

# Small Is Not Always Beautiful, Especially When Aided by (Polish) Government



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The official rhetoric of Law and Justice (PiS) government is “to make it possible to develop micro enterprises into small, small into medium, and medium into large or even into international champions”<sup>1</sup>. However, the actual measures undertaken by the government were, in fact, to petrify the size of the companies. Since 2015, at least three pieces of regulation have been introduced that formally served to promote micro and small enterprises, regardless of their efficiency: a freeze on trade in agricultural land, (very heavy) restrictions imposed on new pharmacies, and a ban on Sunday retail trading. What they do is to render it unprofitable to develop into bigger companies. In addition to this, a new tax relief has been put forward, rendering company growth unprofitable. The conditions have not improved with the introduction of the so-called “Business Constitution”, i.e. a new law on business activity that was intended to improve the conditions of running a business in Poland. However, because of its general character, its effects are negligible in the light of the myriad of existing specific regulations.

### REGULATIONS PROMOTING SMALL AND INEFFICIENT COMPANIES

As mentioned, the official rhetoric of Law and Justice government is to facilitate growth of Polish companies. With regard to building (rather national than international) mostly state-owned champions, the government has at its disposal several instruments that serve to recapitalize them or provide them with preferential loans. However, the environment for smaller entities – especially those privately-owned –

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was not so favorable, because of two reasons. First, smaller companies are often less efficient than bigger ones, especially those foreign-owned. This is not to say that obstacles shall be put on small companies, but rather that the growth of potentially innovative small companies into bigger ones with economies of scale (let them disrupt the market) shall be enabled.

<sup>1</sup> Premier (2018) *Prime Minister Mateusz Morawiecki: We Are Developing an Environment Supporting Small and Medium Enterprises*. Available [online]: <https://www.premier.gov.pl/mobile/en/news/news/prime-minister-mateusz-morawiecki-we-are-developing-an-environment-supporting-small-and.html>



IN 2018, THE SHARE OF EMPLOYMENT IN AGRICULTURE WAS 10.3% – ABOUT 2.5 TIMES MORE THAN THE EU AVERAGE

Second, the regulatory and tax framework has been very complex, which makes it harder to operate for smaller companies. The actions undertaken by the government were not to facilitate the regulatory framework by some deregulatory measures (the so-called “Business Constitution” was not such a measure), but to use new regulations to compensate for lower efficiency of smaller companies.

In light of these developments, three pieces of regulation that were introduced in the last three years shall be discussed. All of them were implemented to favor small enterprises, or at least was claimed by their sponsors or supporters<sup>2</sup>. But by hampering the growth of companies, they also jeopardize the competition between bigger enterprises by making the market less contestable. Therefore, anti-growth tax relief (the so-called “small CIT”), and

<sup>2</sup> The restrictions against new pharmacies were supported by the Polish Pharmaceutical Chamber; the ban on Sunday retail trading, which was introduced as a result of a bill initiated by citizens, was sponsored by the “Solidarity” trade union, which collected signatures in its support.

“Business Constitution” shall be also closely examined.

### **FREEZE ON TRADE IN AGRICULTURAL LAND**

May 1, 2016 was the last day of a transitional period negotiated with the European Union (EU), during which acquisition of agricultural land by foreigners had been prohibited without permission from the Ministry of Interior. Because it was impossible to discriminate against the foreigners, still in 2015, the previous parliament almost unanimously voted for the law which seriously hampered the trade in agricultural land: It banned resale of agricultural land purchased from the Treasury for ten years.

Yet, in 2016, the PiS government introduced a new law, which increased the ban to fifteen years. Furthermore, it suspended the sale of agricultural property by the Treasury for a period of five years and required that the agricultural land of the Agricultural Property Agency would only be leased to the farmers. Moreover, it requires the purchasers of agricultural land to be, as a rule, individual farmers, with agricultural qualifications, holding agricultural property with an area of up to 300 hectares and residing in the commune (*gmina*) for at least five years.

