and the legal, regulatory background (except for the areas of the state budget and welfare), have got near to a dynamic resting point: no transformation similar to the scale of the past half decade should be anticipated, ceteris paribus.

Figure 1. Expansion of the enterprise sector



Source: HCSO database.

1.1. The role of working capital in the transformation

Foreign direct investments (FDIs) played an outstanding role in the transformation of the property and enterprise structure of Hungary.

Concerning foreign capital investments, the Hungarian economy was in a more favourable position than its counterparts in the 1980s. This is partly rooted in subjective, partly in objective reasons. Of the subjective factors, the traditional historical relations, the relative openness and small size of the country, as well as its better-than-average reputation resulting from its reform efforts may be mentioned. Of the objective elements, its regional location and the level of its economic, legal and financial infrastructure shall be referred to. In a combined way, these aspects became stronger at the end of the 1980s as a result of the successful international role of the country. Therefore, in the first half of the 1990s, Hungary attracted nearly a third – 31.4 percent – of all foreign direct investments of the Central and East European region.

Table 1

The inflows of foreign direct investments into the successor states of the former socialist bloc
(USD million)

Country	Year		
	1994	1995	1990–95
Hungary	1 146	4 400	11 200
Poland	1 875	2 500	7 148
Czech Republic	878	2 500	5 666
Slovakia	187	200	775
Slovenia	87	150	501
Albania	53	75	205
Bulgaria	105	150	412
Romania	340	400	933
Other Balkan countries	120	100	300
Former socialist countries without the successor states of the Soviet Union	*4 791*	*10 475*	*27 140*
Baltic states	430	400	1 280
Russia	1 000	2 000	4 400
Ukraine	91	113	574
Other countries of the Commonwealth of Independent States	640	800	2 300
Total	*6 952*	*13 788*	*35 694*

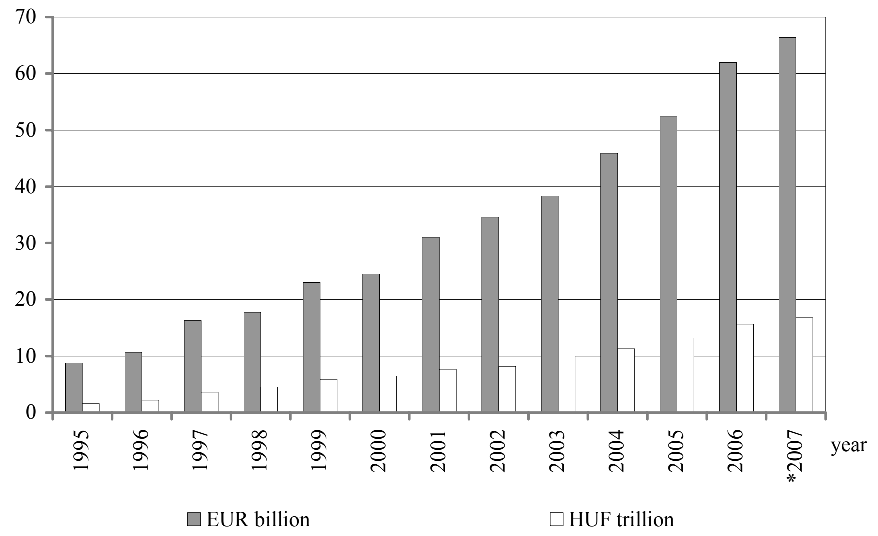
Source: *Magyar Hírlap* [1996]: Növekvő külföldi tőkebefektetés Kelet-Európában, Magyarország az élen. (Increasing Foreign Direct Investment in Central Europe, Hungary at the Head of It.) 26 March. p. 11.

Until 2001, Hungary, as for both privatisation and green field investments, was a prime target area in the region for western investors. Foreign direct investments amounted to USD 56.9 billion up to the end of March 2006.[1]

According to an UNCTAD report[2], in terms of FDI stock, Hungary became the third with a total of USD 97 billion behind Poland (USD 142 billion) and the Czech Republic (USD 101 billion) in the Central and South-East European region in 2000. The combined share of these countries was 72 percent in 2000 and 57 percent in 2007. In the period of 2000–2007, on average, the stock of foreign direct investments flowing into this region increased five-and-a-half-fold, while that of the three countries 4.3-fold. This outlined tendency is likely to continue, especially Romania, Croatia and Bulgaria may be the preferred target areas in the near future.

In Hungary, FDI amounted to a total of nearly EUR 62 billion in 2006 and to an estimated total of EUR 66 billion in 2007.[3]

Figure 2. The stock of foreign direct investments in Hungary



* Data of 2007 is estimated.
Source: Database of the National Bank of Hungary.

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[3] NATIONAL BANK OF HUNGARY [2007]: *Statistics on Direct Capital Investment, Hungary, 1995–2005*. Budapest. http://www.mnb.hu/engine.aspx?page=mnbhu_statisztikai_kiadvanyok.

