The United Nations University
WIDER
World Institute for Development Economics Research

Working Papers No. 216
December 2000

Small- and Medium-Sized Enterprise Development in Poland after 1990

Aleksander Surdej

UNU World Institute for
Development Economics Research
(UNU/WIDER)

Working Papers No. 216

Small- and Medium-Sized Enterprise Development in Poland after 1990

Aleksander Surdej

December 2000

This study has been prepared within the UNU/WIDER project on Small and Medium Enterprises in Transition: How Does Entrepreneurship Develop in Post-Socialist States (Transition from Below: The Role of the New Private Sector), which is directed by Professor Robert J. McIntyre.

Aleksander Surdej is affiliated with the Cracow University of Economics.

UNU World Institute for Development Economics Research (UNU/WIDER)
A research and training centre of the United Nations University

UNU World Institute for Development Economics Research (UNU/WIDER) was established by the United Nations University as its first research and training centre and started work in Helsinki, Finland in 1985. The purpose of the Institute is to undertake applied research and policy analysis on structural changes affecting the developing and transitional economies, to provide a forum for the advocacy of policies leading to robust, equitable and environmentally sustainable growth, and to promote capacity strengthening and training in the field of economic and social policy making. Its work is carried out by staff researchers and visiting scholars in Helsinki and through networks of collaborating scholars and institutions around the world.

UNU World Institute for Development Economics Research (UNU/WIDER)
Katajanokanlaituri 6 B
00160 Helsinki, Finland

Camera-ready typescript prepared by Liisa Roponen at UNU/WIDER
Printed at Pikapaino Paatelainen Oy, Helsinki

ISSN 0782-8233
ISBN 952-455-122-5 (printed publication)
ISBN 952-455-123-3 (internet publication)

CONTENTS

ABSTRACT

The paper analyses the small- and medium-sized enterprise sector in Poland, seeking to answer the question of whether SME development along current lines is sufficient to assure the sustainable development of the Polish economy. Of the many aspects traditionally ascribed to the SME sector, the most important function of these enterprises in Poland seem to be in serving as a cushion against unemployment and increasing social stability. Polish SMEs are weak in innovativeness, have limited exporting power and have small significance in production (of technologically advanced goods). SMEs in Poland have proven to be successful when evaluated against the background of collapsing state-owned enterprises, but their success is partly because of this collapse. SME 'success' appears to be fragile, leading to the need for attention to the instruments of public support for SMEs and their effects on the performance of the sector.

I INTRODUCTION

In evaluating the readiness of Poland to become a member of the European Union, the European Commission stated:

> The Polish economy is characterized by a dichotomy between the results of the private sector dominated by small firms and outcomes of large enterprises most of which are still owned by the state. The private sector is blossoming. Some small enterprises might encounter difficulties in adjusting to foreign competition, but companies acting in trade and services will discover new market opportunities (Agenda 2000: 31).

Such an opinion is not unusual among those who judge that Poland has performed an 'economic miracle' (Barbier-Decrozes 1998). For them, the surprisingly good performance of the Polish economy in the 1990s is chiefly due to the quantity and quality of the small- and medium-sized enterprise (SME) sector. Although there are reasons to share this view, the reality is much more complex. This paper will shed some light on this complexity by trying to explain the reasons for the relative strengths and weaknesses of Poland's SME sector.

The paper begins with a short discussion of the main changes in the Polish economy, which influenced the development and functioning of SMEs in the 1990s. Basic statistical data describing different dimensions of the situation and functioning of SMEs are then presented. The final part discusses public policies that attempt to influence the development of SMEs in Poland.

II GENERAL MACROECONOMIC FRAMEWORK OF SME DEVELOPMENT

The development of entrepreneurship as expressed in terms of the growth of the small- and medium-sized enterprise sector cannot be analysed without reference to the macroeconomic and macropolitical conditions reigning in the country. At the end of 1989 the Polish government undertook radical steps to convert the country's economy from central planning to market mechanism. These actions consisted of restoring the macroeconomic balance of the economy, opening the economy, triggering economic restructuring, changing the ownership structure and reducing administrative barriers to the growth of new enterprises. Initially, during the so-called 'shock therapy' period, transformation policy was almost exclusively concerned with macroeconomic stabilization and neglected institutional reforms. Tight macroeconomic policy was initially seen as a way of pressuring existing enterprises to restructure, but these same overall demand conditions also unfavorably influenced the number of successful business start-ups. Later, especially from 1994 onwards, there was a marked demand expansion, gradual regulatory changes and the build-up of market friendly institutions. Favourable demand conditions increase the chance that potential entrepreneurs recognize market opportunities and undertake business activities.

Privatization of the existing state-owned enterprises (SOEs) was thought to be instrumental in raising economic efficiency. The change in ratio between state (or municipal) and privately-owned business has also been an outcome of the creation of new enterprises. As a result of these two processes, the Polish private sector, after ten years of economic transformations, has reached an important size. The share of the private sector increased from 30 per cent of GDP in 1989[1] to approximately 62 per cent in 1997. In the late 1980s, private sector employment was mostly in agriculture. Estimates suggest that in 1985 private firms produced 4.5 per cent of the industrial output, rising to 6.6 per cent by 1989 (Kłosiński 1991: 21). At the end of 1997, the private sector share in industrial output was 63.5 per cent, in construction 93 per cent and in internal retail trade 94.7 per cent. The share of the private sector in exports was 74.3 per cent and in imports 84 per cent. Altogether at the end of 1997 the private sector employed 68.5 per cent of the workforce, up sharply from 48.9 per cent in 1990.

This impressive shift in the ratio between public and private sector in eight years could have resulted either from massive and rapid privatization of existing SOEs or from the explosion of newly founded private firms, mostly of small and medium size. In Poland, the second alternative is the most important, since privatization of existing state-owned companies, especially large ones, proved to be difficult from both the social and political point of view. There were 8,441 SOEs at the end of 1989 and at the end of 1996 the state still owned 3,847 (46 per cent) of these enterprises.

A prolonged political tug of war resulted in implemention of a mass privatization scheme far smalleer and more limited (covering only 512 enterprises of various sizes) that was originally planned. In addition, by the end of 1996 the government had sold 186 enterprises on a case-by-case basis and leased 854 enterprises to their employees. More than 3,000 state-owned enterprises were liquidated and their property sold primarily to private investors.

The data confirm the observation that only a small part of the rise of private sector employment and output in Poland has stemmed from the direct privatization of SOEs. Statistical analysis has shown that 'privatization has not significantly affected the sales dynamics of private firms employing less than 500 employees since the enterprises which had been privatized in the years 1991-93 were predominantly large enterprises with more than 500 employees' (Zienkowski 1997: 21). Far more important has been the process of creating new companies: that is why one can speak about the 'spontaneous privatization of the Polish economy' or its 'privatization from below'.