As Civil Development Forum (FOR) noticed:

*“[t]hese changes will lead to the freeze on trade in agricultural land. Meanwhile, Polish agriculture is among the least productive in the European Union (...). The main reason for that is the small average size of farms in Poland, which, according to Eurostat, in 2013, was 10 hectares to 16 hectares in the EU-28, 59 hectares in Germany, and 133 hectares in the Czech Republic.*



## KEEPING SMALL BUSINESS SMALL IS A FEATURE OF PRESENT POLICY OF THE RULING PARTY

*(...) The share of agriculture in employment remains very high. According to Eurostat, in 2014, it amounted to 11.5% of the employed (fourth highest rate in the EU), compared to only 5% in the EU-28, 1.5% in Germany and 3.3% in the Czech Republic. At the same time, in Poland, productivity (measured by value added per worker) in agriculture is five times lower than in services (...). This means that the outflow of workers from agriculture to other sectors would be associated with a significant improvement in the productivity of the entire Polish economy.*

*Up to now, the process of quitting farming has continued successfully and spontaneously as a result of market forces (...). Thanks to improved productivity, agricultural production increased, despite the outflow of workers.*

*(...) In 2013, farms with an area of over 100 hectares employed 3% of all workers in agriculture, while producing 16% of the value<sup>3</sup>.*

Indeed, the problem of inefficient agriculture based on smallholding farms had been present at least since the beginning of transformation as a heritage after the Polish People's Republic. Politically, it is highly difficult to implement reforms in this sector because farmers constitute a very powerful interest group. Nevertheless, some beneficial tendencies took place, which are currently being tested.

In 2018, the share of employment in agriculture was 10.3% – about 2.5 times more than the EU average. To be clear, incentives to keep smallholding farms were present before the passing of a new law. One such incentive are subsidies of over PLN 40 billion per year, among which are subsidies to pensions. Admittedly, there is a strong smallholding lobby against large agriculture in Poland, but keeping small business *small* is also a feature of present policy of the ruling party.

### RESTRICTIONS AGAINST NEW PHARMACIES

The so called "Pharmacy for the Pharmacist" law was supposed to stop the development of chain pharmacies. First, it prevents those who run at least four pharmacies from opening new ones. Second, only when there are less than 3,000 people per pharmacy in the commune and there is no pharmacy within the distance of 1 kilometer from it may a permit to create a new pharmacy in the area may be issued. This means that new pharmacies cannot be established in any Polish voivodship city. Third, a permit is issued only to pharmacists with the right to practice.

The pharmaceutical market had already been overregulated before the passing of the "Pharmacy for the Pharmacist" law. As observed by FOR "[t]he rigid prices of reimbursed medicines make it impossible to

<sup>3</sup> Trzeciakowski, R. (2016) *FOR Communication: Politicians Want to Inhibit the Development of Polish Agriculture*. Available [online]: <https://for.org.pl/en/a/3814.for-communication-politicians-want-to-inhibit-the-development-of-polish-agriculture>



## THE PHARMA- CEUTICAL MARKET HAD ALREADY BEEN OVERREGULATED BEFORE THE PASSING OF THE “PHARMACY FOR THE PHARMA- CIST” LAW

compete on price. The ban on advertising restricts competition and also prevents the introduction of new services in the field of health promotion, prevention, and monitoring. The ban on internet sales limits the availability of medicines, including rural areas. The ban on issuing new permits to entities holding 1% of pharmacies in the voivodship limits competition instead of fostering it<sup>4</sup>. Such measures are, of course, beneficial to incumbents, but, at the same time, harmful to their challengers and – what is even more important – to customers (patients).

Despite the fact that the new legislation was introduced, it applies only to new pharmacies, so the already existing ones will keep running, unless they change location. On the face of it, it serves to protect small and independent but inefficient

pharmacies from the competition of big and efficient chains. However, according to a FOR analysis, “the foreclosure of pharmacy market will make independent pharmacies and small networks never grow”<sup>5</sup>. Thus, it is a yet another measure to make an overregulated market even less contestable with the negative impact on challengers and customers.

The effects of the new law can already be seen. According to the recent study by Grant Thornton<sup>6</sup>, in 2018, the quantity of pharmacies in Poland dropped by 458 establishments (or 3.1% of the total of 14,911 pharmacies) as compared to a year before. Earlier, the number of pharmacies had been growing steadily every year – at least since 2001 (which was the first year taken into account by the study). Moreover, Grant Thornton predicts that in 2019 the number of pharmacies will drop by another 400<sup>7</sup>. As the study shows, the hitherto drop is due to a lower number of newly-opened pharmacies.

### BAN ON SUNDAY TRADING

The ban on Sunday trading came into force on March 1, 2018. Until the end of the year trading was allowed on two Sundays per month, and 2019, only on one Sunday per month. Beginning in 2020, the shops will be open only on seven Sundays per year.

There were two rationales for introducing the ban. First, the sponsors of the law (the “Solidarity” trade union) wished to secure free Sundays for retail workers. It could be partially accomplished with the change of

<sup>4</sup> Trzeciakowski, R., and K. Wąsowska (2016) *Analysis 20/2016: Pharmacies for Pharmacists – Contrary to the Interests of Patients and the Constitution*. Available [online]: <https://for.org.pl/en/a/5024.analysis-20/2016-pharmacies-for-pharmacists>

<sup>5</sup> Ibid.