In the first half of the 1990s, privatisation investments played a significant role in the first wave of foreign direct investments. Between 1991 and 1997, EUR 4.6 billion was invested in the context of privatisation (half of that in 1995). Of these, the privatisation of MATÁV, the gas suppliers and the power stations accounted for the highest revenues. Significant privatisation events of the 2000s were the privatisation of the Postabank in 2003 and that of the Budapest Airport and Antenna Hungária in 2005.

Out of sales items, the volume of stocks and other shares were of outstanding importance in 1995 and 2005: it was a two-year period of major privatisation revenues. 2003 was the only year when, though both capital investments and withdrawals reached outstanding values, on the whole, capital withdrawal took place. (Note that there was a strong speculative attack against the Hungarian forint in that year.) Currently, reinvested incomes account for a considerable amount, but their share – similarly to other items – is rather fluctuating concerning foreign direct investments.

In the post-1998 period[4], the main investor countries had/has a steady share, the amount of capital invested by single main partners increased in a quite similar geographical structure.

Traditionally, Hungary has strong economic relations with Germany. German firms have investments in most sections of the economy. The share and dynamics of their investments are the highest among foreign investors, their stock has more than doubled since 1998 and approximated EUR 13 billion in 2005. Foreign direct investments from the Netherlands have showed the highest increase in share and growth rate. Austrian companies, as a result of vicinity and historical traditions, are also important economic partners of the Hungarian enterprises. FDIs from Austria amounted to a total of EUR 5.2 billion in 2005. FDI stock from France (EUR 2.1 billion) and Luxemburg (EUR 1.6 billion) is also of significant value.

Manufacturing accounted for 40 percent of foreign direct investments. Within that, the capital investment stock of the vehicle manufacturing sector continued to grow most dynamically: it increased nearly six-fold between 1998 and 2005, reaching the value of EUR 4.9 billion. This was followed by the manufacture of electrical equipment and instruments and appliances for measuring, testing and navigation, where the stock of investments raised more than three-fold and exceeded EUR 4.1 billion in the observed period. The manufacture of chemicals and chemical products showed a similar outstanding growth (in total four-fold increase in capital investment during the formerly mentioned seven years).

The volume of investments in service activities, both in 2004 and 2005, were in excess of manufacturing investments. There was a rise in the dynamics of single sector branches, especially in business support service activities and in the areas of trade and telecommunications.

[4] Data of branches and countries are available from 1998.

When analyzing capital flows in a national and sector breakdown, larger-scale changes can be observed over the years: individual transactions may completely alter what proportion a country or a branch has. Accordingly, different countries and sectors may have dominance in certain years. In 2005, for example, the EUR 2.8 billion share of the United Kingdom and the majority of the share of “Activities of holding companies” (EUR 2.1 billion) within “Real estate and business activities” derived from the privatisation of the Budapest Airport, and in the fields of transport, storage and telecommunications, a part of investments linked to the privatisation of Antenna Hungária.

1.2. The transformation of the enterprise sphere: growth and structural change

Regarding the number of enterprises (both sole proprietorships and partnerships), the post-1989 economic transition ended in 1995–1997. In these years, the rate of the previous structural change – that could be mainly characterized by the number and composition of economic stakeholders – slowed down considerably and the “revolutionary” changes ended. A new order came into existence for enterprises and legal forms, and this new economic structure continued to develop in a stage of the internal evolution of newly emerging and, as a result of market competition, disappearing enterprises.

The dynamics of the changes of the 1990s are well shown by the fact that there was a nearly three-fold increase in the number of enterprises in six years (between 1989/90 and 1995/96), and with the replacement of the centralized organizational structure, Hungary became the country of small enterprises by the turn of the millennium, regarding international data, we may say to an excessive degree.

At the end of 1989, 360 thousand enterprises and 31 thousand other (non-profit) organizations operated in Hungary. Although sole proprietorships (320 thousand) accounted for the majority of enterprises, the number of enterprises without legal entity (mainly economic associations) was also significant (24 thousand). Cooperatives (7 500) and limited liability companies (4 500) formed the majority of some 15 thousand enterprises with legal entity. However, the rate of centralization is shown by the fact that the number of state companies that accounted for the major share of output and operated the largest part of fixed assets was only 2 400.

The number of registered enterprises reached a high of 1 053 thousand in 1995; in conjunction with them, altogether 1 115 thousand economic organizations were registered in Hungary. Later, the number of sole proprietorships decreased as a result of which, at the end of 1997, the number of registered enterprises were under 1 million (998 thousand) and that of registered economic organizations decreased to 1 067 thousand. Of enterprises, sole proprietorships decreased from 791 to 660 thousand, while limited partnerships increased from 107 to 140 thousand. After 1997, the number of sole proprietorships grew slightly and it settled around the level of 20 000 from 2000 onwards. Since 2001, the dynamic rise in the quantity of joint enterprises has come to an end and was tending to stabilise around the level of three hundred thousand. Despite the significant total decrease – which could be interpreted as a kind of self-correction or clarification – and taking into account that the number of families in Hungary is nearly 3 million, it can be stated that, on the average, every third family took part in some kind of individual enterprises. Although it is true that a part of these enterprises was only virtual with respect to market presence: only 70 percent of the registered sole proprietorships (only 62 percent of them in 1996) and 85 percent of the limited partnerships were actually active at the end of 1997. Nevertheless, one may say that in a historical context with singular rapidity, the significant part of the Hungarian society became entrepreneurs by the second part of the decade whether out of compulsion or based on real economic assets offered by the market, or founded on loopholes of market regulations.