The above statement requires further explanation: it can be argued that the contraction and closure of state-owned enterprises (chiefly in production and transportation)—rather than privatization—have been instrumental in the creation and development of large number of small private companies and this has happened in three ways (Krajewski and Piasecki 1999: 5):

- dismantling of state enterprises and transforming some parts into private firms;
- supplying skilled employees, machines, equipment, buildings, plants and means of transport to private firms on favourable terms, as unnecessary production elements were trimmed;
- streamlining of auxiliary services (for example, security, canteens) and opening up space for small firms to offer these services.

Paradoxically the government's neglect of state-owned enterprises may have contributed to the accelerated creation of private companies. But in such circumstances, the success of private enterprises should be measured against the relative, sometimes purposeful, deterioration of state-owned enterprises. While these developments are not privativization *per se*, they represent refunctioning of assets and capacities of SOEs and are not really *de novo* enterprises.

Despite affirmations by subsequent governments, completion of the privatization of Polish state-owned enterprises remains a continuing, albeit a receding, goal in 1999. The lack of a clear design as to whether, when and how SOEs will be privatized increases the uncertainty state managers and this factor alone can weaken SOE performance.

Having its public revenues earmarked for fixed allocations on debt service and social purposes (chiefly pensions), Poland did not have much room to develop its entrepreneurial policies or to help enterprises grow with significant public aid. Even more important, instead of promoting new innovative activities, public aid has been directed chiefly to support declining enterprises and sectors. Thus, it would seem that public aid to enterprises was extended mainly for the purpose of assuring social peace in well-organized labour sectors like coal mining and steel industry.

From 1989 onwards Poland has made significant progress in terms of openness of its economy. It has liberalized trade with EU members, reduced trade barriers with other countries and subsequently doubled exports and tripled imports in real value. Rapid opening of the economy, which had been developing for decades under relative autarchy, could mean massive destruction of the existing industrial capacity. Yet, Polish economic policymakers viewed opening the economy as the preferred way to bring competition into the monopolized domestic market. It was also believed that Poland would settle on an export-led development path, following the successful example of East Asian countries.

Export-led development turned out to be a myth and Poland accumulated a huge trade deficit throughout the 1990s. In 1998, the deficit reached US$ 13.7 billion (US$ 11.3 billion in 1997). The foreign trade deficit was 45.2 per cent of export earning in 1998 (33.4 per cent in 1996 and 41.5 per cent in 1997). Polish policymakers failed to mobilize export demand as an autonomous force capable of supporting economic growth, increasing the scale of production, introducing new technologies and reducing costs and prices (Kaldor 1971; Beckerman 1962). Similar observations can be made with regard to the benefits of 'imported competition'. As Standing (1996: 230) so expressively puts it:

> The countries of the region were suddenly plunged into the global economy, when their industries were chronically uncompetitive, suffering from antiquated technology, low and declining labour productivity and a pattern of integrated trading between themselves that became severed extraordinarily rapidly.

Policymakers appear to have forgotten to design and implement export policies that could help to finance the modernization of industry via export-led growth.

Increased external competition has had a dual impact on Polish enterprises depending to their size: it has stiffened market conditions for large industrial enterprises (resulting, for example, in an almost complete elimination of domestic producers of home electronics), but has also offered an opportunity for private trading, often to small- and medium-sized enterprises active in import activities. A significantly higher share of private firms in imports than in exports confirms this observation.

Foreign direct investments (FDI) might be considered as an indicator of the internationalization of the Polish economy. After the initial period of distrust in the stability of the economic transformation, Poland has gained the reputation of a country attractive for foreign investors. By the end of 1998, the cumulative foreign direct investments reached US$ 30 billion and are accelerating; in 1997 foreign direct investments exceeded US$ 6.5 billion and in 1998 alone US$ 10.1 billion.[2] In 1997, exports by companies with foreign participation accounted for 23 per cent of total Polish exports and 35 per cent of imports.

To date FDIs have concentrated chiefly in the market sectors of the Polish economy, particularly in financial services (insurance, banking), food processing and transportation industries. Firms with foreign participation have had an important (although unequal) impact on the regional development of the economy. The data show that during 1990-93 in the north–western *voivodships* (provinces) of Koszalin, Olsztyn and Słupsk, firms with foreign participation employing more than 50 persons accounted for more than 30 per cent of the total sales of industrial companies (Zienkowski *et al*. 1997: 25). No data exist as to the role of small foreign direct investors, but anecdotal evidence indicates that they are present in the service sectors (for example, restaurants) in all larger Polish cities.

Radical changes in the 1990s have also included domestic institutions or what can be called the rules of the economic game. In 'transition literature' they are usually subsumed within internal liberalization or within the reduction of governmental control over the economy that is typically embodied in price controls and licensing. In all these respects Poland made significant progress: by 1998 price controls only affect electricity and all other prices are set freely subject only to antimonopoly controls. Barriers to establishing new enterprises have been reduced and government licensing covers just seven areas of economic activity.

III THE STATE OF THE POLISH SECTOR OF SMALL- AND MEDIUM-SIZED ENTERPRISES

In evaluating the state of small- and medium-sized enterprises in Poland, one should start from the basic question: What was the point of departure for launching market reforms in 1990? Was there any space for private enterprises before this watershed year? Did any market institutions exist already at that time?[3] No data exist for the comparison of the so-called old entrepreneurship (existing under the communist rule) with the new. More has been written about the emergence of the sociopsychological conditions for entrepreneurship (for example, approval for economic self-reliance and economic inequality and the like).

During the years of communist rule, Poland maintained a large private agricultural and significant retail and private crafts sectors. Furthermore in the 1980s, governments introduced several pro-market reform measures (economic self-government, relative autonomy for enterprises and partial price liberalization) as well as the fundamental law of 1988, which allowed the creation of private commercial firms, and remained in force until the fall of 1999. In the 1980s one could also notice a growing social approval of entrepreneurship and of the role of financial incentives in economic behaviour—important social preconditions of a private market economy. By the end of 1989, there were approximately 500,000 private enterprises outside agriculture, most of them created in the late 1980s.

Although 1990 marked the launch of the market transformation, there was virtually increase in enterprise creation. It is estimated that 140,000 new enterprises were created during 1990, and 126,000 firms ceased to exist, leaving 518,000 firms at year-end (Kłosiński 1992). Table 1 shows that after the 1990-91 recession the decline of GDP levelled off and an extraordinary increase in the number of enterprises occured in 1992 and 1993. From 1994 onwards the number of operating enterprises remain relatively stable. This can be understood as the function of two factors: the first is of a purely quantitative nature and points to the possibility that the SME niches had been filled; the second indicates a rise of entry barriers.

