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PRIVATISATION IN POLAND (1989-1995): ITS ORIGINS, DEVELOPMENT, AND INITIAL IMPACT

Adli Shehadeh Ayed Kandah

A Ph.D. Thesis submitted in partial fulfillment of the requirements for awarding the degree of Doctor of Philosophy.

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Glasgow - August, 1996

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Rediscovering the Market

Economics, as scholarly discipline, dates back to 1776, when Adam Smith of Glasgow University published his pathbreaking book, the Wealth of Nations. Adam Smith's contribution was to analyze the way markets organized economic life and produced rapid economic growth. He showed that a system of price and markets is able to co-ordinate people and businesses without any central direction.

Almost a century later, there appeared the massive critique of capitalism: Karl Marx's Capital (1876-1894). Marx proclaimed that capitalism was doomed and would soon be follow by business depression, revolutionary upheavals, and socialism. In the decade that followed, events seemed to confirm Marx's predictions. Economic panics and deep depressions between the 1890s and 1930s led intellectuals of the twentieth century to question the viability of private-enterprise capitalism. Economists began to apply their model in the Soviet Union in 1917, and by the 1980s, almost one-third of the world was ruled by Marxian doctrines.

In the 1980s, the wheel turned full circle. The capitalist countries of the West and socialist countries of the East rediscovered the power of markets to produce rapid technological changes and high living standards. The most dramatic development occurred in Eastern Europe, where the peaceful revolution of 1989 forced the socialist countries to cast off their central planning apparatus and allow market forces to develop. The fundamental insight of Adam Smith were rediscovered more than two centuries after he wrote the Wealth of Nations! (*Samuelson, P , and Nordhause, W D, 1992: 3*).

To my Mother and Father, Hadil, Majd, Rawan, Razan, Rula, Faris, and Maram.

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Glasgow, August, 1996
Adli Shehadeh Ayed Kandah

ABBREVIATIONS

FER	Fixing Exchange Rate
CPR	Central Parity Rate
EIT	Enterprise Income Tax
PIT	Personal Income Tax
SOAs	State Owned Assets
SBA	Stand-by-Arrangements
GUS	Central Statistical Office (CSO)
POCs	Private-Owned Companies
FJVs	Foreign Joint Ventures
EFTA	European Foreign Trade Agreement
EU	European Union
LDCs	Less Developed Countries
DC	Developed Countries
WSE	Warsaw Stock Exchange
BOP	Balance of Payments
WWII	Second World War
LC	London Club
PC	Paris Club
FDI	Foreign Direct Investment
PAIZ	Polish Agency for Foreign Investment
SPA	State Property Agency
IPO	Initial Public Offering
GATT	General Agreement on Tariffs and Trade
SOEs	State Owned Enterprises
IMF	International Monetary Fund
WB	The World Bank
IBRD	The International Bank for Reconstruction and Development

CSS Classical Socialist System

VAT Value Added Tax

Comecon Council for Mutual Economic Assistance

STCs State Treasury Companies

GDP Gross Domestic Product

SPC State Planning Commission

CPA Central Planning Authority

COMs Council of Ministers

FTO Foreign Trade Organisation

EEC European Economic Community

CPEs Centrally Planned Economies

PZPR Polish Workers Communist Party

WOG *Wielka Organizacja Gospodarcza* (Large Economic Organisations)

TFP Total Factor productivity

DRC Domestic Resources Costs

PPI Producer Price Index

CPI Consumer Price Index

JVs Joint Ventures

NBP National Bank of Poland

MoP Ministry of Privatisation

MoF Ministry of Finance

ME Market Economy

IFC International Finance Corporation

OECD Organisation for Economic Co-operation and Development

NEM New Economic Mechanism

STEs Soviet Type Economy

EBRD European Bank for Reconstruction and Development

CEM Country Economic Memorandum

PPRG Polish Policy Research Group

US$ United States Dollar

Zl	Zloty (Polish National Currency)
Sejm	Polish Parliament
PSL	United Peasant Party
SD	Democratic Party
IT	Investment Trust
HC	Holding Company
JSCs	Joint Stock Companies
SLD	Democratic Left Alliance
MEBO	Management Employee Buy-out
ZCHN	Christian National Union
NIFs	National Investment Funds
SCs	Share Certificates
USC	Universal Share Certificates
MPP	Mass Privatisation Programme
SRP	Stabilisation Restructuring Programme
IDA	Agency for Industrial Development
IVs	Investment Vehicles
MoIT	Ministry of Industry and Trade
KPN	Confederation of Independent Poland
GIfME	Gdansk Institute for Market Economics
SME	Small and Medium Sized Department