At the beginning of the transition, from 1992/1993 to 1997, the headcount of large enterprises decreased by more than ten percent (nearly three hundred thousand people) owing to the privatisation as well as to the liquidation and division of a part of large enterprises. Then it increased along with the number of enterprises and by 2006 approximated the value of 1992.

At the end of 1997, enterprises with legal entity, whose structure was also characterized by a large-scale transformation, gave the majority of output against a numerical preponderance of sole proprietorships and limited partnerships. The number of partnerships increased around eight-fold between 1989 and 1997. Within this, the number of cooperatives hardly changed (7 546 cooperatives were registered in 1989 and 8 330 in 1997), but the number of limited liability companies increased 23-fold and that of joint-stock companies more than ten-fold (from 307 to 3 929). Limited liability companies accounted for 90 percent of partnerships in 1997. 85–90 percent of the registered limited liability companies and joint-stock companies were active; but it was the case for only slightly more than half of the cooperatives.

In the middle of the 1990s, the several-year-long processes changed significantly, which was expressed by the increasing trend of the number of enterprises and by the changed proportion of active registered enterprises. This latter factually meant that self-clarification started in the middle of the decade after the pace of the initial enterprise boom ran down: the permanently non-active enterprises continued to phase out from the marketplace, so the real market stakeholders accounted for an ever increasing proportion.

The explosive growth in the number of enterprises that was a characteristic of the beginning of the 1990s came to an end around 1994–95. As its first sign, there was no growth practically in the number of registered sole proprietorships in 1995, then, in 1996 their figure decreased by 45 thousand and in 1997 by a further 86 thousand. At the same time, the rate of increase in the number of partnerships also declined considerably and it was supplemented with an organizational change by which the number of enterprises with legal entity (mainly limited liability companies) became close to that of enterprises without legal entity (essentially limited partnerships).

The increase in the ratio of active to registered enterprises was another well-perceivable change of the middle of the 1990s, mainly among enterprises without legal entity. It could be considered completely normal that at the beginning of the decade, in connection with the economy-wide transformation, a number of enterprises were established under constraint or to exploit legal rules without real economic base, which – as a result of the changes in rules – became not viable to operate and even their formal operation generated an ongoing loss. In this sense, one can identify it as self-correction of an uncontrolled, run-away process, as a kind of self-clarification. The ongoing slight improvement came to an end around 2002–2003, the trend turned into a decreasing direction and there was an increase in the ratio of non-active to registered enterprises.

While the overall slow increase in the active/registered ratio could be regarded positive, its rates and absolute values are not so. In total, enterprises accounted for an average active/registered ratio value of 59 percent in 2006, that is, more than two-fifths of enterprises had neither employee, nor revenue. 72 percent of the registered enterprises with legal entity and 63 percent of the registered enterprises without legal entity were active. At the same time, nearly half (47%) of the sole proprietorships, which accounted for the largest proportion, did not operate. Of enterprises with legal entity, around eighty percent of the joint-stock companies were active; but the relevant value of limited liability companies was similar to that of limited partnerships, which have no legal entity (73 and 71 percent, respectively). According to a HCSO report, enterprises with "0" person had the lowest proportion of active enterprises (only 17 600 in 2006).

1.3. The transformation of legal forms

The centralized economic structure – which had operated as a system specific element during the previous period – loosened in the 1980s, then, at last, it was disintegrated and permanently transformed between 1989 and 1995. The transformation of companies was mainly about the division and disintegration of joint-stock companies and the establishment of limited liability companies. Between 1995 and 2000, the companies, in terms of their headcount, net revenues, etc. became statistically unidentifiable.

In the period of the transition, new enterprises with legal entity were mainly established as limited liability companies, while nearly all enterprises without legal entity as limited partnerships. Joint-stock companies (that replaced state companies) demonstrate the characteristics of large enterprises in terms of their operation and management, but limited liability companies show a varied picture: on the one hand they are similar to large enterprises; on the other hand the features of small- and medium-sized enterprises may be identified in them. Micro and small enterprises, which are mainly family enterprises, account for a part of the limited liability companies and for nearly the total of the other legal forms (overwhelmingly limited partnerships). Though, as a result of their small size, the proportion of other enterprises in sales, assets and tax revenues is only some percent, their role is highly significant in employment: a slowly increasing part of the total average statistical headcount reported by the enterprises of the database was employed by them (14 percent (altogether 296 thousand persons) in 2007). Likewise, 43 thousand enterprises with "0" person (self employed persons) operated in Hungary, together with which the number of employees could be significantly above 350 thousand.

The structural change of limited liability companies – namely a shift from smaller enterprises to larger ones, which was showed by an increase in the performance of exports – is reflected by the changes in both total and export turnover. This sector accounted for 56 percent of export sales in 1995 and for nearly three-fourths of them in 2000. As its reverse side, joint-stock companies, cooperatives and other legal forms (limited partnerships) fell back in production of sales revenue.

