



Entrepreneurship and the evolution of income distributions in Poland and Russia

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Differences in the evolution of Polish and Russian income distributions in the post-socialist era can be attributed to different rates of entry of new enterprises. Using regional differences during early privatization as instruments to estimate the impact of this entry, we find that a one-standard-deviation increase in the share of the workforce in new or small enterprises increases the share of income earned by the lowest forty percent of the population by 1.4% and by 1.25% in Polish and Russian regions, respectively. Poland's greater success in de novo firm entry contributes to its more equitable income distribution during the transition. *Journal of Comparative Economics* 34 (2) (2006) 338–356. University of Pittsburgh, WWPH 4711, Pittsburgh, PA 15260, USA; Department of Political Science, University of Michigan, 7766 Haven Hall, Ann Arbor, MI 48109, USA.

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1. Entrepreneurship and the evolution of income distributions in Poland and Russia

Income inequality increased in the transitional economies in Central and Eastern Europe and the former Soviet Union (CIS) according to UNICEF (2001) and World Bank (2000). The more

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successful transitional economies in Central and Eastern Europe experienced relatively modest increases in inequality of about 0.05 in their Gini coefficients from 1987–1989 to 1997–1999 with coefficients still at or below the OECD average of 0.31 by the end of the 1990s. In contrast, the CIS countries, which are regarded as having less successful transitions, had average increases in their Gini coefficients of 0.17 during the same period so that, with the exception of Belarus, all of these countries have Gini coefficients well above the OECD average. These observations raise the intriguing issue of whether the relatively rapid and successful creation of a capitalist market economy has a salutary impact on income distribution. In this paper, we investigate the increased inequality by examining the relationship between the rates of creation and growth of new and small private enterprises and the changes in the income share of the bottom two quintiles within regions in Poland and Russia.

Russia and Poland illustrate two quite different transition experiences. Poland's real GDP increased annually beginning with the third year of the transition and exceeded its pre-transition level by the sixth year. According to UNICEF data, the Gini coefficient measuring income inequality increased from 0.28 to 0.33 between 1987–1989 and 1997–1999 in Poland.¹ However, Russia experienced a major contraction from 1991 to 1998 and, by 2003, real GDP was still below the pre-transition level despite significant growth after 1998. Accompanying this fall in income is a considerable increase in inequality. According to the UNICEF data, the Gini coefficient for income increased from 0.27 to 0.47 between 1987–1989 and 1997–1999 in Russia.² We use these contrasting experiences to test propositions about how entry and growth of new small firms is related to changes in the distribution of income. In the next section, we present arguments for why increased small enterprise growth flattens the income distribution and benefits those in the lower quintiles. Section 3 describes the regional variations in income distributions and the size of the small enterprise sector in Poland and Russia. In the following section, we discuss our estimation methods, which recognize the endogeneity of new firm creation and growth, and present the statistical results. In the concluding section, we draw on our comparison of the Polish and Russian experiences to suggest why Poland did not have the large increase in income inequality that occurred in Russia.

2. New firm entry and changes in income distribution

The entry of small enterprises consists of the creation of *de novo* firms, spin-offs from state enterprises, and small scale privatization of state firms. In all three situations, we expect higher rates of small enterprise creation to promote a more equitable income distribution. First, new small enterprises were the sole source of job creation in many transitional economies and offset layoffs resulting from the introduction of hard budget constraints, privatization, and restructuring of state-owned firms. [Bilsen and Konings \(1998\)](#) provide evidence from Romania, Bulgaria and Hungary; while [Jackson et al. \(2005\)](#) demonstrate this for Poland and [Jurjada and Terrell \(2001\)](#) provide evidence from the Czech Republic and Estonia. The wages earned in these jobs increase incomes at the lower end of the income distribution because they are greater than unemployment benefits.

Second, based on the Schumpeterian notion of creative destruction, new small enterprises will exhibit higher productivity than the firms that they are replacing. Using a detailed sample of 24

¹ [Keane and Prasad \(2002\)](#) provide an overview of the dynamics of the income distribution in Poland during the 1990s.

² [Luttmer \(2002\)](#) provides a comparison of the income distributions in Poland and Russia.

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