TABLE 1
SIZE DISTRIBUTION OF ENTERPRISES IN POLAND
(NUMBER OF EMPLOYEES, 1991-97)

		1991	1993	1995	1997	1997 %	1997 Ratio 1991=1.0
Total		502,275	1,988,079	2,099,577	2,492,489	100.0%	4.96
SMEs	(<251)	494,211	1,980,705	2,093,148	2,486,124	99.7%	5.03
	(0-50	469,436	1,957,209	2,069,930	2,458,712	98.6%	5.23
	(51-250)	24,775	23,496	23,218	19,948	0.8%	0.80
	≥ 251	8,064	7,374	6,429	6,365	0.3%	0.79

Source: *Report on the State of SMEs in Poland in 1997-98* (*Raport o stanie sektora małych i średnich przedsiębiorstw w Polsce*), Warsaw, 1999.

There are 65 SMEs per 1000 inhabitants in Poland, well above the 51 per 1000 average of the European Union countries, suggesting that SME density has reached a saturation point. No such saturation appears if the weight of SMEs is measured in terms of the share of employment in the economy: SMEs in the EU countries employ 72 per cent of the workforce (from 49 per cent in Ireland to 80 per cent in Italy) while Polish SMEs employed slightly more than 62 per cent in 1997. An average EU enterprise employs six people (varying from 11 in Austria to 3 in Greece), the typical Polish enterprise has 4.5 employees (*The European Observatory for SMEs* 1997: 305).

It is probably also true that entrance barriers have increased for all types of economic activities. These barriers should be understood mostly in terms of the minimum capital required to start a business, but also in terms of the knowledge of the market and demands of consumers.

Between 1990 and 1997 the average size of economic organizations fell, as the number of large and medium-sized companies decreased by 21 per cent and 20 per cent, respectively. The total number of business entities increased almost 5 fold as the number of small enterprises rose from approximately 500,000 to almost 2,486,000.

The number of existing business entities is reported in the statistical registry of enterprises (REGON). Although obliged to report business closures or termination of activity, enterprises either do not do so or significantly delay notification. Data on business units that are in actual operation can be derived from reports to fiscal authorities and these show that between 30 and 40 per cent of enterprises formally registered in REGON were inactive or outwardly dead (Chmiel and Pawłowska 1996). A realistic estimate of the actual number of functioning enterprises is 1.4 million, but even with this correction, at least 99 per cent of existing enterprises are small- and medium-sized.

Although relatively more numerous in Poland, SMEs are on average smaller than their European Union counterparts, employing 61.1 per cent of the workforce in 1997, whereas the corresponding EU figure was 66 per cent in 1996. The SME employment share is constantly growing in Poland and all its subcategories have grown more rapidly than the economy wide rate.

The role of SMEs varies depending upon the sector of the economy. In trade and repairs, small- and medium-sized enterprises employ 1.96 million (approximately 90 per cent of sector employment). The number of retail points increased from 249,500 in 1989 to 960,000 in 1997; consequently, almost every second small enterprise in Poland today is active in retail trading. During the same period of 1989-97, the number of retail shops increased from 152,100 to 424,400, respectively, and in 1997 they served an average of just 91 customers—a clear sign of organizational fragmentation. Modernization of retail trade comes from external sources, chiefly through the expansion of foreign hypermarket networks (mostly French and German) that had already gained 20 per cent of the Polish retail market by the mid-1999.

The hotel and restaurant sector in 1997 employed 197,500 persons, 88.2 per cent in SMEs. Between 1989 and 1997 the number of hotels and restaurants increased from 45,512 to 63,976. Foreign fast food networks are expanding rapidly, encouraged by an environment rich with traditional Polish and ethnic restaurants.

In business and real estate services, SMEs account for 80.3 per cent of total employment. In the construction sector SMEs employ 76.7 per cent of the total labour force. In industry as a whole SMEs account for 48.7 per cent. The role of SMEs in other sectors is significantly smaller: 30 per cent in transportation, 20.4 per cent in health and social services; 9.8 per cent in energy supply and 3.7 per cent in mining.

In summary, the role of SMEs diminishes as the capital requirements and skills needed to start and run a business activity increase. Of the many aspects traditionally ascribed to the SME sector—as a source of innovation, a factor in creating social stability and the like—the most important function of these enterprises in Poland seem to be in serving as a cushion against unemployment: between 1993 and 1998 the share of SMEs employment in the whole economy increased by 14.6 per cent to 62.1 per cent.

The latest available data show that SMEs generated approximately 45 per cent of GDP in 1997 (PFSMEPD1999: 25), but this share was not distributed evenly across the sectors of the economy. The highest figure for SMEs was 95 per cent in the trade and repairs sector, followed by 87.8 in the hotel and restaurant sector, 85.4 per cent in the so-called 'other activities sector', 79.5 per cent in 'real estate and business sector services' and 74.7 per cent in construction.

In industry 36.5 per cent of value added was generated by SMEs, but if only the so-called processing sector (industrial activity excluding mining and power generation) is considered the figure jumps to about 45 per cent. In the transport and communication sectors, the figure was about 30 per cent, while in financial intermediation (banking and insurance), the SME share did not exceed 25 per cent.

The organizational structure of the Polish economy in general reflects a universal rule that larger economic organizations dominate in branches that require considerable initial capital outlay, large R&D spending or heavy advertising expenditures.

The qualitative development of the SME sector in Poland is contingent upon its investment dynamics. Investments in fixed assets are a precondition for company growth; they constitute the well-recognized foundation for *learning by doing* and *by using* new machines (Arrow 1962). It has been observed that many Polish SMEs are undercapitalized, which is why the fixed assets they have at their disposal are comparatively too few and too old, but are used with greater intensity. The data available confirm the above statement: in 1995 the SME sector share of gross fixed capital totalled 39.1 per cent (up from 34 per cent in 1993), a few points less than the sector's contribution to GDP.

The survival orientation of micro-enterprises makes them unwilling and/or unable to invest. Therefore it is not surprising that the investment rate of small firms has been low in the 1990s and is decreasing slightly, while medium-sized and large private enterprises invest more in absolute and relative terms.[4] It should be added that all private firms lagged behind state-owned enterprises with regard to investment: private firm investment outlays did not exceed 50 per cent until 1997, whereas their employment share surpassed 50 per cent already in 1992.

The investment behaviour of Polish enterprises can be explained by the following factors:

(i) Many enterprises were created to serve the consumption purposes of their owners, thus they are oriented towards survival rather than development. Almost 95 per cent of Polish enterprises are businesses of individual people: they are not incorporated, do not have the status of legal persons and, in some aspects, their operations are hardly distinguishable from the activities of households. Regardless of actual sales, 46.7 per cent of Polish enterprises pay income tax (CIT) in a reduced form as a lump sum. It is possible that this mode of operation is intended to hide the financing of domestic consumption from pre-tax business profits.