Among forms of management, which also reflect partly the size of enterprises, there is a characteristic difference between fixed and current assets: joint-stock companies comprising rather larger companies have significantly larger share of fixed assets than that of current assets. However, limited liability companies, limited partnerships and cooperatives account for a larger share of current assets.

Similarly to assets, there are also typical dissimilarities among different legal forms concerning liabilities: the involvement of external resources features limited liability companies and limited partnerships, while own resources are of primary importance at joint-stock companies and cooperatives.

1.4. The size of enterprises, the degree of organizational decentralization

A natural corollary to the hierarchical economic organization is the concentration of assets, labour, inputs and outputs, whose "carriers" were formerly the state companies. In 1989, this legal form had more than four-fifths of fixed assets and more than two-thirds of employees. In the subsequent two years, a significant part of these companies was transformed into joint-stock companies and a smaller part of them into limited liability companies. At that time, the other ideological pillar of the previous system, the cooperatives showed only a smaller decrease, primarily in the number of employees.

The significant fall in the asset concentration of enterprises is indicated by the stock of fixed assets per enterprise as well as by the number of employed persons per enterprise. The change was extremely rapid: the average asset value and headcount was HUF 206 million and 222 persons in 1989 against the respective values of HUF 76 million and 60 persons of 1991 owing to the growth in the number of enterprises without legal entity. Nevertheless, the average asset values of corporations and limited liability companies remained nearly unchanged, while those of joint-stock companies significantly increased. The radical decrease in the number of employees took place primarily at corporations, secondarily at cooperatives.

Between 1992 and 2007, the number of partnerships increased three-fold, their GDP output at current prices grew ten-fold, but the number of persons employed by them slightly decreased. Consequently, concerning employee numbers, the size of an average enterprise lessened from 21 persons to its third.

As for partnerships, the average balance sheet total per enterprise at current prices increased 6.3-fold, while the number of enterprises following the "foundation boom" increased by only seventy percent, which resulted in a 3.7-fold growth in the asset value per enterprise. Of assets, the value of current assets per enterprise indicated the most rapid increase.

Of fixed assets per partnership, "Plant and Machinery" rose most quickly (2.6-fold), but there was no considerable difference among single types: average "Tangible assets" per enterprise increased 2.56-fold, "Land and buildings" 2.45-fold.

The reduction in the average enterprise size experienced in the first half of the 1990s continued at a lower rate. It is apparent in the changes of the average wealth/reserves on the resources side: between 1995 and 2007 the called up share capital per enterprise grew by only 27 percent, which is a significant decrease in real terms. Lagging behind the 3.7-fold increase of assets, the rise of average capital and reserves per enterprise was three-fold. These two show a growth of the average indebtedness of enterprises and that of the average size of their short- and long-term liabilities.

2. The characteristic differences of enterprises by domestic and foreign owners

Between 1995 and 2007, the number of those enterprises, which were included in the database and filed a corporate tax return, grew by 70 percent. While the proportion of wholly domestic-owned enterprises increased by six percentage points during this period, there was no change in that of the wholly foreign-owned ones. Thus, the numerical proportion of enterprises with mixed ownership significantly decreased, and “other associated enterprises” (0–25 percent foreign share in the founders’ assets) essentially disappeared.[5] So enterprises became polarised: they are either wholly domestic- or wholly foreign-owned enterprises, the proportion of “mixed” types is negligible.

As for the average statistical staff reported by enterprises, other proportions are typical compared with the previous ones: the wholly domestic-owned enterprises accounted for around three-fourths of the total number of employees in the observed twelve years. The number of employees of other associated enterprises and partnerships showed a 75 percent decrease, while the proportion of persons employed by subsidiary companies and wholly foreign-owned enterprises significantly grew, one out of every four employees – a total of 360 thousand persons – was employed by these enterprises in 2007. Thus, polarisation in employment increased too: foreign subsidiaries and wholly domestic-owned enterprises accounted for nearly the total of the headcount in 1:3 ratio.

Compared to the previous ones, the structure of capital and reserves differ in every detail: the proportion of wholly domestic-owned enterprises decreased by one-third over the observed twelve years and did not reach the half (40%) of the total capital and reserves at the end of the period. Together with the other associated enterprises, it accounted for a value of only 44 percent. The combined proportion of wholly foreign-owned enterprises as well as subsidiary companies was 54 percent of capital and reserves, thus, foreign subsidiaries representing seven percent of all enterprises had the majority of capital and reserves and together with the associated enterprises a combined total of 58 percent.

