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Free 'Entry' and free 'Exit' are fundamental mechanisms of the competitive market economy operation. Free entry ensures that potential entrepreneurs will take advantage of profitable opportunities and enter profitable segments of the market, increasing competitive pressure on the incumbent firms, lowering output prices and improving the overall allocation of resources. Both free entry and free exit guarantee that more efficient firms and those producing in accordance with the market demand, survive and prosper while inefficient units and those whose production is not geared to the market will contract and eventually embark on exit. Barriers to entry and exit influence the development of competitive conditions in established market economies, however, for economies in transition the freedom of entry and exit has an even more significant dimension. The reason for that are particular 'initial conditions' which the economies inherited from their communist past: massive distortions of the economic structure, highly monopolistic and oligopolistic markets, and a large average firm size. With a collapse of the old regime, transformation of the old economic structure had to take place through the entry of new, market-oriented firms particularly in the undeveloped sectors of the economy and the exit of inefficient and uncompetitive enterprises especially from the over-grown industrial sector.

This report presents some outputs of the research project 'The Impact of Barriers to Entry on the Speed of Transition: A Comparative Study of Countries in Different Stages of Transition' (PHARE ACE project No. P95-2047-R), coordinated by Leszek Balcerowicz and done by an international team which included: Ewa Balcerowicz (Poland), Andrzej Bratkowski, (Poland); Irena Grosfeld (France); Iraj Hashi (U.K); Jan Mladek (the Czech Republic); Gediminas Rainys (Lithuania); Jacek Rostowski (Hungary); Miklos Szanyi (Hungary); and Lindita Xhillari (Albania). The main aim of the project was to investigate nature and impact of barriers to entry in five countries at different stages of transition with various development backgrounds and traditions. The study has been based on the experience of new firms in Poland, Hungary, the Czech Republic, Lithuania and Albania -- the first three having reached an advanced stage of transition and the latter two having embarked on the transition process later, thus lagging behind the front-runners. The study has focussed on the legal, fiscal and institutional factors which impede new entries and slow down the expansion of new firms in each country.

The report consists of two parts. In Part I, Chapter 2 we discuss the interaction between the government's regulatory activity and the entry of new firms into the formal or informal sectors of the economy. Here we highlight the necessity of this important function of the government as well as its undesirable implications such as rent seeking and corruption. In Chapter 3 we consider a framework for the analysis of barriers to entry and growth of new firms, highlighting the main constraints to entry and growth considered by this report. Chapter 4 is devoted to the review of an actual pattern of new firms' entry in the early transition period in the five countries under consideration. Part II reports on the results of our enterprise survey; it is a detailed study of 400 firms in five transition economies. Here we first discuss (Chapter 5) the composition of the sample on which the study is based and then (Chapters 6, 7, 8, 9 and 10) summarize main findings of the study in terms of the relative importance of different barriers facing new firms in each country. Chapter 11 discusses the main policy recommendations of this study.

Abstract
1. Introduction

The main aim of the present study is to investigate the nature and impact of barriers to entry in five countries at different stages of transition with differing development backgrounds and traditions. The study is based on the experience of new firms in Poland, Hungary, the Czech Republic, Lithuania and Albania — the first three having reached an advanced stage of transition and the latter two having embarked on the transition process later thus lagging behind the front-runners. The study focuses on the legal, fiscal and institutional factors, which impede new entries and slow down the expansion of new firms in each country. This report presents some outputs of the research project 'The Impact of Barriers to Entry on the Speed of Transition: A Comparative Study of Countries in Different Stages of Transition' (PHARE ACE project No. P95-2047-R). The research was co-ordinated by Leszek Balcerowicz and done by the international team, which included the following partners and associates: Ewa Balcerowicz, Center for Social and Economic Research – CASE Foundation, Poland; Andrzej Bratkowski, Center for Social and Economic Research – CASE Foundation and Bank Handlowy, Poland; Irena Grosfeld, DELTA, France; Iraj Hashi, Staffordshire University, U.K.; Jan Mladek, The Czech Institute of Applied Economics, The Czech Republic; Gediminas Rainys, Economic Research Centre, Lithuania; Jacek Rostowski, Central European University, Hungary; Miklos Szanyi, Institute of World Economy of the Hungarian Academy of Sciences, Hungary; Lindita Xhillari, National Agency for privatization, Albania.