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INTRODUCTION

In the mid to late 1980s, the governments of the Central and Eastern European countries started searching for a more efficient economic system. This was due to the fact that, during the 1970s and 1980s, Socialism had lost most of its allure. Compared to what had been achieved in Western Europe, the USA, Japan, and the Pacific Rim after the Second World War, the Socialist countries had fallen far behind[1].

In the late 1980s and very early 1990s, it was reluctantly decided by many of the governmental planners to take the road to a market economy, or what was understood by these governments to be a market economy. This meant that many, but not all, of the barriers that hinder the growth of the market were to be removed. Governmental planners in these countries were initially confronted with two major questions: which approach ('big-bang' or gradual) should be adopted for the transition?, and once a decision about the approach had been made, what should be appropriate strategies for transition?.

Each country adopted a strategy and an approach that has suited its society and economy[2]. Poland, the case chosen here for analysis, adopted a 'big bang', or 'shock therapy' approach[3]. The outcome of that decision, arrived at jointly with the IMF staff and Western experts (especially Sachs), produced a radical transformation programme, later called the 'Balcerowicz Plan' by the media.[4] The Plan had two main components: a stabilisation and liberalisation package, and an institutional reform package.[5] In fact, privatisation was one of the main elements of the institutional reform package. The main concern in this thesis is the element of privatisation, as an economic policy.

1. The importance of the study

The appearance of privatisation on the World's economic policy agenda can be attributed to different reasons. In the developed countries in the early 1980s,

privatisation was inspired mainly by a revival of 'New Right' thinking, that is to say, it was an ideological decision, with issues of economic efficiency assuming a significantly important role later.[6]

In the developing countries, privatisation was linked with the macroeconomic burden of the State Owned Enterprises (SOEs). SOEs were seen by the World Bank (WB) and the International Monetary Fund (IMF) as an important contributory factor to surmounting fiscal imbalances. Financial support directed to SOEs reduced the amounts of funds available for social services, crowded out private sector borrowing, and undermined the development of the private sector.[7]

In the 1990s, following the democratic 'revolutions' and collapse of the Socialist regimes, Eastern European countries adopted *privatisation* as a *central element* in their *economic reform programmes* to transform their economies from socialist, centrally planned to capitalist, market orientated ones.[8]

The popularity of privatisation in Central and Eastern Europe can be explained in a variety of ways. Politically, it was a way for established political leaders to retain their influence in the face of growing disenchantment with socialist economies. Younger generations of economists were enamoured with the allures of economic efficiency, both productive and allocative, promised by traditional market models. Good Socialist enterprise managers and employees may have seen privatisation as a way to secure their continued employment, by advocating increased output, improving product quality and variety, reducing costs of production, improving innovative behaviour, and fostering investment based on - prospective profitability. The IMF and the World Bank staff might have hoped that privatisation could curb the growth of public spending and raise cash to reduce government debts. They argued that this objective can be achieved if the assets of SOEs are sold in the market at more than give-away prices, and if the resulting revenue is not entirely absorbed by the administrative and other costs (transaction costs) associated with carrying out the privatisation. Others, who believe in the Schumpeterian innovative theory, favour privatisation as an economic policy because of its general emphasis on private initiative and private markets as the most

successful route to economic growth and human development. Finally, a large group of Central and Eastern European countries, views privatisation as a way to broaden the base of ownership and participation in a society- encouraging larger numbers to feel that they have a stake in the system. One aspect of this is the attempt to create a new "middle class".[9]

