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The Role of Small Business Development in Stimulating Output and Employment in the Polish Economy

Lucyna Kornecki

Abstract

With the fall of Communism in the former Soviet Union, a number of countries have been faced the prospect of transforming from a command economy to a market-oriented one. This paper is a preliminary investigation of entrepreneurial activity and economic development in the Polish economy. Entrepreneurial activity is believed to be the fundamental force in the transformation of economies in former communist countries towards free markets. The paper discusses small business development in Poland, one of the Central and Eastern European Countries transforming from a command economy into a market-oriented economy. The paper is primarily concerned with the key components of transition: restructuring of the ownership and changing the character of firms into private enterprises in building market economy, The paper examines macroeconomic aspects of small business development in the Polish economy such as: number and size of business firms, share of the small and medium size firms in gross domestic product (GDP), their share in national employment, and foreign trade, The study shows that small business development plays a very important role in the process of transition in Poland. Expansion of free enterprise in Poland constitutes an important factor in economic development, stimulating output, creating employment and expansion of small and medium firms in foreign trade (www.parp.gov.pl/publikacja17.php).

JEL Classifications: O11, P2, P52.

Introduction

Development of the private business sector in Poland constitutes an important component of economic development and is an essential factor stimulating output and generating employment in the Polish economy. In order to analyze small business development in Poland, it is important to understand the following issues: transformation of a centrally planned economy to a market oriented economy, macroeconomic changes related to economic growth, replacement of the command mechanism with market mechanism, privatization of the Polish economy (www.parp.gov.pl/publikzam.php).

This study assumes that the number of registered small business firms in the economy is a key measure of entrepreneurial activity and that the growth in the number of private firms indicates growth in entrepreneurial activity (Adrangi, Allender, and Anderson, 2003). Entrepreneurial activity constitutes an important ingredient in the process of economic development and transformation from central planning to market oriented economies. This transformation has been facilitated by the privatization of small and medium state-owned companies and a liberal law on establishing new firms that has allowed for the development of the private business sector.

The first section of the paper deals with the transformation from a centrally planned economy to market oriented economy and examines macroeconomic indicators with the focus on high unemployment rate. The second section compares the dynamic growth of GDP with the growing number of firms in the private sector, particularly small and medium size firms. It shows the increasing share of the small and medium firms in GDP The third section examines the role of the private sector, particularly small and medium firms, in generating employment in the Polish economy. The final section shows the result of the globalization process and the strong involvement of small and medium firms in foreign trade (Prater and Ghosh, 2005).

The sources used in this paper are reliable, and have been published mostly by the Government of Poland (Polish Official Statistics and Polish Agency for Enterprise Development), and world wide recognized organizations, such as the European Bank for Reconstruction and Devel-

opment, the World Bank, the International Monetary Fund and The European Union. Entrepreneurship approach and macroeconomic aspects of small business development discussed in the paper have been based on the United States Association for Small Business and Entrepreneurship (USASBE) conference proceedings and the International Council for Small Business (ICSB) publications, such as: Journal of Developmental Entrepreneurship (JDE), Journal of Small Business Management (JSBM).

Transformation from a command into a market oriented economy

Assessing Transition

State-owned enterprises were the dominant players in the socialist economies during the command era. The main economic problems related to the command era included inefficiencies in production methods, stagnation of production rates, poor quality of the items produced, high pollution rates and lack of technological innovation. Transition is the process of replacing of one economic system with another. The command system in Central and Eastern Europe dates from the end of World War II. In 1980s, the command economies of Eastern Europe collapsed, culminating in the 1989 fall of the Berlin Wall and Germany re-unification; in 1991 Cold War was over (Case & Fair, 2004). Changes to Poland's economy began in 1980 with the Solidarity movement, followed by martial law in 1981. Poland was the first of the former socialist countries to begin recording positive economic growth. Foreign investment was flowing into the country and thousands of entrepreneurs started new businesses. Privatization took place and state owned firms were converted to private ownership. The past decade has been Poland's most successful in 300 years. Poland is strategically integrated with NATO and, on May 1, 2004, became a member of the European Union together with the Czech Republic and Hungary (www.eurunion.org).

Poland is one of the largest economies in Central and Eastern Europe with a mostly Roman-Catholic population of 38.6 million, a relatively high GDP per capita (US\$9,410) that is comparable to that of the Czech Republic (US\$12,900) and Hungary (US\$11,200).