Free 'Entry' and free 'Exit' are the fundamental mechanisms of the operation of a competitive market economy. They will guarantee that the more efficient firms and those producing in accordance with the market demand, survive and prosper while the inefficient units and those whose production is not geared to the market will contract and eventually embark on exit. Free entry will ensure that potential entrepreneurs will take advantage of profitable opportunities and enter the profitable segments of the market, increasing the competitive pressure on the incumbent firms, lowering output prices and improving the overall allocation of resources. In the absence of free entry, imperfect market structures will survive, inefficient firms will be able to maintain their prices and profit margins, and there will be no incentive to reduce costs.

Recent developments in the 'industrial organization' theory, particularly the work on the 'contestable market' theory by Baumol and his associates, have clearly established that the existence of free entry and exit conditions, which will make a market 'contestable', ensures an improvement in the allocation of resources and the overall welfare. These authors have shown that the presence of potential entry, in contestable markets, will impose a discipline on incumbent firms and force them to behave 'as if' these rivals have already entered the market. The focal point of this literature is that conditions of entry are the main determinants of the performance and structure of an industry.

Of course, it is not only the contestable market theorists who have highlighted the importance of entry conditions for industrial structure and performance. Years earlier, Bain (1968), Stigler (1968), Von Weizsacker (1980), Demsetz (1982), and many others had elaborated on the impact of barriers to entry on technical and allocative efficiency and consumer welfare.

Barriers to entry and exit influence the development of competitive conditions in established market economies as well as in transition economies [1]. The literature on barriers to entry is almost completely based on the experience of developed market economies. However, for economies in

[1] Although the present study will focus on barriers to 'entry', the conditions of 'exit' are equally important for the development of a competitive economy. The nature and intensity of the exit processes during the transition to a market economy was the subject of another research project financed by the ACE programme. See Balcerowicz, et.al. (1998) for a detail investigation of types of exit, the legal and institutional framework for different exit processes, and government policies influencing the pace of exit in each country.
transition the freedom of entry and exit condition assumes an even more significant dimension than in the already-established market economies. This is because of the particular 'initial conditions', which they inherited from their communist past: massive distortions of the economic structure, highly monopolistic and oligopolistic markets, and a large average firm size. With the collapse of the old regime, the transformation of the old economic structure had to take place through the entry of new, market-oriented firms particularly in the undeveloped sectors of the economy and the exit of inefficient and uncompetitive enterprises especially from the over-grown industrial sector [2]. These initial conditions meant that, in the early stages of transition, the volume of entries and exits will be, by necessity, very high - reflecting the large scale changes that had to take place before these economies attain a macroeconomic structure consistent with their level of development and with the needs of a market-based economy open to international competition.

One of the main elements of the reform programme in all economies in transition was the liberalization of entry conditions. Along with the liberalization of prices and foreign trade, appropriate measures facilitating the establishment of new enterprises were approved in the very early phase of reforms in all of these countries. The effectiveness of liberalized entry conditions, of course, depends on the presence of appropriate legal and institutional framework in which new firms will operate. The establishment of a conducive, legal and institutional environment, however, takes much longer. In practice, new firms come into existence before the rules of the game are properly established. These rules develop gradually and are not always, and everywhere, consistent with the aim of liberalizing the entry conditions. The conditions facing new firms, therefore, have fluctuated in some countries in accordance with changes in the political environment and in line with the strength of different lobbies and interest groups [3]. Furthermore, given that the composition of the bureaucracy has changed slowly, and to varying degrees in different countries, the old prejudices against private entrepreneurship has not always disappeared quickly in all transition economies [4]. Consequently, in some countries, although the measures aiming at the liberalization of entry conditions have been on the statute books for some time, the actual conditions regulating the entry of new firms are still far from 'accommodating' and 'facilitating'.