<sup>6</sup> Grant Thornton (2019) “*Apteka dla aptekarza*” *wywołała rewolucję w branży*. Available [online]: <https://grantthornton.pl/publikacja/apteka-dla-aptekarza-wywolala-rewolucje-w-branzy/> [in Polish]

<sup>7</sup> Ibid.



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the Labor Code guaranteeing, for example, two free Sundays for all employees. The ban on Sunday trading granted a privilege to retail workers but did not apply to employees from other branches – for instance, those working in restaurants or gas stations.

Second, the intention was to promote small family-owned stores. This is why over thirty exceptions to the ban were introduced. Many of them were formulated imprecisely, which allowed some retail chains to operate on Sundays, funnily enough, post offices were exempt (e.g. Żabka and Freshmarket chains). Now, the ruling party is trying to patch the law by

extending the ban on those stores<sup>8</sup>.

After almost a year with the law being in force, the tendency of small shops disappearing from the market has not reversed. It has not even stopped. Many customers buy on Saturdays in advance, and the operating costs of big chain stores (supermarkets and discount stores) decreased because of free Sundays. The revenues of discount stores and gas stations increased, while those of small shops decreased<sup>9</sup>. It is another anti-market regulation that was aimed to help some groups at the expense of their competitors and customers. The goal of aiding small family-owned shops was not attained, and there is no reason to privilege some workers.

#### SMALL CIT FOR SMALL TAXPAYERS

A very interesting example of a reform colliding with government's declaration to help develop various businesses is the so-called "small CIT" for small taxpayers. To obtain the status of a small taxpayer, a company has to be either newly established, or show a revenue up to EUR 1.2 million in the previous fiscal year. In such a case, it will pay corporate income tax according to a reduced rate of 9%. In other cases, it will pay the standard rate of 19%.

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<sup>8</sup> Wachowiec, P., and M. Zieliński (2019) *FOR Communication 1/2019: Amendment to the Law on the Prohibition of Trade on Sundays: Superficial Corrections to a Bad Law*. <https://for.org.pl/en/a/6482.for-communication-1/2019-amendment-to-the-law-on-the-prohibition-of-trade-on-sundays-superficial-corrections-to-a-bad-law>

<sup>9</sup> Biuro Analiz Sejmowych (2018) *Ocena prawnych skutków regulacji zawartych w poselskim projekcie ustawy o uchyleniu ustawy – o ograniczeniu handlu w niedziele i święta oraz w niektóre inne dni (druk sejmowy nr 2423); Ocena skutków regulacji poselskiego projektu ustawy o uchyleniu ustawy o ograniczeniu handlu w niedziele i święta oraz w niektóre inne dni (druk sejmowy nr 2423)*. Available [online]: [http://orka.sejm.gov.pl/rexdomk8.nsf/0/895F7128601895AEC125835A003913E1/%24File/i2876\\_18.rtf](http://orka.sejm.gov.pl/rexdomk8.nsf/0/895F7128601895AEC125835A003913E1/%24File/i2876_18.rtf) [in Polish]



MANY CUSTOMERS BUY ON SATURDAYS IN ADVANCE, AND THE OPERATING COSTS OF BIG CHAIN STORES (SUPERMARKETS AND DISCOUNT STORES) DECREASED BECAUSE OF FREE SUNDAYS

Noteworthy, the government has not introduced typical tax progression, but instead introduced two flat income taxes depending on revenue. As a result, when a company does not pay to increase the scale of operation, a gap emerges. Simply put, in the case of an enterprise that has constant return on sales of 5%, if it has a revenue of EUR 1.2 million, it earns a gross income of EUR 60,000. After paying CIT of 9%, the company receives EUR 54,600 in net profit. But if it exceeds the revenue threshold by only 1 euro, it would have to pay 19% from its whole gross income next year. Assuming that the aforementioned company will not increase its operations in the next year, it will get only EUR 48,600 in net profit. It is an obvious disincentive to grow, which is even stronger when a company cannot know exactly what its future revenue will be (and

it is always the case because of market uncertainty).

Furthermore, such a measure discriminates against companies with low return on sales but high revenue. This does not mean that such enterprises are inefficient, because they can still show high return on equity because of high turnover. Nevertheless, the threshold of EUR 1.2 million in revenue may be too low for them to benefit from the small CIT. The last thing is that small CIT creates an incentive to divide operations between many entities with small revenue.