There are a variety of indicators assessing transition outcomes in the Polish economy. Analysis will be limited to the main macroeconomic indicators with a focus on gross domestic product (GDP), unemployment, and inflation

GDP per Capita and Economic Growth

As the centrally planned economy began to collapse, state control of economic activity collapsed and decentralization of decision making occurred. GDP per capita and the economic growth are important indicators for judging transition. The most characteristic aspect of economies in transition has been the initial collapse of output and its slow recovery. During the early years of transition, the decline of economic activity in all transition economies was significant. The collapse of the Polish economy was modest and recovery relatively fast (Gregory & Stuart, 2004). Growing GDP per capita, between 1990 and 2000, indicates an increase in the standard of living in Poland (Figure 1) and analysis of real GDP, between 1995 and 2001, also shows a dynamic increase in domestic output by 29.7% with a declining rate of economic growth from 6% to 1.3%.

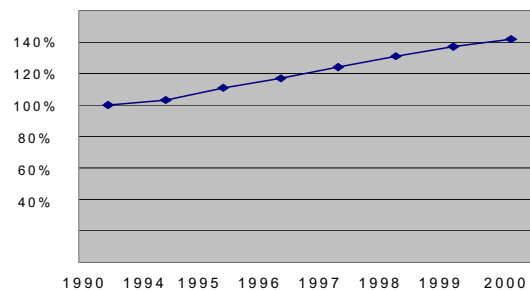


Fig. 1. Gross Domestic Product per capita (1990-2000) Source: Polish Official Statistics
www.stat.gov.pl/english/servis/polska/2001/rocznik19/dypkb.htm

Unemployment Rate

Unemployment was theoretically nonexistent during the command era and became an important problem during transition period. It is known that there was hidden unemployment during the command era. It was difficult to dismissed workers, whether productive or not. The job was guaranteed by the law. The central issue during the transition era has been the movement of labor from the inefficient state sector to the emerging private sector. As a result of this process, the unemployment rate increased significantly. Liquidation of state own firms, and the direct or indirect transformation from state owned firms to private ownership contributed to the high unemployment rate in Poland. Other factors influencing unemployment rate relate to the introduction of the market economy and modern technology; inefficient private enterprises go out of business and new technologies require more skilled labor and lead to structural unemployment in the industry sector in Poland. Between 1990 and 2004 the unemployment rate in Poland increased from 0.3% to 20% (Figure 2). Very high unemployment has been a serious problem in Poland. The transition economies have developed systems of unemployment compensation, however, inequality and poverty have become a great threat.

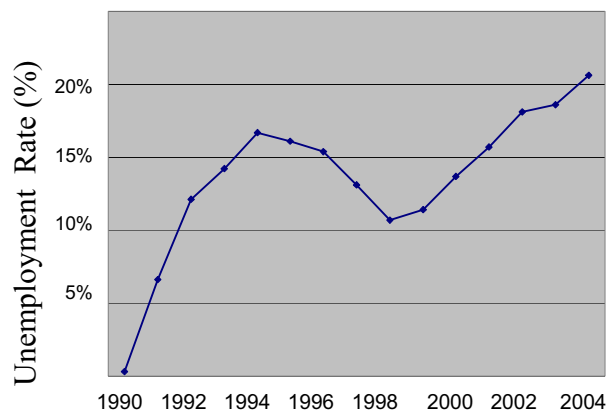


Fig. 2. Unemployment Rate in Poland, 1990-2004

Source: Polish Official Statistics www.stat.gov.plInflation.

During the command era, prices were set by the state. In the early period of transition prices were released from state control. In the early 1990s, prices increased sharply as a result of a market imbalance. Centrally planned economies have been characterized as economies of shortages. With the transition to a market economy, the prices of goods and services in short supply were pushed upward. Another important factor that fueled inflation during the early years of transition was the devaluation of currency that led to an increase in exports and financial inflows of loans, grants and direct foreign investments. Between 1989 and 1990, the consumer price index increased from 351.1% to 685.8%, causing the highest inflation rate during the transition period, called hyperinflation or shortage inflation. To stabilize the economy and decrease the inflation rate a radical strategy called shock therapy was introduced (Kolodko, 2003). It resulted in further institutional changes and government decentralization, increased private ownership, reconstruction of the banking system and stock exchange development.

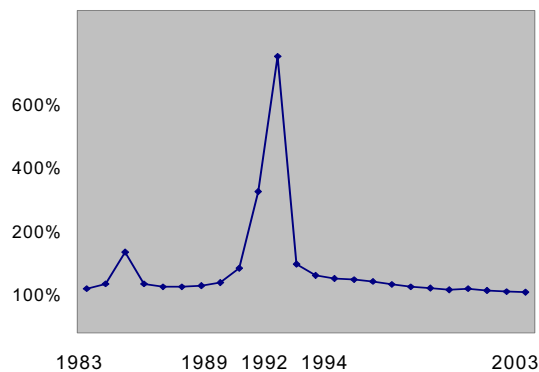


Fig. 3. Consumer Price Index 1980-2003 (previous year = 100)