As a result of the liberalization of entry conditions, there was an explosion of new firm entry in every transition economy across Central and Eastern Europe. Even so, entry has not been uniform across sectors and size groups [5]. The great majority of the new entries have been very small firms concentrated in sectors such as trade and services. Some of these activities, such as banking and financial services, were highly undeveloped while others, such as marketing and advertising, were almost non-existent in the former economic system. Here, new entries filled a gap in the market. In other areas, such as distribution, the former networks were both insufficient in meeting the market demand and inefficient in their operations, offering profitable opportunities to new entries. Entry to other sectors of the economy, however, has not been as numerous as that in trade and service activities.

Despite the large scale liberalization of entry conditions, the number and size distribution of firms in many branches of economic activity remains skewed. Many activities, especially in the industries, are still dominated by a small number of large firms. Medium and large size new firms in industrial and commercial activities are rather rare. The underlying reason for these features is the fact that barriers to entry have not been completely eradicated and conditions facing new enterprises, when they do enter a market, are not always conducive to stability and expansion.

The improvement of conditions of entry and the consequent development of new private firms also has another, and more crucial, dimension in the course of transition. New firms constitute the most dynamic part, or the engine of growth, in transition economies (see Blanchard 1997). They are not constrained by traditional ownership relations or the incentive system, which dominate the state-owned or privatized sector of the economy. They recognize the promising segment of the market to enter and respond quickly to changes in demand and cost conditions. Evidence is gradually emerging (see for example Belka, et.al. 1995) that although 'privatized' firms perform better than firms which are still state-owned, there is a significant difference the performance of newly set-up private firms and 'privatized' firms. The removal of entry barriers, therefore, is important for transition economies as it can have a major influence on their growth performance.

With the exception of the very early stages of transition, when small entrepreneurs took over pavements and empty spaces in city centres all across Eastern Europe and embarked on business activities without any rules or restrictions, the liberalization of entry conditions did not, of course, mean a complete abolition of all regulations affecting the establishment of new businesses. New laws were quickly promulgated to oversee and regulate the entry of new firms – specifically requiring them to register with municipal or higher authorities, tax offices, social insurance offices, and in some or all cases obtain a license or permit from the competent state authorities. While there is no doubt that new firms have to be subject to certain

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[2] For a detailed analysis of the nature and magnitude of exit process in the Czech Republic, Hungary and Poland, see Balcerowicz, Gray and Hoshi (1998), Chapter 4.


laws and be governed by regulations designed to protect the citizens, these laws and regulations provide the arena for the state (and state officials) to exercise an effective influence over private sector development. They fall in the category of ‘government erected barriers’ with two important implications. Firstly, state-sponsored rules and regulations create the opportunity for rent seeking activities by government officials and bureaucrats, i.e., bribery and corruption. During the transition period, governments often comply with the demands of various interest groups and may even turn a blind eye to rent seeking activities.

Secondly, these rules and regulations may push the entrepreneurs to the informal sector of the economy. With underdeveloped rules of the game and under non-conducive environment, all economic agents, new firms in particular have to decide whether – and to what extent – they wish to operate in the formal economy. This decision is based on the incentive system generated by the legal and institutional mechanisms operating in different countries. New entrepreneurs have to assess and weigh the opportunity costs of entering a new business. They will have to compare the gains from entering the official economy with, firstly, the gains from operating in the unofficial or shadow economy and, secondly, with what they can earn in employment or even unemployment. In many cases, the legal and institutional structures and a wide variety of rules and regulations provide sufficient incentive for new firms (or existing firms) to operate outside the formal economy. It is therefore not accidental that a significant shadow economy has emerged in all transition economies – with a severe impact on state finances, resource allocation and the establishment of a competitive market economy.