In 1995 and 2000, the ownership ratios showed essentially the same values for called up share capital as for capital and reserves. However, there was a significant deviation in 2007: the share of wholly domestic-owned enterprises decreased at

[5] Distinctly from the practice of HCSO, the content of the categories used in analyzing foreign and domestic enterprises were determined according to the Act C. of 2000 on Accounting. Its Section 3; Subsection 2 sets out definitions based on the size of ownership shares, naturally irrespective of the owner’s nationality. Starting from and slightly breaking down these definitions, hereinafter the following concepts are used: *1. Wholly domestic-owned enterprise*: the proportion of foreign called up share capital is zero percent. *2. Other associated enterprise*: the proportion of foreign called up share capital is higher than zero percent, but smaller than twenty percent. *3. Associated enterprise*: the proportion of foreign called up share capital is higher than or equal to twenty percent, but it is lower than or equal to fifty percent. *4. Subsidiary company*: the proportion of foreign called up share capital is higher than fifty, but lower than one hundred percent. *5. Wholly foreign-owned enterprise*: the proportion of foreign called up share capital is one hundred percent.

The referred Act does not use the first and last categories, they were created according to the previously specified aspects of this study. Our analysis shows that the separation of associated enterprises, subsidiary companies and wholly foreign-owned enterprises is of negligible importance, the economy is polarizing at the two ends named as “wholly”.

half the rate as that of capital and reserves, that is, domestic owners had exactly the half of the total called up share capital, while solely foreign owners and their subsidiaries possessed 45 percent. It should be noted that associated enterprises played a much greater role in terms of capital and reserves and called up share capital than in terms of the number of enterprises or the number of employees in 1995. By the middle–end of the period, the significance of these enterprises became marginal; they became wholly foreign-owned presumably in the course of privatisation or with buyouts.

The original source of asset accumulation is the retained earnings/consolidated profit remaining after paying tax and disbursing capital income (dividends), which is indicated by an increase of other reserves in the course of years. Therefore, its growth depends on two factors: how much profit the enterprise has after taxes and how much dividend is paid and assets are accumulated.

In 1997, both majority-domestic- and majority-foreign-owned enterprises accounted for half of the retained earnings/consolidated profit shown that was modified to 40:60 by 2000 and to 43:57 by 2007. At the same time, the ratios regarding majority-foreign-owned enterprises changed significantly: the share of wholly foreign-owned enterprises was three-times higher than that of subsidiaries in 2000, but these ratios were clearly reversed by 2007.

Profit or loss is the sum of incomes minus costs, expenses, tax liabilities and dividends. Total turnover (net sales) is the aggregate of domestic and export turnover. Domestic turnover of majority-domestic-owned and majority-foreign-owned enterprises was modified from the 3:1 rate of 1995 to the 2:1 rate of 2000, that is to say, exports played a significantly larger role in changes of the revenues of enterprises. (In the following years, there was no change in the latter ratio.)

An average 40–50 percent of dividends are paid to foreign companies, 30–35 percent to domestic private entities and around 20 percent to domestic companies. The share of foreign private individuals (excluding some years when dividends were paid in an order of hundred billions) on average was very small compared with that of the others.

In 1995, there was hardly any identifiable difference between wholly domestic-owned and wholly foreign-owned companies in terms of the composition by the number of employees: respectively 91 and 89 percent operated with 0–10 persons and 99 percent of them with maximum 300 persons. The number of domestic enterprises employing over 1 000 persons was 106, while a total of a dozen such enterprises were in foreign ownership.

In 2007, there were larger and more essential differences: the wholly domestic-owned enterprises showed no change by size, but among wholly foreign-owned companies, the number of enterprises with more than fifty employees increased significantly. The number of domestic-owned enterprises with over one thousand persons decreased to 63, while that of foreign-owned ones grew nearly four-fold to 47. It is clear from the foregoing that foreign-owned enterprises (that are subject to corporation tax in Hungary) have a more evenly balanced structure by enterprise size than wholly domestic-owned enterprises.

Table 2 shows the number of employees and GDP output of all enterprises and those of the foreign-owned ones (foreign-owned enterprises and subsidiaries together) by complex size categories.

Table 2

Enterprises in Hungary by enterprise size, 2006

Denomination	Number of employees	Proportion (percent)	GDP (HUF million)	Proportion (percent)
Large enterprises	814 509	34.7	6 287 809	50.6
– of this, foreign-owned	364 284	65.1	4 302 057	67.5
Medium enterprises	485 721	20.7	2 299 695	18.5
– of this, foreign-owned	117 329	21.0	1 014 366	15.9
Small enterprises	519 076	22.1	1 918 403	15.4
– of this, foreign-owned	51 502	9.2	461 162	7.2
Micro enterprises	526 886	22.5	1 926 687	15.5
– of this, foreign-owned	26 553	4.7	597 462	9.4
Total	*2 346 192*	*100.0*	*12 432 593*	*100.0*
– of this foreign-owned	*559 668*	*100.0*	*6 375 047*	*100.0*