Source: Polish Official Statistics www.stat.gov.pl

Globalization of the Polish Economy; The European Union

The centrally planned economies were isolated from the global markets and world competitive forces. Sudden transition in the late 1980's forced the transition economies to adapt to the global environment. The most dramatic example of such change is the development of the European Union. Joining the European Union has been an important goal for the transition economies of Central and Eastern Europe (www.eur.union.org). During the command economy there was no mechanism for the inflow of foreign capital because of the lack of financial markets. There was absence of a convertible currency during the command era, leading to the dominance of barter arrangements functioning through state trading organizations. The membership of Poland in the European Union has been important for political as well as economic reasons. The government's determination to enter the EU has shaped most aspects of its economic policy and new legislation. The top priorities in Polish economy are the competitiveness of exports, the problem of unemployment and budget deficits, and the development of financial markets.

Macroeconomic aspects of Small Business Development job in Poland

Number and Size of the Small Business Firms in Poland

During the early years of transition, many entrepreneurs started private businesses. This study assumes that the number of registered small business firms in the economy is a key measure of entrepreneurial activity. The growing number of private firms indicates growth in entrepreneurial activity. Entrepreneurial activity constitutes an important ingredient in the process of transforming Central and Eastern Europe from centrally planned to market oriented economies (Mueller & Goic, 2002). In early 90's Poland, DDR, the Soviet Union and the Czech Republic reached relatively high levels in private enterprise development. Transitioning economies, particularly Poland, show tremendous dynamics in small business development. The numbers of small business firms registered in Poland during 1991 and 2004 increased from 1,200,000 to 4,736,000 (Table 1).

Poland is acknowledged as the leader in Eastern Europe in privatization and in the movement to a market oriented economy. Micro, small and medium size business firms (1-249 employee) constitute 99.8% of all the private firms in Poland. The most common form of business firm in Poland is the micro firm (1-9 employee). Micro firms constitute 95% of all the firms in the private sector (www.parp.gov.pl/01.php).

Table 1

Number of Firms in Private Sector in Poland; 1991-2004

Year	Number of businesses
1991	1,200,000
1994	2,031,972
1995	2,099,577
1996	2,379,949
1997	2,552,649
1998	2,792,697
1999	3,013,876
2000	3,182,877
2001	3,374,956
2002	3,521,189
2003	3,520,000
2004	4,736,000

Source: Polish Agency for Enterprise Development www.parp.gov.pl

The Share of Private Sector in Gross Domestic Product

Transitioning economies focus on the creation of markets through a process of privatization. Privatization is the replacement of state-owned property with private property and the transformation of ownership from government to private hands. The development of small business enterprises represents an important aspect of the transition process.

To assess the success of privatization efforts, the extent to which economic activity has been privatized must be examined and the share of private sector output in national output must be determined. In 1992 less than half of the output was derived from the private sector whereas in 2000, the share of the private sector in the total output increased to 70% in Poland, 80% in Hungary and 80% in the Czech Republic.

Micro, small and medium firms (1-249 employees) play a critical role in the national economy in Poland, generating about 48% of the Gross Domestic Product (Table 2). The micro firms (1-9 employee) accounts for about 30% of the national output, showing an increasing share in GDP between 1999 and 2002, while small (10-49 employees; and medium firms (50-245) demonstrate a decline in GDP share during the period. This leads to the conclusion that the smallest firms, micro firms, show sustained growth in comparison with other categories of firms in Poland.

Table 2

Share of Private Sector in GDP in Poland (%): 1999-2002

	Private sector	Firms	Micro	Small	Medium	
Year	All firms	1-249 employee	1-9	10-49	50-249	large (250+)
1999	70.4	48.2	25.0	13.0	10.2	22.2
2000	69.4	48.6	30.6	8.4	9.6	20.8
2001	68.2	48.3	31.0	8.3	9.0	19.9
2002	68.7	48.6	32.4	8.1	8.1	20.1

Source: Polish Agency for Enterprise Development, www.parp.gov.pl/03.php

Economic Growth and the Growth of the Private Business Firms

Economic growth in the Polish economy seems to be a strong indicator of entrepreneurial activity. This is consistent with the Schumpeterian view that entrepreneurial activity and economic growth are closely linked (Mueller & Goic, 2002).