(ii) Investing is like betting on the future; it was therefore rational to delay investment decisions during the general uncertainty (social, political and economic instability) of the first years of economic transformation. Investment was delayed in responding to the general economic recovery and political stability, but has increased with the passing of time: 0.4 per cent in 1992, 2.3 per cent in 1993, 8.1 per cent in 1994, 17.1 per cent in 1995, 19.2 per cent in 1996, 22.2 per cent in 1997 and 15.8 per cent in 1998.

It was assumed that the development of SMEs would smooth out the spatial disparities caused by the disruptive economic transformations, but the distribution of small- and medium-sized enterprises differs across regions: 25 per cent of SMEs are located on 6 per cent of Poland's area, the subsequent 25 per cent of SMEs were situated on 17 per cent; thus, half are located on 23 per cent of the country's territory. The highest concentration of SMEs is in the highly urbanized and industrialized areas, particularly around Warsaw, Katowice and Gdansk. General factors in these areas encourage the rise of enterprises, in particular larger local markets, a more educated population, closeness to metropolis, existing entrepreneurial traditions and, last but not least, the opportunity to utilize resources released from large SOEs.

An interesting and contradictory set of economic aspects characterizes the Katowice region. It is a problem region with obsolete heavy industries releasing labour and requiring restructuring, yet has low unemployment and a concentrated network of productive SMEs. In this area, small- and medium-sized enterprises have been instrumental in easing industrial restructuring. In other areas, particularly underdeveloped areas of Eastern Poland, the rate of SME formation has been too low to 'cushion' the rise of unemployment resulting chiefly from agricultural restructuring.

Furthermore, SMEs cannot counterbalance the 'natural' market led growth of regional disparities, nor can they automatically restore national economic cohesion. Paradoxically, SMEs seem to blossom in the most developed areas of Poland, but are in short supply in the most underdeveloped ones.

The regional differences in SME density highlight the fact that entrepreneurial attitudes evolve in, and are nurtured by, an advantageous social and economic environment, raising the question of the social characteristics of Polish entrepreneurs. Who are the entrepreneurs of the country and what are their socio-demographic characteristics? In the popular press they are presented as being young and well educated, hence less affected by the syndrome of learned helplessness that is assumed to characterize *homo sovieticus*. Yet, this conclusion cannot be confirmed by existing data: the 1997 entrepreneurs survey shows that the average entrepreneur is 41.2 years old, which corresponds to the average age of the entire working population (Demoskop 1997).

The average Polish entrepreneur is now significantly older than ten years ago, when it was easier for the young to start their businesses. Now there are greater entrance barriers (such as the level of initial capital, market knowledge, networks, etc.) with which to contend. Data from the Polish General Social Survey 1996 show that 66 per cent of all entrepreneurs are men. The Demoskop survey (1997) reports an even higher figure of 80 per cent.

The educational level of small business owners is similar to that of all working persons. The average entrepreneur has completed 12 years of schooling, against an average adult of 11.4 years. While 17 per cent have a university degree (compared to 10 per cent of the adult population), 40 per cent have less than secondary education. The bi-modal educational background suggests that there are two main paths to small business ownership:

- through practical experience: a worker or technician, building on work experience, becomes an entrepreneur;

- through the accumulation of human capital; an individual, relying on advanced education, starts their own business.

These paths are branch specific: it is more common for people coming directly from school or white-collar jobs to start business services, information technology or other high-tech enterprises than car repair services, for instance.

Even though the socialist system in Poland discouraged entrepreneurship, a significant group of private business owners existed throughout the post-war period and expanded rapidly in the 1980s. How many contemporary Polish entrepreneurs have parents (or grandparents) who were also entrepreneurs? Survey data (Demoskop 1997) indicate that 14 per cent of entrepreneurs come from families of business owners, 35 per cent come from families of skilled workers, 26 per cent from farm families and 13.3 per cent from the intelligentsia. This ratio is usually higher in stable developed economies, and is likely to increase in Poland in the future.

IV PUBLIC POLICY TO SUPPORT THE DEVELOPMENT OF SMALL- AND MEDIUM-SIZED ENTERPRISES

In the literature (Storey 1994) there is agreement that the pace of SME development is affected by both general economic factors and specific conditions pertaining chiefly to this category of enterprises. This section analyses the latter, considering the effects of:

- market-related factors;
- financial sector factors;
- government SME policy.

The most important elements of the first two groups of factors are singled out and their relative importance for SME development in Poland is considered. Then government policies explicitly aimed at supporting the development of SMEs are described.

4.1 Market-related influences on SME growth

The market-related group of factors includes regional differentiation of demand, the degree of market competition and the shadow economy.

4.1.1 Regional differentiation of demand

Most SMEs are chiefly associated with local and regional markets. Regions in Poland vary greatly in their economic potential; SMEs in certain regions face severe demand barriers. It was noted above that there is dynamic SME development in highly urbanized parts of Poland, but not in rural areas. One reason for this is the relative poverty of rural Poland and slow growth of farm incomes.

4.1.2 The degree of market competition

Sectoral analysis shows that SMEs face extremely strong competition in certain fields of activity where the market is local and entrance barriers are low. The food industry is such a case in point. Competition in the food industry is driven by small firms, and the degree of concentration in this sector is rather low. Retail trade is a sector where the fast development of large size retailers (super- and hyper-markets) compete with the small- and medium-sized enterprises.

4.1.3 The extent of the shadow economy

According to some estimates, the grey zone produces up to 20 per cent of GDP in Poland. SMEs particularly resent the pressure from shadow economy companies that operate without paying taxes, making social insurance contributions, or meeting health and safety standards.

4.2 The influence of the financial sector on SME growth

This sector includes problems with capital procurement and the taxation of small- and medium-sized enterprises.

4.2.1 Difficulties raising capital from external sources

Polish entrepreneurs face severe problems in raising the capital needed to start a business: in the case of most start-ups, the initial capital comes from personal and family savings. Banks in Poland impose demanding terms for loan securitization and preparation of business plans and it is also difficult to obtain capital from other sources. As of the end of 1998 there were only five venture capital firms in Poland[5] and they support mainly medium-sized operations. Acccording to fund managers 'investments in a given firm start from one million dollars' (*Rzeczpospolita* 1999). Although the introduction of a measure for tax deferral has been proposed, income tax legislation in Poland forbids the deferment of payments (so-called tax credits).

Leasing is rarely used as a form of financing investments, due to contradictory tax and legal regulations on leasing contracts. The share of leasing to finance investment was low, oscillating around 7 per cent in the mid-1990s.[6] In 1997 and 1998, 21 per cent of firms employing between 6-250 persons leased machines and equipment, while 11 per cent of the smallest firms (fewer than 6 employees) used this option.

Small- and medium-sized enterprises also complain about disruption of payments in inter-firm transactions.[7] A significant although decreasing share of payment defaults is due to dishonest business practices. Judicial procedures to seek redress are time consuming and not always successful. SMEs are vulnerable to liquidity disruptions and this causes additional problems in procuring investment capital.