Finally, in addition to the regulatory and fiscal barriers, private sector development may be further constrained by the continued dominance of some economic activities by large state-owned or privatized enterprises and their entry deterring behaviour. Some of these enterprises are, to varying degrees, still subject to semi-soft budget constraints and have close contact and relationship with banks (which are also still to a large extent state-owned). Some authors have expressed a concern that these firms, at least in some countries, may exercise a strong influence on prices and output levels in their product and input markets. The dominant firms also enjoy lower cost of credit compared to new entrants and can potentially ‘crowd out’ new entrants in the credit and raw material markets (Hussein 1994 and OECD 1996).

This study aims at investigating the impact of above factors in five countries at different stages of transformation with a view to identifying those barriers that still impede the establishment of new firms and their early growth. It is divided into two parts. In Part I, Chapter 2 we discuss the interaction between the government’s regulatory activity and the entry of new firms into the formal or informal sectors of the economy. Here we shall highlight the necessity of this important function of the government as well as its undesirable implications such as rent seeking and corruption. In Chapter 3 we consider a framework for the analysis of barriers to entry and growth of new firms, highlighting the main constraints to entry and growth considered by this report. Chapter 4 is devoted to the review of the actual pattern of new firm entry in the early transition period in the five countries under consideration. Part II reports on the results of our enterprise survey, a detailed study of 400 firms in five transition economies. Here we shall first discuss (Chapter 5) the composition of the sample on which the study is based and then (Chapters 6, 7, 8, 9 and 10) summarize the main findings of the study in terms of the relative importance of different barriers facing new firms in each country. Chapter 11 discusses the main policy recommendations of this study.

2. Government and Transition

The massive deregulation of economic activities was a fundamental feature of transformation in all Central and East European countries. The all-pervasive system of state control established under socialism was inappropriate for these transforming economies and had to be replaced by a completely different set of rules and regulations designed to facilitate the establishment of a market economy. While the vast machinery of the former system was being dismantled, the state had to assume new functions and formulate the ‘rules of the game’ appropriate for the operation of the new system. Given the legacy of the old system and the manner of its disintegration, new rules had to be devised at the same time as the new system was taking shape. It was therefore inevitable that the new regulatory framework would develop unevenly in different countries and that some countries would suffer from a ‘regulatory vacuum’, a near-total-absence of an appropriate regulatory framework for the protection of citizens’ economic interests [6]. In other countries, many of the old rules and regulations were retained until new ones could be promulgated – a policy broadly aimed at preventing opportunism.

The newly elected governments had to design new rules and regulations for various aspects of economic activity, including the conditions of entry and operation of new firms. The

[6] The attitude of the ruling parties in some countries (Albania and the Czech Republic, e.g.) was that all economic activities were legal as long as they were not explicitly forbidden by law - an attitude which resulted, for example, in financial scandals such as the formation of pyramid schemes in the former and the ‘tunnelling’ of privatization investment funds by their main shareholders and managers in the latter. Similarly, almost all transition economies suffered from environmental damage caused by the massive, uncontrolled and wholesale import of second hand cars from Western Europe, many of which were not road-worthy.
process was by definition time consuming since changes in regulations also required various legal changes which could not be brought in immediately. New regulations ranged from those dealing with the registration and licensing of new firms; to fiscal regulations governing taxes, social and health insurance and other contributions, accounting and financial rules covering book keeping, expenses, depreciation, and banking; labour code governing conditions of work, minimum wage, dismissals, etc.; real estate regulations dealing with conditions of lease or sale of commercial property; and many others.

The aims of government regulations in transition countries are not always explicit. Sometimes they are expressed in terms of correcting market failures arising from externalities or asymmetric information (establishing minimum standards in the interest of consumers, and licensing of certain activities and professions); at other times in terms of promoting public welfare and protecting citizens against scrupulous businessmen (employment laws, tenancy laws, etc.). Mostly, however, they are designed to facilitate the identification of economic units for tax purposes (tax base) and to ensure that the state treasury receives its dues [7].