In Poland, small-scale privatisation as an "*unofficial*" economic policy was known since 1988, when the last Communist government of **Rakowski** opened the door to the development of the private sector.[10] However, that kind of privatisation which was termed as '*nomenclature*' was rejected by the public, the first non-Communist government, and some of the interest groups, because it was 'biased' towards the managers of state enterprises, and was held to be 'improper' (See Section Six). But after the collapse of the Communist system, the first non-communist government of **Mazowiecki** adopted privatisation as an integral element in its *economic reform programme*, the "Balcerowicz Plan" of 1989/90, which then became "official" economic policy. At the time, privatisation had been gradually accepted by the Polish people in general, and by various interest groups in particular, for different reasons.[11] Therefore, privatisation as an economic policy has become very important in Poland, and this forms the basis of this study.

Poland is chosen as a case study because it is a front-runner in the process of economic transformation in Central and Eastern Europe. Poland was the first of the ex-Communist countries to embark on a radical economic transformation programme, in which privatisation was a central element of that programme.[12] I believe that the Polish privatisation methods may be taken as models to follow by many economies in other Central and Eastern European countries.

2. Scope of the study

a. Period of study

The study covers the period 1990-95. 1990 is the beginning of the Polish economic reform programme. During the period of analysis, two major sub-periods can be distinguished: first, January, 1990-September, 1993; and second, September 1993-December, 1995. The first period covers the era when the non-Communists were in power, while the second covers the era when the ex-Communists returned to power. This gives us the chance to investigate whether there were changes in the attitudes of the different "*interest groups*" towards privatisation during the two distinct periods.

3. Objective of the study

Since privatisation is such a vast topic, and cannot be treated comprehensively in a single thesis, it is important to spell out what I will not discuss here. I will not discuss the process of privatising the banking system. I will not analyse the process of agriculture privatisation. I will not discuss the involvement of the international organisations in the privatisation process. I will not touch on the socially and politically complex question of restitution of property (or reprivatisation as it is called in Poland) that was nationalised from the 1940s through the 1950s. The concern of this study is Polish privatisation policy concerning only the 8,441 SOEs, excluding the (1,659) agriculture state farms (ASFs). That is to say the main concern of the study is the industrial sector. In addition, I will say little on small-scale privatisation. This study also can serve as a test of privatisation theories/approaches/models in settings for which we have no historical precedents.

The **main general aim** of the study is *to analyse the Polish privatisation process and examine its contribution in creating a market economy in Poland during the period 1990-95.*

4. Methodological and empirical difficulties

The objective of examining the contribution of privatisation in shifting the economy from a Centrally planned system, to a modern market orientated system, involves an attempt to develop some indicators or measurements of the impact privatisation has had on the performance of Polish economy. Researchers in this field face many difficulties. For example, it is a difficult task not only to obtain data on a consistent and comparable basis pre and post-privatisation, but also to define the variables that can be taken as proxies when it comes to measuring the success or failure of the privatisation process; secondly, it is not easy to specify precisely a period that might be considered as "transition"; thirdly, it is difficult to remove the financial effects of balance sheet restructuring, and to measure changes in quality of inputs and outputs[13]; fourth, there is also the difficulty of separating out the effect of ownership changes from the changes in the other elements of the *economic reform programme* (i.e. liberalisation and stabilisation factors). For instance, it is difficult to separate the impact of privatisation on the growth of the private sector and foreign direct investment, from that of other factors that have some effect on the growth of those variables[14].

In the case of Poland, the privatisation process is still ongoing, and only a short period of time has elapsed following the privatisation and corporatisation of the first 1000 enterprises between December, 1993 and December, 1995. Consequently, **only** an ***preliminary assessment*** is feasible at this time.