4.2.2 Taxation of SME enterprises

SMEs are faced with an income tax system that differentiates according to the legal form: if they are registered as businesses of physical people, they pay income tax as individuals; if they are registered as legal entities they pay corporate income tax. It is usually assumed that enterprises in transition countries need to retain the largest possible part of their pre-tax profits to help them build their financial strength and to promote investments. The high social security charges are another problem area: in Poland these amount to 48 per cent of the total wage bill and significantly increase the costs of labour, discouraging firms from hiring more people.

4.3 Effects of government policy on SME growth

The effects of government policy on SME growth take many different forms, some of which are considered here.

4.3.1 Quality and stability of legal regulations

The legal system plays a very important role in defining the conditions of enterprise functioning. Legal norms, rules and other governmental regulations need to protect important social values without imposing undue burdens on enterprises. The whole regulatory framework should be relatively stable and transparent.

Rapid legal changes are to some extent justified by the scale of the economic transformations currently underway in Poland. In 1997 alone, parliament passed 190 legislative acts, the majority of which had direct or indirect impact on the activities of enterprises. Although not often discussed in parliament, the impact of some legislation, like the 1988 Law on Economic Activity, changes as a result of its adjustment to other legislative acts.

Polish entrepreneurs complain about the inaccurate and often complex language of legislation, which requires additional technical interpretation. This streamlining and clarification of the laws is done by administrative organs that subsequently produce a kind of 'second written law', which at times can even countradict the legislative intent.

The legislative process in Poland has not been safeguarded by measures that would compel proponents of regulatory procedures to carry out a 'regulatory impact analysis' of their effects on the economy and enterprises. Thus, it is impossible to evaluate which regulatory procedures are justified by the goals they hope to achieve and how efficient these are.

4.3.2 Government policy regarding small- and medium-sized enterprises

All post-1989 Polish governments have made public their desire to support the development of entrepreneurship (particularly with regard to establishing new SMEs), as well as the stabilization and development of existing businesses, and reduction of the number of bankruptcies.

SME development was perceived as vital in the struggle to cure the transformatory and structural diseases of the Polish economy and in particular to strengthen its adjustment capacities, mobilize local resources, facilitate the restructuring of rural areas and to reduce unemployment.[8]

4.3.3 Government policy instruments to support SMEs

The main instruments used by the government to support SME development can be classified into four groups: (i) legal and regulatory; (ii) financial; (iii) organizational, and (iv) knowledge dissemination.

4.3.3.1 Legal and regulatory instruments

Changes in the general legal framework for business activities: Post-1989 governments introduced a host of new laws of special importance for entrepreneurs and their businesses. Appendix 1 provides an extensive list of these measures which together provide all of the legal regulations required for the functioning of modern enterprises, ranging from constitutional guarantees for private ownership, through company law to bankruptcy procedures. The completeness of the legal framework is confirmed by surveys of entrepreneurs who have no complaints about the law as such, but are unhappy about its implementation by the court system.

Tax laws: Polish governments attempted to create a tax environment favourable for the functioning of SMEs. Appendix 2 contains a brief overview of the key changes in the tax law, the most important of which was the approval of the so-called Tax Ordinance, which defines the rights and obligations of taxpayers and procedures for the settlement of disputes.

4.3.3.2 Financial instruments

Various types of financial factors directly or indirectly support the functioning of SMEs. The first approach is of a general nature and consists of creating competition among financial intermediaries by privatizing and restructuring state-owned banks and thereby reducing the costs of entry into this sector. As a result of these demonopolizing policies, SMEs can now seek credit from almost 90 commercial banks, more than 10 investment banks and investment funds and a host of venture capital firms. Competition among them has reduced the cost of credit, as is apparent in the diminishing gap between the interest rate on bank deposits and bank credits.

If ease of access to external financing is measured by the share of SMEs using bank loans to finance their operations (approximately 40 per cent), this access is difficult. However, some researchers (Bratkowski, Grosfeld and Rostowski 1998: 17) state that 'imperfections in capital markets in Central European economies do not seem to actually inhibit the growth of new private firms and their contribution to the economic restructuring of their countries'; that 'banks are able to discriminate between good and bad firms' and that 'the banking system behaves rationally in allocating loans, and there is no perverse selection'.[9]

The gradual reduction of inflation (from 44.3 per cent in 1992 to 8.6 per cent in 1998 and 9.6 per cent in 1999) has allowed lower interesst rates, strengthening SME borrowing prospects. The government and the central bank have also taken action to ensure the stability of the financial sector: there were no bankruptcies of financial institutions, and banks have been able to build up reserves to cover bad loans accumulated during the initial years (1990-92) of the transition.

The second measure consists of developing the system of loan guarantees for SMEs. In 1995 the government established the Credit Guarantee Fund in the National Economy Bank (*Bank Gospodarstwa Krajowego*), with the aim of facilitating SME access to bank credit. The initial capital of the Fund amounted to 45 million PLN (approximately US$ 15 million). By the end of 1998, it had signed 261 guarantee agreements[10] for a total of 87.2 million PLN. The average loan guaranteed was 0.335 million PLN (approximately US$ 111,000), a considerable amount for a small enterprise, suggesting that mainly larger enterprises were served.

For small- and medium-sized enterprises there are also 12 local guarantee funds that operate as separate organizational units of local and regional development agencies. By the end of 1998 the capital reserves of these funds totalled approximately 23 million PLN, and 42 million PLN guarantees had been issued on 1,020 loans worth 86.5 million PLN. This indicates that on average some 50 per cent of the value of the loans is covered. The average guarantee was 0.042 million PLN, about 10 per cent of the average National Credit Guarantee Fund endorsement. The local funds have lost only one per cent of the total amount committed for credit guarantee purposes—a clear sign of the efficiency of this method of support for the SMEs.[11]

Acting indirectly and stipulating special loan and assistance agreements with the sources of foreign assistance (for example, the European Union, World Bank, USAID), the Polish government has helped to create specialized loan institutions for SMEs. By the end of 1996 there were 49 such Local Loan and Guarantee Fund (*Lokalny Fundusz Pozyczkowo-Gwarancyjny*). On average they have capital equal to 1.12 million PLN, 75 per cent funded from the state budget and the rest from the European Union. At the end of 1998 the average fund had distributed 38 loans (Matusiak 1999).

Guarantees covered altogether loans of approximately 170 million PLN, a very small share of total enterprise debt (127.5 billion PLN in mid-1999). Such limited operational resources imply that these funds should be considered experimental. It is not unusual in EU countries for credit guarantees to cover 2 per cent of issued loans: similar coverage in Poland would require guarantees of at least 2.5 billion PLN, 14 times the present level.