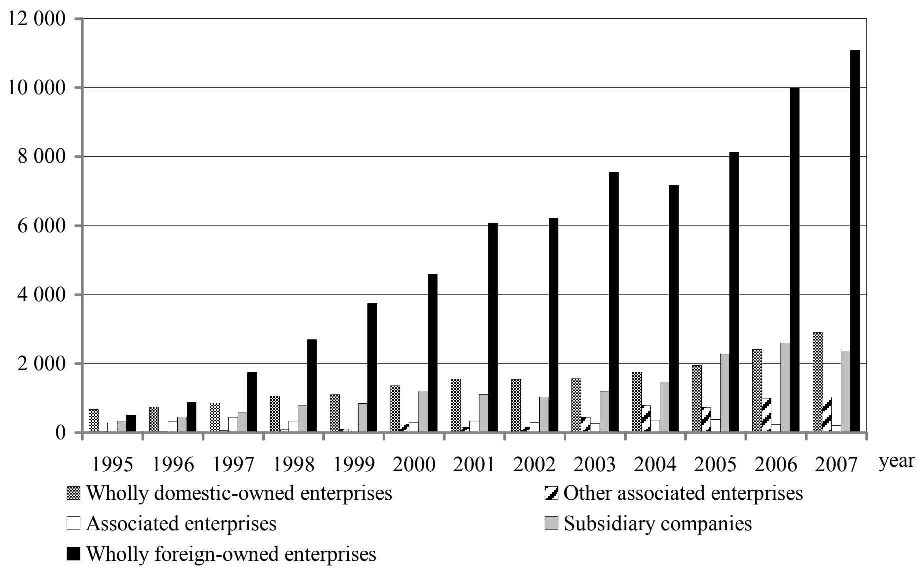
Source: ECOSTAT database.

These data clearly indicates a close link between enterprise size and foreign ownership: foreign ownership is especially typical of bigger enterprises. Furthermore, in the referred year, the foreign-owned enterprises and subsidiaries accounted for a fourth of the employees of all undertakings and for half of their GDP. Thus, the GDP per employee figure of foreign-owned enterprises was two-times higher than that of all enterprises.

3. The degree of export concentration in Hungary

Between 1995 and 2007, there were significant changes in the distribution of export turnover. In the middle of the 1990s, the majority-foreign-owned enterprises gave nearly half, the wholly foreign-owned ones 28 percent, while subsidiary companies 18 percent of it. As a result of a dynamic increase in the export turnover of majority-foreign-owned enterprises and a moderate growth in that of domestic-owned ones, wholly foreign-owned enterprises accounted for 59 percent of total sales in 2000, meanwhile subsidiary companies that showed only a slight decrease for 16 percent. In 2007 the same share of wholly foreign-owned enterprises approximated two-thirds and that of subsidiary companies exceeded one-eighths, so the majority-foreign-owned enterprises gave more than three-fourths of the total of export revenues, that is to say, seventy-five out of every one hundred forint. Figure 3 shows the changes in export revenues.

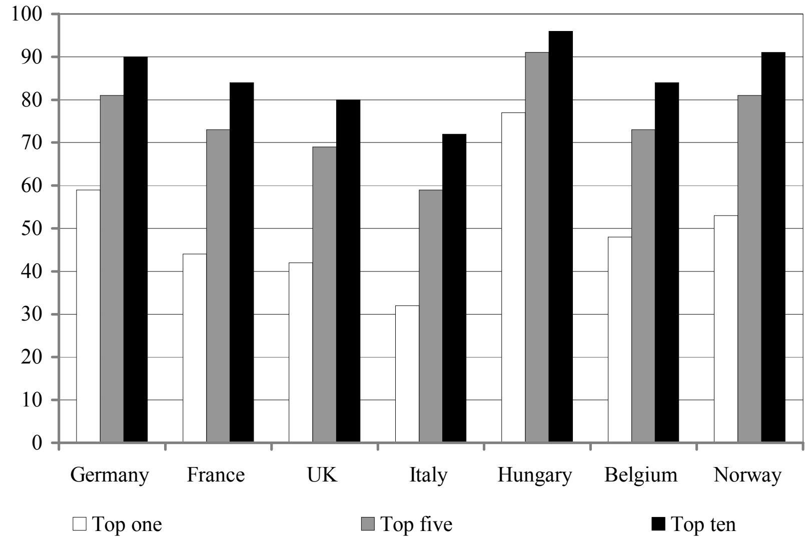
Figure 3. The export turnover of enterprises by ownership
(HUF billion)



Source: ECOSTAT database.

One of the peculiarities of the Hungarian export performance is that the foreign-owned companies account for an overwhelming majority of the sales of partnerships. Another characteristic is the high level of organizational concentration. According to an EU research, in the manufacturing industry of Hungary, the top one percent of the exporting companies gives 77 percent of total export sales. The rate of concentration in Germany, which holds the second place, is less than sixty percent, while that of other observed countries is less than fifty percent. In Hungary, the top ten percent of companies account for almost the total share (96%), the same value is below 90 percent in other countries.[6] (See Figure 4.)

Figure 4. The share of exports of top exporters, total manufacturing, 2003
(percent)



Source: MAYER, T. – OTTAVIANO, G [2007]: *The Happy Few: New Facts on the Internationalisation of European Firms*. CEPR Policy Insight No 15. Brussels.