### “BUSINESS CONSTITUTION”

As a remedy for overregulation in Poland, the government introduced a new law on economic activity, the so-called “Business Constitution”, dubbed by the lawmakers “the most important reform of Polish economic law for almost 30 years”<sup>10</sup>. Supposedly, the most relevant feature of “Business Constitution” is that it states many general rules of economic activity, for example that “everything which is not forbidden is allowed” (Article 8 of the Law of Entrepreneurs<sup>11</sup>).

The very construction of this rule (along with other general, similarly vague, rules) results in the fact that it cannot be applied in cases regulated by other, more specific, rules that prohibit something. Thus, it cannot reverse aforementioned regulations. In fact, such a rule was in force earlier, as it stemmed from the Polish Constitution (and so is the case in every liberal order). Its application by courts and state

<sup>10</sup> Ministerstwo Przedsiębiorczości i Technologii (2018) *Konstytucja biznesu i inne zmiany prawne dla firm*, p. 7. Available [online]: [https://www.mpit.gov.pl/media/56139/Broszura\\_o\\_KB.pdf](https://www.mpit.gov.pl/media/56139/Broszura_o_KB.pdf) [in Polish]

<sup>11</sup> Ustawa z dnia 6 marca 2018 r. – Prawo przedsiębiorców. Available [online]: <http://prawo.sejm.gov.pl/isap.nsf/DocDetails.xsp?id=WDU20180000646> [in Polish]

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AS A REMEDY FOR OVER-REGULATION IN POLAND, THE GOVERNMENT INTRODUCED A NEW LAW ON ECONOMIC ACTIVITY, THE SO-CALLED “BUSINESS CONSTITUTION”, DUBBED BY THE LAWMAKERS “THE MOST IMPORTANT REFORM OF POLISH ECONOMIC LAW FOR ALMOST 30 YEARS”

offices was and still is restricted by a myriad of detailed regulations, which in the legal system take precedence over general rules.

Another issue beside overregulation that

jeopardizes the growth of companies in Poland is legal uncertainty. And this problem was also to be remedied by “Business Constitution”, which introduces some rules of lawmaking. But in fact, it was the ruling party that added to the poor quality of law. As FOR stressed, “the current legislative practice of the PiS government, which is characterized by hasty adoption of important legal acts, abuse of the deputies’ legislative initiatives, poor regulatory impact assessments, and unjustified shortening of the duration and a lack of transparency of public consultations. In this situation, it rings hollow when the PiS government, having reduced unprecedently the quality of law-making, announces that its bill will introduce high standards of the legislative process in business law”<sup>12</sup>. Unfortunately, the new rules of lawmaking are too vague to solve the problem. It seems that such rules can be easily bypassed, when the political will to liberalize economy is lacking<sup>13</sup>.

## CONCLUSIONS

Despite its declaration to promote economic growth and development of Polish companies of all sizes, the current Law and Justice government introduced numerous bad regulations (a freeze on trade in agricultural land, restrictions imposed on new pharmacies, and a ban on Sunday retail trading) that were intended to promote small companies and not their expansion. However, due to a multitude of factors working in different directions,

<sup>12</sup> Zieliński, M. (2018) Analysis 11/2018: “Business Constitution” – Propaganda Slogans Instead of Real Reform. Available [online]: <https://for.org.pl/en/a/6231.analysys-11/2018-business-constitution-propaganda-slogans-instead-of-real-reforms>

<sup>13</sup> For the general assessment of law-making in Poland, see periodical reports of Civic Legislative Forum at Stefan Batory Foundation. Available [online] [http://www.batory.org.pl/programy\\_operacyjne/przeciw\\_korupcji/przejrzystosc\\_w\\_procesie\\_stanowienia\\_prawa\\_1/obserwacje\\_rzadowego\\_procesu\\_tworzenia\\_prawa](http://www.batory.org.pl/programy_operacyjne/przeciw_korupcji/przejrzystosc_w_procesie_stanowienia_prawa_1/obserwacje_rzadowego_procesu_tworzenia_prawa) [in Polish]





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it is difficult to tell whether this goal was achieved in every case (for example, a ban on Sunday trading did not stop the dropping number of small shops, but still it cannot be excluded that to some extent it confirmed this tendency). Nevertheless, not only do these regulations restrict competition and hamper expansion, but they also hurt long-term prospects of Polish economy.

If we want Polish companies to grow, we need legislation that would not give privileges to small ones and petrify their size. What we need is pro-competitive legislation that would allow market forces to operate and challengers to contest the incumbents, and not specific regulations that make it unprofitable to expand the scale of operations. In case of agriculture, the pharmaceutical market and retail trading there was a space for market reform even before the new regulations were implemented by the current government. And market reform is the direction that should be taken by Poland, if it is to secure its long term growth. ●



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