The activity of the *Fundusz Mikro* (Micro Fund) is an example of an institution created specifically to offer small loans to micro-enterprises. The US$ 20 million fund was created in 1994 by the Polish-American Enterprise Fund. Its operational rules stipulate that the maximum value of a single loan is 30,000 PLN, with a minimum loan as small as 3,000 PLN. By June 1999 the Micro Fund had granted 24,177 loans for a total value of 148.3 million PLN. The Micro Fund does not require extended paperwork for loan justification: guarantees are based on civil law obligations. The Micro Fund has applied a *group lending* approach drawn from the experience of developing countries, in which at least four people endorse a loan issued to one group member. Since this form of lending implies a high degree of mutual trust, its potential scope is rather limited.[12]

The third group of financial instruments consists of direct financial aid to enterprises. This aid can take the form of tax deferrals, postponement of payment of obligations to the state budget, or direct subsidies. In Poland as elsewhere this type of aid is often granted under the pressure of politically strong large enterprises or other organized economic interests.

4.3.3.3 Organizational instruments

The Polish government (during 1993-97) introduced investment allowances based on the achievement of a given level of profitability and the amount of investment outlays. In addition, the government created 15 special economic zones in areas of high unemployment and 2 special technological zones which offer investors 10-year tax deferrals and a subsequent tax reduction contingent upon the amount of capital invested and employment effects of these investments. As of 1998, the succeeding government started to reduce fiscal incentives and instead attempted to radically reduce corporate income tax levels.

Pecuniary and in-kind assistance has been offered through the so-called 'entrepreneurship incubators' targeted for small- and medium-sized companies in need of technical, legal and financial help. Between 1990 and 1998, 52 such incubators and 18 technological centres were created, hosting 1,015 enterprises with 4,936 employees (Matusiak 1999). Operating on or through incubators and technological centre premises, SMEs are provided with access to low-cost productive space (usually at half the market rent) and on-the-spot technological and business consulting.

Are business incubators an important instrument in the development of SMEs? In quantitative terms their influence is almost nil. As the average period of operation in an enterprise incubator lasts 3 years, three 'generations' comprising only 3,000 enterprises and 15,000 employees have benefited. In qualitative terms, however, enterprise incubators have a decisive effect in local economic areas hit by a decline of the single dominant employer.

Despite the variety of forms of public action, it cannot be said that Polish SMEs benefit from extensive direct or indirect public aid. Total annual direct and indirect public aid to SMEs can be estimated at 100-150 million PLN (US$ 25-35 million). This low level of activity is not solely the result of the scarcity of public funds, but (especially during the periods of conservative government in 1990-93 and 1998 onwards) refects the rhetoric of the 'natural' process of enterprise growth and doubt about the role of government in creating strategic competitive advantages. The lack of clarity on the role of the government results in chaotic action and ill-coordinated public programmes.

The creation of the Network of Contracting Agencies *(Sieć Agencji Kontraktowania Kooperacyjnego-SAKK*) in 1997 is the first example of governmental efforts to build market-friendly institutions to support SMEs. The task of SAKK is to develop cooperative links between SMEs and large industrial enterprises, promoting the transfer of new production and organizational techniques to SMEs. The agencies are supposed to identify foreign and domestic companies eager to cooperate with one another. As of mid-1999 more than dozen of these contracting agencies are already at work, but it is too early to evaluate their performance.

4.3.3.4 Instruments for knowledge dissemination

Access to information reduces decision-making uncertainty and decreases enterprise transactions costs. It is generally acknowledged that SMEs face objective (lack of resources and specialists) and subjective (level of education) barriers in getting and transforming business and economic information. This fact—coupled with the well-known paradox that the production of information is costly, while its dissemination proceeds at low costs—justifies an active government role in the production and diffusion of business information.

As a part of the policy towards SMEs the Polish government supports regional and local institutions which furnish information and business expertise. At the end of 1998 there were 174 centres of training and consulting (*Osrodki szkoleniowo-doradcze*) owned by local governments. These centres provide information services for entrepreneurs, local authorities, business partners and consultants. More than 60 such centres are grouped into 5 networks: the Euro-Info network; the Business Foundation of Solidarity Trade Union; the Polish-American Enterprise Clubs; the Foundation in Support of Local Democracy; and the National Business Information System of the Polish Chamber of Commerce (KIG).

In addition to public training centres, there is an expanding private training sector (approximately 450 organizations in 1998) which offers specialized training for a fee. These organizations participate as subcontractors in offering subsidized training to SMEs within the scope of domestic and foreign assistance programmes.

Access to information and training differs among regions: the network of commercial institutions offering such services is roughly three-times more dense in large cities and their immediate proximity than in rural areas. Governmental policy attempts to counterbalance this market tendency by offering special support for information and training institutions in agricultural provinces. For the time being, remoteness from large towns significantly reduces the chances of taking advantage of the newest, up-to-date information and training. This may change as information technologies develop and their use is propagated among SMEs. Some of the information and training centres use the Internet to offer a kind of long-distance consulting and training.

The data show that less than 5 per cent of entrepreneurs benefit from these informational activities. They tend to rely more on first-hand knowledge of markets and business partners. Public support for training and information dissemination centres helps to maintain institutions whose capacity is not yet fully used by small entrepreneurs. This support should be strengthened as the role of training and information becomes crucial for the efficiency of market processes.

4.3.4 Future directions of government policies towards SMEs

4.3.4.1 Regionalization

The Polish administrative reform introduced in January 1999 and anticipation of European Union membership are factors encouraging the integration of SME policy into a broader bundle of regional measures. This means that SME development has a dual role: on the one hand, it should support the positive economic trends observed in the regions that are leading the market transformation; while on the other hand, it should fight the social and economic crisis in areas where the economic basis is collapsing. Regional policymaking in Poland will be based on contracts between different layers of the government (for example, between the central and regional governments) and on the increasing role of local governments in formulating, implementing and financing public policies.

Will local governments be friendlier to SMEs than the central government? Past experience of the communes (*gminas*) suggests a positive response to this question. Before 1999, *gminas* were unique self-governing units with their own budget revenues and considerable power to utilize them. Their expenditures amounted to 15 per cent of all public expenditures in Poland. *Gminas* have had at their disposal a number of mechanisms to support business activities: local taxes and other fees, investments in technical infrastructure in order to improve conditions for business activities, subsidies for institutions assisting local business and local development programmes. *Gminas* used some of these options: 45.9 per cent granted tax concessions to businesses and 11.8 per cent applied lower-than-market rents. Many *gminas,* recognizing the importance to enterprises, have heavily invested in technical infrastructure (water supply and sewage treatment). Small- and medium-sized enterprises have received a significant share of the benefits delivered by *gminas* to businesses.

4.3.4.2 SMEs in transforming agriculture and rural areas

Agriculture accounts for approximately 6 per cent of Poland's GDP, yet it employs almost one-quarter of the entire workforce, and 37 per cent of the population live in rural areas. This disparity is indicative of the low agricultural productivity of Poland and the magnitude of the restructuring needed. Since it is unlikely that the restructuring of agriculture will be eased by a massive flow of rural people into towns, the goal of rural policies is to support the creation of new non-agricultural jobs in the countryside. The implementation of this policy is partially in the hands of the Agency for Agriculture Restructuring (*Agencja Rozwoju i Modernizacji Rolnictwa*) who are responsible for supporting investments in social and technical infrastructure of rural areas, but also for providing credit to rural SMEs.