To deal with these problems, I shall utilise *main approaches* that have been used to assess the privatisation process around the world, but also point to areas of uncertainty in these models to answer some of the questions posed. This remains the area where systematic case studies can assist the researchers to broaden the scope of existing research designs. A review of the existing work shows that **five** main approaches can be used to assess the impact of any privatisation process. Box (1) summarises these approaches:

Box (1)

Alternative Approaches to Assess the Impact of Privatisation

The Approaches	Type of Assessment
1) **The World Bank's Approaches (1992)**	**a)** *The **macroeconomic** impact of privatisation.* Indicators taken are: Investment, output, productivity, economic welfare, diversification. **b)** *The **social** impact of privatisation.* Indicators taken are: employment, wage levels, employment benefits.
2) **The IMF Approach (1988)**	**a)** *The **fiscal** impact of privatisation.* Indicators taken are: revenues, expenditures, external debt.
3) **Vickers' & Yarrow's (1988); Weiss's (1995); Karatas's (1995); Pott's (1995) Approach:**	**a)** *The **microeconomic** impact of privatisation, or the so-called the impact of privatisation on the **enterprise** level.* Indicators taken are: labour productivity, profitability, sales, exports, profit-asset ratios, etc..
4) **Cook's & Kirkpatrick's Approach (1995)**	**a)** *The impact of privatisation on **economic welfare**, using Cost-Benefit Approach.*

Source: ***See Bibliography for complete citation.***

In the specific Polish situation no single approach will be used[15]. Therefore, in this study, I propose an alternative way utilising the first three approaches. The rationale is be both comprehensive and systematic, and capable of assessing some of the questions posed for this research. This approach assesses the impact of privatisation on the ***macroeconomic, social, fiscal and enterprise*** levels. Box (B) is primarily an elaboration on methodology used:

Box (B)

An Approach to Assess The Performance of The Polish Privatisation Process

A. Macroeconomic Level

Indicators taken are: GDP, Investment, productivity, employment, wages, prices, revenues, expenditures,

B. Enterprise level

Indicators taken are: labour productivity, profitability, sales, exports, profit-asset ratio, the new form of corporate governance

5. Sequence of presentation

The study is divided into **three major parts**. **Part One** is on the features of the Classical Socialist System and why it failed (Section One), and (Section Two) the economic features of the Socialist system in Poland (1945-89). **Part Two** is concerned with the theoretical background on economic transformation and the Polish experience in 1989/90 (Section Three), and (Section Four) the new economic system in Poland (1990-95). **Part Three** is on the theoretical background on privatisation (Section Five), the development of the Poland's philosophy on privatisation (Section Six), the statistical and economic results of privatisation in Poland during the 1990-95 period (Section Seven), the impact of privatisation on enterprises (Section Eight), and finally (Section Nine) conclusions and general lessons. The sequence of presentation is as follows:

a. To understand the logic behind the urgent need for a radical economic reform, in general, and for privatisation in particular, in **Section One,** I analyse the main economic features of the Classical Socialist System (CSS) in general, in order to shed some light on the main weaknesses and strengths of that system. Then, I try to answer the old question; "Why did that system fail?". This serves as a general background to my analysis to the main features of Socialist system in Poland during the period 1945-89, in **Section Two.** The main purpose of Section two is to discuss the different economic development stages that Poland has passed through during the period 1945-89, and to highlight the main economic elements of the heritage of the Socialist system in Poland in the late 1980s. More specifically, I focus mainly on the characteristics of the private sector, the sources of output and employment, the effectiveness of the industrial sector in Socialist Poland, foreign direct investment, etc.. The aim is to point out the main factors responsible for the urgent need for a radical economic transformation programme in the late 1980s, in which privatisation was one main element.

b. Since it was decided by the Polish governmental planners to take the road to a market economy, and to adopt privatisation as a central element in the transition process, I investigate in the first part of **Section Three** how economic theories, and the

experiences of other countries, can help in formulating a reasonable economic transformation programme to transfer an economy from a Centrally planned, to a modern market orientated one. In this part, I sketch the most important *economic transformation approaches* that had been proposed by different economists at the start of the transformation process. And analyse the main stabilisation approaches, as well as the experiences of some countries that have gone through similar stabilisation process. In the second part of this section, I investigate how Poland managed to adopt its economic transformation programme of 1989/90, and analyse the main assumptions and components of the programme. In addition, the major economic policy changes are discussed. Here I argue that Poland did not have the guidance that could be gleaned from theoretical economic models. The transformation in Poland happened before other economic reform programmes appeared in 1990. However, the aim is to find out how much the Polish economic transformation programme of 1989/90 resembles other theoretical models and the experiences of other countries that have gone through similar stabilisation process. It is important to discern the role of privatisation as an element in the whole transformation process.