But these rules and regulations, useful as they may be, play an additional, rather negative, role too. Regulations affecting entry and survival of firms put politicians and bureaucrats at different levels of government in a strong position to exercise influence over new firms. They provide the politicians with legitimate means to pursue their own objectives – which may range from extracting a rent, to using subsidies to create employment in friendly companies and areas, favouring their political allies and penalizing their opponents. Taxes, subsidies and various contributions may also be used to achieve the same objectives. The success of transition policies is closely bound with the way governments and politicians use their newly acquired (or retained) powers to control the entry and operation of new private firms (see Frydman and Rapaczynski 1991, Boycko, Shleifer and Vishny 1996, Shleifer and Vishny 1993 and 1994 for a discussion of the role of government and the relevant empirical evidence).

The establishment of new firms and the growth of this sector are closely influenced by the type of regulatory policy referred to above and the consequent exercise of discretion by politicians. The politicians' attitudes have a crucial impact on the entrepreneurs' decision on whether or not to enter a market. In some transition economies, such as Russia, many old style politicians hostile to the market system retained power and have engaged in 'predatory' actions against new firms. In other countries such as Poland, on the other hand, politicians responsive to the needs of the newly emerging market economy have facilitated the growth of registered new businesses. For example during 1995, the number of businesses slightly surpassed 2 million in Poland and reached only one million in Russia (with a population four times larger) (see Chmiel 1998 and Shleifer 1997). In effect, politicians exercise control rights over firms through a variety of regulations including the registration and licensing requirements, sale or lease of real estate, the level and type of taxes and contributions, and rules governing exports and imports. Furthermore, in addition to central authorities, regional, municipal and local governments too devise their own rules and regulations – to pursue their own objectives – which erect further obstacles for the newly established firms.

There is no hard and fast rule about the optimum level of regulation – a level that has to be worked out for each country or industry separately. On the one hand, of course, the establishment of a market economy requires the abolition of the system of rules and regulations, which was in force under socialism. On the other hand, the new system requires its own new 'rules of the game' aimed at creating a level playing field for all participants. While governments should provide sufficient 'space' for entrepreneurs to engage in lawful economic activities, it should also ensure that no one's rights (including the citizens' and the state's) are violated by the emerging entrepreneurs. In some areas such as environmental protection or the financial system, many countries still do not have sufficient rules to protect their natural environment or their citizens' financial interests against new firms and their self-seeking managers [8].

In areas such as taxation, on the other hand, the legacy of the socialist system (with its massive state sector and high levels of expenditure) led to the imposition of very high levels of taxes and contributions and to too many complicated and constantly changing rules. Expenditure on the 'safety net' (e.g. unemployment and other social benefits) was often misused because of the absence of an appropriate monitoring system and suitable rules. It is clear that if the government does not take a conscious and clear view of the appropriate level of regulation, it will either not be able to resist the pressures for 'excessive' regulation from different levels of bureaucracy or it will not bring in the basic regulations which are necessary for the development of a market economy.

The impediments to private sector development also play an important role in pushing certain entrepreneurial activities...
into the shadow economy. Naturally, many new businesses wish to evade what they consider ‘excessive’ levels of taxes and ‘troublesome’ rules and regulations if at all possible. To this end they may try to conduct some or all of their business outside the formal sector. This will have a distorting effect on the development of the private sector as well as major implications for government finances. A shortfall in government revenue will reduce its ability to provide the normal services expected of a government in a market economy – including policing of the informal sector. This will create incentive for more entrepreneurs to try to shift some of their activities into the shadow economy, reducing government’s revenues and its normal expenditure programme further. The available evidence from transition economies shows that the size of the shadow economy is related to the level of ‘legal protection’ and ‘legal effectiveness’ provided by the government. These services, in turn, are dependent on government’s revenues and its taxation policies (see Johnson, et. al. 1997, Kaufmann and Kaliberda 1995).