V CONCLUSIONS

The fast development of the small- and medium-sized enterprise sector has been credited with the relative success of the Polish economic transformation. This is certainly true if one compares the economic performance of Poland with the dismal economic situation of most post-socialist countries. Yet, if we acknowledge the weak innovativeness of the Polish SMEs, their limited exporting power and small significance in production (of technologically advanced goods, in particular), success appears to be fragile. SMEs in Poland have proven to be successful when evaluated against the background of collapsing state-owned enterprises, yet it must also be recognized that they have been successful *because of* this collapse.

One cannot but appreciate the role of SMEs in filling the space left by state-owned enterprises and the changing institutional and market conditions. However, one can express doubt as to whether the SME sector alone can assure the sustainability of the country's economic development. If the target of economic policy is to reduce the developmental gap with EU countries, Poland will need a high level of investment, technological upgrading of industry and skill improvement programmes for employees for many years. It is unlikely that such positive developments will appear as a result of spontaneous market process without any economic policy guidance. That is why the present level of public aid to small- and medium-sized enterprises in Poland should be considered insufficient.

Polish governments in the 1990s have experimented with a range of policy instruments intended to stimulate the creation and growth of SMEs. In particular, the government has developed several assistance programmes for SMEs for the purpose of creating institutions of financial and in-kind support to this sector. Yet, government policies have been backed by insufficient financial resources and the goals have been too broad for the resources provided. It seems warranted to conclude that government policies have had little impact on the development of SMEs in Poland. Thus, it is desirable for the government to strengthen its system of public services to SMEs. In particular, industrial SMEs should get technological assistance to improve their capacity to absorb new technologies.

Rapid economic growth is the central goal of economic development policy in Poland. Yet, one should also look at the structural changes of the economy to see the pitfalls threatening sustainable rapid development. As has been pointed out in this paper, the relative weakness of the small- and medium-sized enterprises in Poland is one of them.

NOTES

1 The private sector includes enterprises exclusively or predominantly owned by domestic or foreign private agents. Cooperatives are considered a part of the private sector (see The Polish Statistical Yearbook, various years).

2 The FDI statistics include only investments of US$ 1 million or more. Data on smaller investments can only be captured by surveys.

3 These questions are considered in detail in Kolodko (2000: 39-52).

4 See PFSMEPD 1998: 36.

5 Foreign financial organizations and governmental institutions supply almost all of venture capital in Poland. In 1996 they accounted for 95 per cent of venture capital, or US$ 1.25 billion, which is 4 per cent of all foreign direct investment in Poland (see PFSMEPD 1998: 68).

6 Data from the Conference of Leasing Enterprises in Poland.

7 A survey carried out in 1996 indicated that SMEsmake up more than 74 per cent of the portfolio of so-called 'bad debts' of the banking sector. The most difficult credit situation is faced by SMEs employing between 6 and 50 peopleand made up 38.8 per cent of the bad debt portfolio (see PFSMEPD 1998: 64).

8 Policy intentions of the government with regard to SMEs were defined in the Council of Ministers documents adopted in June 1995 and in February 1999.

9 This research was conducted on a limited sample of enterprises (including 89 in Poland). More research is needed to validate such a result.

10 This number was further boosted by the fact that the Fund was allowed to service companies hit by consequences of the summer flood in 1997.

11 In addition to these funds, there is one mutual guarantee fund operating in Dzierzgon. The fund's capital is equal to 462,000 PLN and it supports local small firms employing up to 50 persons with guarantees that cannot exceed 60,000 PLN. By mid-1999 the fund had disbursed 54 guarantees totalling 1.4 million PLN.

12 According to Wedel (1998), this programme was funded by USAID but designed by Polish specialists on the basis of South American and South Asian experience.

REFERENCES

Agenda 2000 (1998), 'The Opinion of the European Commission about the Motion of the Republic of Poland Concerning Membership in the European Union'.

Arrow, Kenneth J. (1962), 'The Economic Implications of Learning by Doing', *Review of Economic Studies,* 29: 155-73.

Barbier-Decrozes, M. (1998), 'Le Miracle Polonais', *CCE-International*, 469 (December).

Beckerman, W. (1962), 'Projecting Europe's Growth', *Economic Journal*, 72.

Blanchard, Oliver (1997), *The Economics of Post-Communist Transition*, New York, Oxford University Press.

Bratkowski, Andrzej, Irena Grosfeld and Jacek Rostowski (1998), 'Investment and Finance in the non-Private Firms: Empirical Results from the Czech Republic, Hungary and Poland', CASE-CEU Working Paper Series, 21, Warsaw, Center for Social and Economic Research, Central European University.

Chmiel, Józef and Zofia Pawłowska (1996), 'Miany w strukurze własnosci: sektor prywatny gospodarki polskiej w latach 1990-94' (The Changes in the Ownership Structure: The Private Sector of the Polish Economy in the Years 1990-94), Zeszyty Centrum Adama Smitha Nr 19, Warsaw, ASRC.

Council of Ministers of Poland (1995), 'Small and Medium-sized Enterprises in the National Economy. Policy Towards Small and Medium-sized Enterprises', Warsaw, June.

Council of Ministers of Poland (1999), 'Policies towards SMEs', Warsaw, February.

Demoskop (1997), *Study of Households,* Warsaw, Demoskop.

Kaldor, Nicholas (1971), 'Conflict in National Economic Objectives', *Economic Journal*.

Kłosiński, Krzysztof (1991), *Produkcja rynkowa drobnej wytworczości w Polsce w latach 1989-1990 (Small Scale Production Activities in Poland in 1989-1990)*, Warsaw, Instytut Rynku Wewnętrznego i Konsumpcji.

Kłosiński, Krzysztof (1992), *The Policy of SMEs Development,* Instytut Rynku Wewnętrznego i Konsumpcji, Warsaw.

Kolodko, Grzegorz W. (2000), *From Shock to Therapy: The Political Economy of Postsocialist Transformation*, Oxford, Oxford University Press.

Krajewski, Stefan and Bogdan Piasecki (1999), 'SME Development as a Consequence of the Privatisation and Restructuring of State Property in Transition Economies', *Emergo* 6, 1 (Winter): 2-10.

Matusiak, Krzysztof B. (1999), 'Infrastruktura przedsiebiorczosci i transferu technologii w Polsce' (The infrastructure for entrepreneurship and transfer of technology in Poland), in J. Targalski (ed.), *Przedsiebiorczosc a lokalny i regionalny rozwoj gospodarczy (Entrepreneurship and Local and Regional Development*), Krakow, AE.