The formerly referred analysis identified interactions between openness and export activity at the level of firms for 14 countries in the European Union. It showed that:

> – the size of a country seems to be negatively related to its export participation rate (EPR). Germany, France, UK, Italy and Spain have an EPR in the range of 60–75 percent, Sweden, Denmark, Ireland, Belgium, Austria, and Slovenia in that of 70–90 percent. For the EU as a whole, the (weighted) export participation rate is 70 percent.
>
> – for the export intensity rate the pattern is similar. The previous five large EU-countries have export intensity rates of about 30 percent. In the smaller countries an average firm of the database exports about 50 percent of its production.

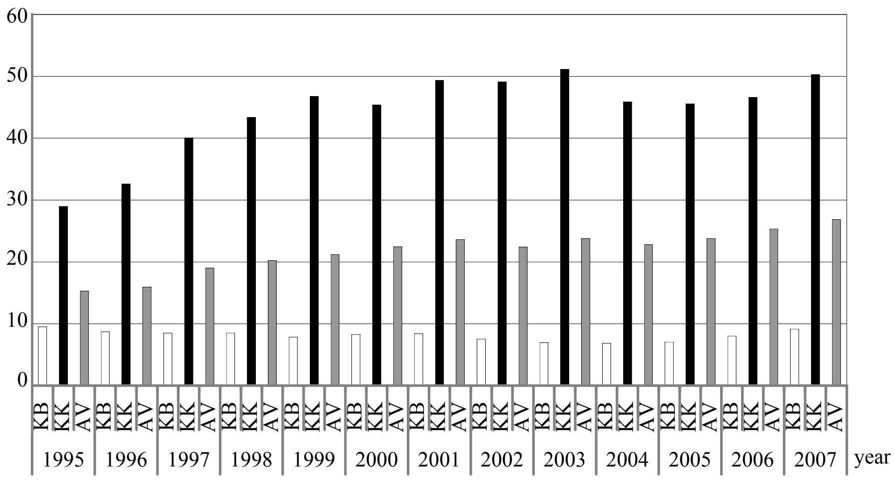
[6] COMMISSION OF THE EUROPEAN COMMUNITIES [2008]: *Commission Staff Working Document. Accompanying Document to the Communication from the Commission on the European Competitiveness Report 2008*. SEC(2008) 2853. Brussels. pp. 38–39.

These results are consistent with the fact that large economies are less open. Firms in small countries have to export or import to benefit from large markets. The outcomes seem to suggest that higher openness in small countries can be explained by more exporting firms (higher extensive margin) and by higher export intensity (intensive margin). The investigations also found evidence that the extensive margin (number of firms exporting) is more important than the intensive margin (average exports per firm). (See Footnote 6.)

Although Hungary belongs to the group of small and open EU countries, it does not correspond to the others with respect to extensive and intensive margins: among the 14 economies analyzed, Hungary had the third lowest EPR (48 percent) in 2007 after the UK and Norway, meanwhile EPR of Sweden, Slovenia and Belgium was 83, 81 and 80 percent, respectively. (See Footnote 6.)

Finally, it is necessary to highlight a very important conclusion of the referred working document on the relation between innovation efforts and export behaviour: the empirical analysis of firms shows a significant and sizeable innovation premium – exporters have five times more sales of new or improved products than non-exporters. (See Appendix.)

Figure 5. The proportion of export turnover to total turnover, 1995–2007
(percent)



Note. KB: wholly domestic-owned enterprises, KK: wholly foreign-owned enterprises, AV: average rate
Source: ECOSTAT database.

Analysing the ECOSTAT database, we are able to outline the level of concentration in Hungarian exports not only for manufacturing but for a wider sphere (for the total sector of corporate ventures). For 2007 the database included 328 243 enterprises without those belonging to the “J” (financial) branch. The covered undertakings accounted for a total turnover of HUF 62 913 billion, from which HUF 17 609 billion derived from exports (28 percent). Export turnover per total turnover showed an increasing trend over the last fifteen years with an around two-fold increase in the average rate. The output of the wholly domestic-owned enterprises didn’t change, while the production of the foreign-owned ones increased from 29 to 50 percent. (See Figure 5.)

Out of 328 243 enterprises, only 24 700 (7.5%) generated revenues from export activity. Against this low rate, they employed 953.5 thousand (44%) of a total of 2 170 thousand employees of enterprises. In 2007, exporters accounted for 41 percent of the total capital stock and for 55 percent of total owners’ equity (capital stock plus retained earnings).

Table 3

The concentration of the Hungarian export activity

Denomination	Number of enterprises	Employee (thousand)	Export turnover (HUF billion)	Total turnover (HUF billion)	Stockholder’s equity (HUF billion)	Owner’s equity (HUF billion)
TOP 10	10	41	6 149	7 857	3 543	317
Share from exporters (percent)	0.04	4.3	34.9	18.8	23.4	8.4
TOP 25	25	70	8 351	10 649	4 673	555
Share from exporters (percent)	0.10	7.4	47.4	25.5	30.8	14.6
TOP 50	50	164	9 910	13 003	5 400	644
Share from exporters (percent)	0.20	17,2	56.3	31.2	35.6	17.0
TOP 100	100	133	11 444	15 891	6 213	923
Share from exporters (percent)	0.41	13.9	65.0	38.1	40.9	24.4
Exporters together	24 701	954	17 609	41 726	15 173	3 788
Share from all (percent)	7.5	43.9	100.0	92.1	54.8	40.6
All together	328 243	2 170	17 609	45 304	27 699	9 321

Source: ECOSTAT database.