c. In **Section Four**, the main general features of the structure of the *new economic system* that has emerged in Poland during the first six years of the transition period (1990-95) are discussed. Originally, the aim of this section is to investigate the impact of privatisation on the performance of the Polish economy. However, since it is very difficult to separate out the impact of the three elements of the *economic transformation programme* of 1989/90, therefore, one might argue that the impact of privatisation is implicitly included with the other impacts. Whenever possible, I try to divorce the impact of privatisation from other effects. In this section, I try to assess some of the official goals of privatisation that were set by the Polish government. These are: *"Did privatisation process help in creating an efficient market economy?".* More specifically, *"What is its impact on the output?"; "What is its impact on the private sector?"; "What is its impact on the fiscal budget?"; "What is its impact on foreign trade?"; "What is its impact on the capital market?"; and "What is its impact on the labour market?".*

d. In **Section Five**, a theoretical background on privatisation is created. I discuss the meaning of privatisation in Central and Eastern Europe in general, the main issues of privatisation in Eastern Europe, focusing on the overall role of privatisation, the compartmentalisation of privatisation policies, corporate governance and property rights, and finally, privatising large enterprises. In addition, I outline the various privatisation objectives focusing on the declared privatisation goals in Eastern Europe. Then, I outline the main methods and procedures of privatisation from the more radical to the more moderate, and outline their possible advantages and disadvantages in greater detail. Finally, the main constraints to privatisation are analysed. This Section serves as a general framework for my empirical work on the Polish privatisation process in the following sections of the thesis.

e. In **Section Six**, the development of Poland's philosophy on privatisation, from the late 1980s to the end of December, 1995, is analysed. The main proposals that were initiated in Poland during that period are discussed and related to the Polish economic, political, and social set up. Our attention is directed to discern whether there is a change in the attitude of the Polish governments in respect of privatisation policy, and to ascertain the main reasons behind that change. The main questions that are tackled in this section are: (1) "Did Polish privatisation philosophy change in the latest part of the period of the study (September, 1993- December, 1995), in comparison to that at the start of the period of the study- when the non-communists were in power (September, 1989- September, 1993)?. (2) "Why certain privatisation methods were chosen, above others?". (3) "How much the political, social, and economic pressure groups (managers of large state enterprises, workers' councils, and trade unions) were able to shape (or reshape) Polish privatisation philosophy during the period under analysis?".

f. **Section Seven** analyses, statistically and economically, the main results of the different paths to privatisation, focusing at the end, on the *involvement of foreign investors* in the privatisation process. More specifically, the following will be analysed: (1) the number of SOEs under processes of ownership transformation. (2) the number of SOEs which are subjected to ownership transformation by legal path as of September, 1995. (3) the number of State Treasury Companies (STCs) privatised

during the period 1990-95. (4) the number of SOEs privatised through liquidation procedures under Article 37 of the July 1990 law on privatisation. (5) the number of SOEs privatised through bankruptcy liquidation procedures under Article 19 of the law on SOEs of 1981. (6) the extent and scope of foreign investment that entered to Poland through the process of privatisation, by the number of companies, size of investment, origin of investor, type of privatisation, and economic sector. (7) and finally, revenues from privatisation are analysed. The aim of this section is to try to answer the following questions; "Did Polish privatisation policy meet the goals as stated by the successive Polish governments: "speed of adaptation and implementation"; "promoting wider share ownership among the public at large, including employees of enterprises"; and "generating funds for the budget" ?".