PFSMEPD (1998), *Report on the Condition of the Small and Medium Size Enterprise in Poland for the years 1996-97*, Warsaw, Polish Foundation for Small and Medium Enterprise Promotion and Development.

PFSMEPD (1999), *Report on the Condition of the Small and Medium Size Enterprise in Poland for the years 1997-98*, Warsaw, Polish Foundation for Small and Medium Enterprise Promotion and Development.

Rzeczpospolita (1999), 'Ludzie z pomyslami' (People with ideas)', 29 June.

Standing, Guy (1996), 'Social Protection in Central and Eastern Europe: A Tale of Slipping Anchors and Torn Safety Nets', in G. Esping-Andersen (ed.), *Welfare States in Transition,* Sage, Newbury Park.

Storey, David (1994), *Understanding the Small Business Sector*, London, Routledge.

The European Observatory for SMEs, Fifth Annual Report (1997), Zoetermeer, The Netherlands, ENSR on behalf of the European Commission.

Wedel, Janine (1998), *Collusion and Collision: The Strange Case of Western Aid to Eastern Europe 1989-1998*, New York, St. Martin's.

Zienkowski, Leszek (ed.) (1997), *Wkład małych i średnich przedsiębiorstw w rozwoj gospodarki polskiej* (*The Contribution of Small- and Medium-Sized Enterprises in the Development of the Polish Economy*), Warsaw.

APPENDIX 1
CHANGES IN THE GENERAL LEGAL FRAMEWORK FOR BUSINESS ACTIVITIES IN POLAND

The scope of legal changes undertaken by subsequent post-1989 governments in Poland has been enormous and include a host of new laws of special importance for entrepreneurs and their businesses. Particularly important measures include:

(i) the *law on tax obligations and rights of taxpayers* (called the Tax Ordinance) passed by parliament in 1997. The Law clarifies the procedures to be applied by fiscal offices (*Urzedy Skarbowe*) in collecting taxes and specifies the legal measure through which taxpayers can defend their rights. The Tax Ordinance increases the protection of taxpayers from arbitrary decisions by the fiscal offices;

(ii) a *new Customs Code* effective since 1 January 1998 which facilitates the exports and imports of goods and services (by introducing among others the status of reliable importer/exporter linked with simplified customs procedures for of goods imported for processing and then re-exported, freeing financial resources previously tied up in paid customs fee);

(iii) a *new Law on Registered Pledges and the Pledge Registry* passed in 1996 which increases the security of economic transactions by eliminating double pledging and facilitating a more effective procedure of claiming debts. This law and its efficient implementation is particularly important for SMEs since they are especially vulnerable to frauds and dishonest business practices;

(iv) the *Law on Public Procurement* of June 1994 (amended July 1995) which guarantees equal treatment of contractors and sets the rules of equal access to information and tender documents. Although the Law is a major advance in terms of transparency of tender procedures, the SMEs would need reduced requirements in regard to financial guarantees of contract execution.

(v) a *major revision of the Labour Code* passed in 1996 which defines anew legal requirements of employment contracts, sets rules for the calculation of weekly working hours and annual holidays and regulates relations between employer, employees and their representatives. It is worth noting that the Labour Code treats those companies separately which employ fewer than 20 employees and releases them from certain obligations (for instance from the creation of the mandatory Social Fund).

(vi) a *new Banking Law* passed in 1997 and *Law on Investment Funds* passed in 1997 which set the rules for the functioning of financial intermediaries in maturing market economy conditions. They define the types of activities permitted for banks and investment funds and set the rules, which should guarantee the security of the financial system.

Recently the government that emerged from the September 1997 elections has formed a taskforce charged with reviewing laws and regulations and proposing changes that would simplify the existing laws. The results of this work are yet to appear.

APPENDIX 2
CHANGES IN THE POLISH TAX LAWS

The reduction of the general level of taxation and tax incentives have a great significance for the development of SMEs since Polish SMEs rely chiefly on their own resources for development purposes.

Polish governments have attempted to create tax environment favourable for the functioning of SMEs. The following is a brief overview of changes in the key dimensions of tax policy towards SMEs:

(i) *scheduled reduction of corporate income tax*. Before 1997 all SMEs having corporate status paid corporate income tax of 40 per cent. The rate of this tax was reduced to 38 per cent in 1997 and to 36 per cent in 1999. Further reductions were written in the budgetary law so as to reduce corporate income tax to 32 per cent by 2000. SMEs without corporate status are subject to personal income tax of which varies between 20 per cent and 44 per cent.

(ii) *tax withholding*. Dividend payments made to SMEs shareholders are subject to 20 per cent tax withholding regardless of the cumulative level of income.

(iii) *depreciation and depletion*. Tax depreciation for all SMEs follows the straight-line method, but under some conditions accelerated depreciation is also possible.

(iv) *net operating losses*. An SME has the right to carry forwards a loss incurred in an accounting period by deducting the loss from its taxable income in three equal parts over the next three years.

(v) *deduction for taxes paid*. VAT paid on inputs is deductible for corporate/personal income tax purposes if it cannot be offset against the company output VAT. Other taxes that are part of expenses are deductible in full.

(vi) *investment deductions for SMEs with corporate status*. Qualifying investment expenditures can be deducted from pre-tax profits for corporate tax purposes. The deduction is generally limited to 15 per cent of taxable income, reduced to 10 per cent in 1999. In the year following the deduction, SMEs can deduct 50 per cent of the prior year investment deduction limited to 15 per cent of taxable income in that year. This percentage is reduced to 10 per cent in 1999.

(vii) *investment deductions for SMEs without corporate status*. Qualifying investment expenditures can be deducted from pre-tax profits for personal tax purposes. The rules and limits of such a deduction are similar to those those for SMEs with corporate status.

APPENDIX 3
SELECTED MACROECONOMIC INDICATORS OF POLAND, 1992-98

	1992	1993	1994	1995	1996	1997	1998
Real GDP (in %)	2.6	3.8	5.2	7.0	6.1	6.9	4.8
Inflation rate (in %)	44.3	37.2	29.5	21.6	18.5	13.2	8.6
Unemployment rate (in %)	13.6	15.7	16.0	14.9	13.6	10.8	10.4
Investment outlays (annual % change)	100.4	102.3	108.1	117.1	119.2	122.2	115.8
Real wage[a] (annual % change)	96.4	98.7	104.2	103.4	105.9	105.7	103.8
Exports (change over previous year in %)	109.7	97.1	124.8	135.0	106.7	111.5	111.1
Imports (change over previous year in %)	106.1	117.7	112.0	138.9	131.9	118.2	113.9

Sources: *Ocena sytuacji spoleczno-gospodarczej w 1998 roku wraz z elementami prognozy na 1999 rok*, Warsaw, Rzadowe Centrum Studiow Strategicznych, March 1999; Central Office of Statistics (GUS).

Note: [a] enterprises sector only.