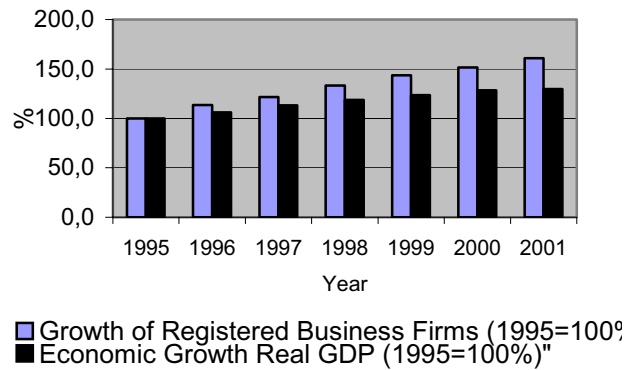


Fig. 4. Economic Growth vs. Growth of Registered Business Firms

Source: Polish Official Statistics, www.stat.gov.pl
Poland Economy, www.theodora.com/wfb2003/poland

Dynamic growth in real GDP in Poland has been compared with the growth of the registered private business firms in Poland between 1995 and 2005 (Figure 4). The results indicate a link between growth in the number of private business firms in the Polish economy and the level of economic growth measured in terms of real GDP.

Share of Private Sector in Employment

Dynamic development of the private sector in the Polish economy constitutes the most important factor generating employment in the economy and the key factor decreasing the number of unemployed. The private sector accounts for 72.5% of employment in Poland while the public sector constitutes 27.5% (www.stat.gov.pl). Micro, small and medium firms (1-249 employees) constitute the base of employment in the Polish economy, generating employment of about 62.2%. The structure of employment in the firms employing 1-249 labor units in 2001 was as follows: micro firms employed 14.7%, small firms 20.9% and medium firms 26.6% of the national employment.

Table 3

Employment in Private Sector in Poland (%)

Year	Private Sector	Firms				
		1-249 employees	Micro	Small	Medium	large (250+)
1999	100.00	57.7	13.8	17.5	26.4	42.3
2000	100.00	59.6	14.4	18.1	27.1	40.4
2001	100.00	62.2	14.7	20.9	26.6	37.8
2002	no data					

Source: Polish Agency for Enterprise Development, www.parp.gov.pl/05.php

According to the government of Poland, it is necessary to encourage entrepreneurship and create the conditions for the acceleration of economic development and the improvement of job opportunities. In *Entrepreneurship-Development-Work*, the government presents its strategy to develop entrepreneurship, which it sees as the basic source of both economic growth and the creation of new jobs. The package provides for actions to eliminate formal barriers to the establishment and running businesses and facilitate the growth of employment (www.parp.gov.pl).

Share of Small and Medium Firms in Foreign Trade

Centrally planned economies were isolated from the global markets and world competitive forces. The sudden transition of the late 1980's forced the transition economies to adapt to the global environment. The most dramatic example of such change is the development of the European Union. Joining the European Union has been an important goal for the transition economies of Central and Eastern Europe (www.eur.union.org). It has been a stimulating force in the development of foreign trade. The foreign trade in Poland, between 1999 and 2001, illustrates involvement and important role of small and medium firms in Polish export and import. In 2001, small and medium firms participated 44% in export and 59.4% in import. The large firms accounted for 56% in export and 40.6% in import (Polish Agency for Enterprise Development www.parp.gov.pl/10/.php).

Summary

The study confirmed that small business development plays a very important role in the process of transition from command to market oriented economy in Poland. Growth of free enterprise in Poland constitutes an important factor in economic development, stimulating output, creating employment and expansion in the foreign trade in the Polish economy.

This paper has found that private business enterprise development plays an important role in the acceleration of economic growth and constitutes a crucial factor in building labor markets in Poland. The private economy in Poland shows tremendous dynamism in small business development. The private sector continues to facilitate economic growth and employment in the economy, constituting about 70% of GDP and generating 72.5% of employment in the country. Micro, small and medium business firms in Poland (1-249 employees) constitute 99% of all the firms in private sector, accounting for about 48% of GDP and create about 62% of employment in the national economy. The smallest business firms, micro firms (1-9 employees), account for 95% of all the firms in private sector, 30% of GDP, and 14% of the employment in the private sector. Micro firms show an increasing share in GDP between 1999 and 2002, and sustained growth in comparison with other categories of firms.

This paper showed the results of the globalization process and the strong involvement of small and medium firms in foreign trade. The membership of Poland in the European Union has been an important factor in foreign trade expansion. In 2001, small and medium firms participated 44% in export and 59.4% in import while large firms accounted for 56% in export and 40.6% in import.

This paper is of empirical character, however it has the potential to contribute scientifically in building a macroeconomic model of transitioning economies in Central and Eastern Europe. This preliminary investigation of macroeconomic aspects of small business development in Poland constitutes a strong empirical base for constructing a macroeconomic model of the Polish economy. It shows how growth of free enterprise in Poland contributes to economic development by stimulating output, creating employment and expansion in the foreign trade in the Polish economy. Further research on macroeconomic aspects of small business development in Poland is necessary and the author is planning on pursuing this research in the near future.

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