g. **Section Eight** discusses the impact of privatisation on enterprise. The main points that I focused on are; "Who are the new owners of the enterprises?"; "Corporate governance and privatisation in Poland"; and finally, on the impact of privatisation on the performance of enterprises, relying mainly on some survey studies done by some Polish institutions, and individual experts. I focus on the issue of whether the Polish privatisation experience does (or does not) support the idea that ownership matters. This is done by comparing the performance of *commercialised* enterprises (*i.e. those which were transformed into companies solely owned by the State Treasury),* as well as

those enterprises that were *completely privatised* through other paths to privatisation (*like capital privatisation - which is the second step after commercialisation*) before and after privatisation. The rationale is to try to find some evidence to assess the magnitude of the *potential gain or loss* from both privatisation and marketisation. In this case, I argue that marketisation has two faces: the first where enterprises are still owned by the state (SOEs) and have access to the government's financial resources, but are operating in a new market environment; the second, when SOEs are transferred into limited liability companies solely owned by the State Treasury (i.e. commercialised), with new administrative and market conditions: new boards of directors, and in most cases new managers, and no workers' councils, and finally 'hard budget constraints'.

The final goal is to try to derive some suggestions for Polish policy makers. The main argument I shall advance here is to proceed, or not, with the second step of 'capital' privatisation, that is 'commercialisation'. The policy recommendation would be to proceed with second step of 'capital' privatisation, if the gains from 'commercialisation' are comparatively small. Or to stop and save time, effort, and money, if the gains from marketisation are big. The importance of the exercise is the fact that capital privatisation in Poland, is the most significant path to privatisation, because it involves numerous large enterprises that have high percentage shares in the Polish economy, measured by their shares in total output, employment, as well as exports. However, the problem is to define the meaning of the gains from 'commercialisation'.

To make the analysis more reliable, a comparison between the performance of privatised enterprises of one specific sector (e.g. construction sector), with the performance of the whole sector (i.e. construction), is done in study number six. This might be the closest available study to what is called "like-for-like" comparison studies.

h. Finally, the study ends by **summarising** and discussing the main **conclusions** and **general lessons** that can be learned from the Polish experience and the theoretical background.

Endnotes:

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[1] This can be seen if one contrasts East and West Germany, which had roughly equal levels of productivity and similar industrial structure at the end of the Second World War. After 4 decades of Communism in the Soviet Bloc, and Capitalism in the West, productivity in East Germany had fallen to a level estimated between 1/4 to 1/2 of that in West Germany.

[2] For example, Russia adopted a step-by-step approach, the Czech Republic chose to adopt shock therapy.

[3] The Polish Approach was much more radical than the approaches adopted in the Czech Republic, the Slovak Republic and Hungary, because of the fact that in Hungary, some economic reforms were taken in the 1980s, while in the cases of the Czech and the Slovak Republics, it was partly because of the lower rates of inflation and less public support for the 'big bang' (*Bryant, 1994:61*).

[4] Balcerowicz, 1990; Sachs, 1990; Rosati, 1991b:21.

[5] Blaszczyk & Dabrowski, 1993; Bryant, 1994:60-61.

[6] Bryant, 1993; Vickers & Yarrow, 1988

[7] Cook & Kirkpatrick, 1995

[8] Duke & Grime, 1994

[9] Frydman & Rapaczynski, 1994; Poznanski, 1992; The World Bank, 1991; The IMF, 1994; Clague, 1992; Balcerowicz, 1990 & 1994; Balcerowicz & Dabrowski, 1993.

[10] Poznanski, 1992.

[11] One should differentiate between the official and public attitude towards privatisation. In the case of Poland, the shift in the official attitude towards privatisation began in the late 1980s, during the Communist government's discussion of economic reform. The government's initial strategy was not to privatise the overall economy; rather, it was to inject competition into the state-run sector. Eventually, however, it proved difficult for state leaders to praise market mechanisms while suppressing the private sector. The government's change in strategy coincided with shifting popular attitudes towards privatisation. A 1984 survey reflected the public's ambivalent attitude toward privatisation: 82% of those responding favoured the introduction of a competitive market economy, but only 50% wanted to expand the

private sector. Social acceptance of privatisation came late in the 1980s, as the government increasingly consented to private sector growth. By 1988, the vast majority of those surveyed supported expansion of the private sector. At the time the public was prepared for some form of economic change. There were mainly two schools of thought: the first believed the change should occur through the introduction of market mechanisms into the state economy; while the second believed that the change should be through the privatisation of SOEs. The fall of Communist from power in 1989 made the second approach the only available option. (*Kolarska-Bobinska, 1994:120-121*). For more details on the attitudes towards privatisation in Poland since the reforms were launched, see Kolarska-Bobinska, 1994, "Privatisation in Poland: The Evolution of Opinions and Interests, 1988-1992", In "*A Fourth Way?: Privatisation, Property, and the Emergence of new market Economies*", edited by, G S Alexander, and G Skapska, (Routledge:London).