Irrespective of the height of entry barriers and the role of fiscal, regulatory and institutional constraints, some firms will always carry out a part or all of their activities in the informal sector. Most of these, by nature, are small owner-managed units. What is more significant (and serious) is the fact that many formally established firms, even some large ones, do not report a proportion of their sales and expenditure and pay some of their employees in cash (over and above their declared wages) and suppliers in cash or kind. In this way, they reduce their own (and their employees’ or suppliers’) tax and contribution obligations. For many years now, economists have argued that high rates of taxation is a major factor in pushing employers and employees into tax evasion and underground activity. In their study of the impact of government taxation policies in 15 transition economies, Johnson, et. al (1997, p.20) show that the size of unofficial economy in transition economies is significantly correlated with the effective tax rate (or tax burden) [9].

In order to understand one of the main complaints of the management of new firms in transition economies, it is useful to compare the overall tax burden in these countries with those in established market economies. This is done in the table 1, which shows the levels of actual taxes, and contributions paid by employers and employees in the five transition economies under consideration, the U.K. and EU countries.

With the exception of Hungary, personal income tax rates are slightly lower than those in the EU countries are, though the thresholds for the application of the higher tax bracket are generally smaller. Company taxes are about the same as those in the EU countries, with the rates in Poland and the Czech Republic similar to the upper range of EU countries rates. The striking point of this table, however is that, compared to West-

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[9] See also Kaufmann (1995) for a framework for the measurement and analysis of the informal sector.
ern market economies, the level of social security, health and unemployment contributions in four of our five countries (particularly in Hungary), is much higher. This observation clearly supports the claim that high levels of contributions forces many entrepreneurs (and employees) to operate outside the formal economy.

There is no general agreement on the method of estimation of the size of the informal sector or the factors influencing it. While the size of shadow economy may depend on a variety of economic, social, cultural and institutional factors in each country, the high rate of obligations is undoubtedly a major factor in the partial reporting of sales and costs (especially labour costs) in these economies. Table 2 is an indication of the estimated size of the informal sector in the four countries under consideration.

### 3. A Framework for the Analysis of Barriers to Entry

New firm entries in transition economies are generally small and medium sized, with larger firms, which are often set up by foreign investors being exceptions. The obstacles impeding the entry of domestic firms and those discouraging joint ventures and foreign investment are the major impediments to private sector development and their identification and eradication must be of prime concern for policy makers.

At the start, we must distinguish between two types of new entries: those entering the market for the first time (start-ups) and those that have their origins in older established firms but have been separated in the privatization process and have become new legal entities (spin-offs). As we have already pointed out, start-ups or de novo firms play a particularly important role in the early transition process and therefore this study will concentrate on the specific obstacles facing them. The problems facing the second group, spin-offs, are discussed at length in the privatization literature.

New firms have to pass through two stages before being established on the market: the initial creation and the early development. New entries not only face a number of important and relatively severe barriers to entry, they face continued difficulties even when they have succeeded in overcome the early barriers. In each stage they face a number of problems and impediments specific to that stage. New firms need a conducive environment and a supportive institutional framework for one to two years before they can spread roots and develop their own relationships with customers and suppliers. Nurturing and support is not, of course, achieved by subsidization but by the creation of level playing field (especially in comparison to the shadow economy), the provision of information, and minimizing the unnecessary restrictions in procedures.

Table 3 summarizes the main constraints faced by new entrants in the two stages of development.

The present study will therefore consider the impact of four specific areas on the establishment and growth of new firms in five countries. These are: regulatory barriers including the legal, institutional and fiscal environment; financial constraints influencing the availability of initial capital and investment resources; informational barriers including the knowledge of the available support programmes; and the competitive environment, particularly the role of existing state-owned firms and that of the informal economy.

### 4. New Firm Entries

We can now consider the actual picture of new firm entries in the five countries under consideration in the early transition period and note the changes in new firm entries in the course of transformation. One of our aims was to collect data on the number of new companies (which we call 'entrants') according to the following criteria: according to sectors, legal form and size. We wanted to gather information from the whole transformation period in order to identify trends over time. This part of the project turned out to be a very difficult task. Causes are numerous, let us enumerate only some of them.