Data of Table 4 show that the top 10–100 exporters’ share from stockholder’s equity is much larger than from owner’s equity. The same is also true – although to a lesser extent – for all exporters, which underlines the fact that exporters have a substantially better ability to accumulate capital than non-exporters do.

*

In summary, examining enterprises subject to corporation tax by owners, the following conclusions can be drawn.

Until 2000, the changes were of great importance, the structural transformations were significant. Then the internal structure seemed "to settle down" and currently, no changes of a scale similar to that of the past period may be anticipated.

Micro and small enterprises account for an overwhelming proportion of enterprises, which is not due to organic development. Foreign-owned enterprises that are subject to corporation tax in Hungary show a more evenly balanced micro, small, medium and large enterprise structure by enterprise size than the wholly domestic-owned enterprises.

The wholly foreign-owned enterprises play a primary role especially in the larger enterprise categories (of over one thousand persons).

Domestic- and foreign-owned enterprises have become polarised: as time went by both wholly domestic-owned and wholly foreign-owned enterprises gained a greater importance, while the proportion of mixed enterprises – that had been established based on the foreign partner's (frequently a relative's) contribution in kind and the Hungarian partner's labour force at the beginning of the period (following 1989), in the era of "garage capitalism" – decreased.

Domestic- and foreign-owned enterprises show characteristic differences in their ability to accumulate capital as well as in their opportunities and endeavours. Foreign-owned companies represent much greater power in reinvesting profit after tax than the domestic-owned ones, so an ever increasing proportion of wealth accumulated in this way is concentrated in the hands of foreign owners. This process has both bright and dark sides: the foreigners' capital accumulation on the one hand increases national wealth and enhances the owners' attachment to the country; on the other hand it increases the risk since a possible withdrawal of foreign capital is accompanied by ever-increasing wealth and labour movements. The domestic micro-, small- and medium-sized enterprises – whose significant part was established under constraint without entrepreneurial experiences in the period of "garage capitalism" and suffered from the lack of capital – practically used up their profits and had no resources to accumulate capital, so they were not able to move up into higher categories. This partly resulted from the high level of taxes and contributions, which created extraordinary capital recovery requirements for enterprises.

Foreign-owned enterprises and subsidiaries increased their role in Hungarian exports to the greatest extent; thus, in this respect, the country's economy became absolutely dependent on the performance of these multinational companies in the analyzed enterprise population. Consequently, in a combined way, the Hungarian export performance finally showed two main characteristics: the foreign-owned companies generated an overwhelming part of the export revenues of enterprises, which was accompanied by an outstandingly high degree of organizational concentration in a European context.

In the observed period, the wholly foreign-owned enterprises were a driving force concerning GDP output, so at the end of the period, the domestic and foreign-owned enterprises both produced half of the GDP of those ventures involved into the analysis.

Polarisation by domestic and foreign owners as well as the fact that foreign-owned enterprises account for an increasing share in Hungarian exports have a detrimental influence on the domestic competitiveness of small and medium enterprises. Owing to the low-level participation of these latter in exports, there is no „learning-by-exporting" effect[7], reduction of X-inefficiency[8] or export market stimulated innovation and productivity.

Appendix

The "Observatory of European SMEs" survey (*The Gallup Organization* [2007]) contains information on the percent of sales generated by new or significantly improved products or services for each firm. This percentage can be used as an indicator of the firm's innovation efforts, which is run against export variables: an export dummy (whether or not the firm exports) and an export intensity dummy (ratio of exports to total sales). Using the export dummy, the results show that exporters are more innovative and have five times more sales of new or improved products. When export intensity is used, the innovation premium is even higher. The additional empirical analysis also showed that the innovation indicator is positively related to the proportion of imported inputs.

Export innovation premium (OLS regressions)

Denomination	2005		2006	
	Export dummy	Export intensity	Export dummy	Export intensity
Export variable (β)	5.43*** (0.77)	10.75*** (1.42)	5.28*** (0.78)	8.41*** (1.53)
Observations	3,617	3,613	3,69	3,69

Note. Constant term and control variables (country, sector and size class) were not reported. Standard errors in brackets: * significant at 10 percent; ** significant at 5 percent; *** significant at 1 percent.

Source: The Gallup Organization [2007]: *Observatory of European SMEs. Technical and Evaluation Report*. Flash Eurobarometer 196. http://ec.europa.eu/enterprise/enterprise_policy/analysis/doc/2007/04_technical_report.pdf; Commission of the European Communities [2008]: *Commission Staff Working Document. Accompanying Document to the Communication from the Commission on the European Competitiveness Report 2008*. SEC(2008) 2853. Brussels. pp. 42–43.

[7] Learning-by-exporting effect: firms participating in foreign markets are exposed to the best-practice technology and receive knowledge and information about processes and products.

[8] X-inefficiency: the difference between efficient behaviour of firms assumed or implied by economic theory and their observed behaviour in practice.