It should be emphasized here that statistical agencies in the five countries do not publish regular, comparable and reliable data on new entries and, for example, in Poland this data is not published at all [10], while in Hungary it was published only...
until 1994. The information on new firms is not kept centrally in any of the five countries. The data is kept separately in different regions and in different institutions depending on a variety of factors. Moreover, the quality of what is published varies considerably across different countries. For example in most countries the data does not identify the number of active firms, as opposed to the dormant ones or those that have ceased operation altogether. In theory it is of course possible to identify active firms if tax returns are used as the basis for the identification of economic units. This, however, is not the practice in most countries. Therefore, the number of entries in most cases overstates the effective entry. Another problem is the change of the statistical classification from the one typical of communist economies to NACE. In Poland this resulted in incomparability of sectoral data classified until 1992 with those collected since 1994. For the Czech Republic data for 1990 and 1991 are not available, because in that period the data covered the whole of former Czechoslovakia.

The tables 4-6 illustrate the scale of new firm entries in the five transition economies.

All the five transition economies witnessed an enormous wave of new enterprise entries, which resulted in a rapid increase in the number of registered private firms (see Tables 4 and 5). The most dramatic increase in the number of private companies took place in Albania and this process continued for quite a long period (1991–1994). Albania began practically at

### Table 3. Types of Constraints to Entry and Development of New Firms

<table>
<thead>
<tr>
<th>Constraints</th>
<th>Initial Creation 1st stage</th>
<th>Early Development 2nd stage</th>
</tr>
</thead>
</table>
| Government Sponsored Constraints | Registration and Licensing  
Length and number of stages in the process, costs, minimum capital requirement | Renewal of Licenses        |
|                      | Fiscal  
Levels of taxes and contributions, compliance cost                                     | Fiscal                     |
| Input Constraints    | Source of Initial Capital  
Own, family, banking system, special facilities, informal market                        | Source of Capital for Investment |
| (Capital)            | Cost and Availability of Credit  
Criteria for obtaining a loan (track record, collateral), high risk-weighted interest rates | Same                       |
| Information Constraints | Support Programmes  
Governmental, NGO and other programmes to support new firm entries                       | Support Programmes          |
|                      | Same                                                                                     | Programmes to support existing SMEs |
| Environmental        | Behaviour of Existing Firms  
Impact on availability and price of inputs, conditions of product market and sales outlets | Same                       |
| Constraints          |                                                                                           |
| Informal Sector      | Competitors in Shadow Economy  
Impact of the informal sector on input and output prices and conditions of competition  | Same                       |

### Table 4. Number of Registered Firms a

<table>
<thead>
<tr>
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<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>37</td>
<td>2,336</td>
<td>6,640</td>
<td>11,556</td>
<td>19,967</td>
<td>9,960</td>
<td>7,892</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>-</td>
<td>-</td>
<td>1,050,278</td>
<td>1,158,902</td>
<td>1,018,404</td>
<td>1,207,905</td>
<td>1,347,992</td>
</tr>
<tr>
<td>Hungary</td>
<td>446,861</td>
<td>603,910</td>
<td>733,410</td>
<td>857,899</td>
<td>969,534</td>
<td>1,011,945</td>
<td>-</td>
</tr>
<tr>
<td>Lithuania</td>
<td>8,991</td>
<td>40,841</td>
<td>61,923</td>
<td>80,606</td>
<td>103,360</td>
<td>116,600</td>
<td>121,437</td>
</tr>
<tr>
<td>Poland</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,772,186</td>
<td>1,884,784</td>
<td>1,863,867</td>
<td>2,098,294</td>
</tr>
</tbody>
</table>

Notes:

[a] All sectors except for agriculture, state enterprises excluded.
[b] Data for Albania includes only limited liability companies and natural person businesses.
[c] For 1990-1991 – before Czechoslovakia’s split no separate data is available for the Czech Republic.

Source: Data delivered by co-researchers in their papers on statistics of entry for individual countries, available at CASE.
the zero starting point. Therefore, the net rate of entry (for a definition see the note to Table 6) was very high, ranging from 6212.5 percent (!) in 1991 to 72.8 percent in 1994. Lithuania came second, with the net rate of entry amounting to 354.2 percent in the peak year of 1991 (see Table 6). In the years 1992–1996 the increase in the number of private firms was slowing down (with the exception of 1994), consequently, also a net rate of entry was slowing down (from 51.6 percent in 1992 to 4.1 percent in 1996).

With respect to the Czech Republic and Poland, we miss comparable data for the first years of transition [11], which were the most important years as far as the growth of the private sector is concerned. The tables show a much slower net rate of entry in later years.

Hungary is a country with a steady growth in the number of private firms and with a steady decline of the rate of entry. It needs to be emphasized that both Poland and Hungary had a much better starting point than Lithuania and Albania. In the former two countries the private sector started to grow slowly as early as in the second half of the 1980s due to relaxation of economic policies at that time.

Out of the five investigated transition economies Albania witnessed the most dramatic pace of the growth of the private sector. It was also Albania, which demonstrated a dramatic decrease in a number of companies (by 50.1 percent in 1995 and 20.8 percent in 1996). This tremendous drop is the indication of a dramatic impact on the economy by financial pyramid schemes that developed in Albania in the 1990s.

In other four countries the private sector has been steadily growing and strengthening. A sudden decrease in the number of private companies in Poland, observed by statistics in 1995 (see Tables 5 and 6), was not a sign of a crisis in the private sector. Contrary to what one may expect, this was caused by the change of a regulation on the statistical register, which forced many owners of dormant companies to delete them from the register. As a consequence, the register's contents were changed, whereas nothing was changed in real terms. It is yet one more example of the caution and care needed to deal with statistical data in transition economies.

---

**Table 5. Net Entry a**

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>-</td>
<td>2,299</td>
<td>4,304</td>
<td>4,916</td>
<td>8,411</td>
<td>-10,007</td>
<td>-2,068</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>108,624</td>
<td>-140,498</td>
<td>189,501</td>
<td>140,087</td>
</tr>
<tr>
<td>Hungary</td>
<td>-</td>
<td>157,049</td>
<td>129,500</td>
<td>124,489</td>
<td>111,635</td>
<td>42,411</td>
<td>-</td>
</tr>
<tr>
<td>Lithuania</td>
<td>-</td>
<td>31,850</td>
<td>21,082</td>
<td>18,683</td>
<td>22,754</td>
<td>13,240</td>
<td>4,837</td>
</tr>
<tr>
<td>Poland</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>112,598</td>
<td>-20,917</td>
<td>234,427</td>
</tr>
</tbody>
</table>

Note: [a] Increase in the number of firms (year to year).
Source: Calculations based on data presented in Table 4.

**Table 6. Net Rate of Entry (in percent) a**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>-</td>
<td>6,213.5</td>
<td>184.2</td>
<td>74.0</td>
<td>72.8</td>
<td>-50.1</td>
<td>-20.8</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>10.3</td>
<td>-12.1</td>
<td>18.6</td>
<td>11.6</td>
</tr>
<tr>
<td>Hungary</td>
<td>-</td>
<td>35.1</td>
<td>21.4</td>
<td>17.0</td>
<td>13.0</td>
<td>4.4</td>
<td>-</td>
</tr>
<tr>
<td>Lithuania</td>
<td>-</td>
<td>354.2</td>
<td>51.6</td>
<td>30.2</td>
<td>28.2</td>
<td>12.8</td>
<td>4.1</td>
</tr>
<tr>
<td>Poland</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>6.4</td>
<td>-1.1</td>
<td>12.6</td>
</tr>
</tbody>
</table>

Source: Calculations based on data presented in Table 4.
Notes: [a] The net rate of entry is the ratio of the difference between the number of economic entities at the end of the year (t) and (t-1) to their number at the end of the year (t-1). In other words, the net rate of entry is an increase of number of registered firm in the year (t) in relation to the stock of firms in (t-1).

[11] This is due to reasons explained earlier on in the text.