[12] Kramer, 1995:72.

[13] Bollard & Mayes, 1991:23.

[14] In the case of Poland, the growth of the private sector has been affected by a number of factors such as privatisation, reprivatisation, reclassification of some economic units by the Central Statistical Office, and the removal of the barriers to entry and exit on domestic and foreign private investors. Therefore, it was difficult to divorce the effect of privatisation on the growth of the private sector from the impact of the other factors.

[15] Because this depends not only on the approach used, but also on who is reading the results: Politicians, Sociologists, Economists, or even the Public. When they assess the performance of privatisation, Politicians concentrate on the change in the structure of the economy and the role of the State after privatisation. Some economists read the impact in the short run: high rates of inflation, and reduction in the growth rates of the GDP, the appearance of the unemployment phenomenon. Others wait and assess the whole privatisation process on the medium and long terms: high growth rates of investment and the GDP and the attraction of foreign investment. Sociologists read the results starting with unemployment, social security benefits, and deterioration of real wages.

PART ONE: THE FEATURES OF THE CLASSICAL SOCIALIST SYSTEM AND WHY IT FAILED, AND THE ECONOMIC FEATURES OF THE SOCIALIST SYSTEM IN POLAND (1945-89)

SECTION (1) THE ECONOMIC FEATURES OF THE CLASSICAL SOCIALIST SYSTEM AND WHY IT FAILED

The main purpose of this section is to examine the general features of the economic structure of the Classical Socialist System[1] (CSS), and to try to answer the question; "Why did the CSS fail?." This enables us to have a better understanding of the main weaknesses and strengths of that system, and, at the same time, serves as a general framework for our discussion on the Polish Socialist System during the period 1945-89, in the next section.

1. The economic features of the Classical Socialist System

The general economic structure of the CSS can be reduced to four fundamental elements; (1) social ownership of the means of production; (2) concentration of power in the Communist party; (3) central economic planning; (4) and finally, socially-equitable distribution of national income.[2]

a. Social ownership and concentration of power

In the CSS, the nominal owner of the means of production is the state, represented by the national government. However, other forms of property exist when the enterprise is owned by a regional organisation of the state in federal countries, a national or provincial government, or a county, city, or village council.[3]

One of the most important property forms is the bureaucratic State Owned Enterprise (SOE). Another form of state property is the co-operative, especially in the agricultural sector. In most countries, the classical agricultural co-operative is exclusively a production and sales co-operative[4].

Under the pure form of CSS, private firms employing hired labour either do not exist, or are restricted to a small segment of the economy.[5] The almost total elimination of private capitalism is precisely what the official ideology considers a major, or even the criterion of socialism. Only state and co-operative ownership are recognised ideologically as socialist. However, there were a variety of private forms (and partly related to them; production activities of a private nature), although they are dwarfed by the state and co-operative sector. Among these private forms, the most notable are small-scale private industry and commerce, household farming, and the informal private economy (such as production or service activity performed by one individual for another for compensation in money or kind; production and marketing of foodstuffs by those where full time job is not agriculture; subletting a privately owned or rented dwelling; trading activity outside the framework of state-owned; and co-operative and officially permitted private commerce)[6].

The unique feature of the CSS was that the central power, represented by the Communist Party, used to intervene from above artificially, by means of legal regulations, in the development of society, to decide that a market co-ordination should vanish, or at least be confined to insignificant positions, and replaced by centralised bureaucratic co-ordination. This was carried by the central decisions of power, and by fire and sword. It was then followed by numerous on effects (concomitants) that arose spontaneously without any central decision expressly being taken: the atrophy of self-governing forms, the dwindling of enthusiasm for family and community life to a subordinate role[7].

b. Co-ordination[8] Mechanism

Under the heading of co-ordination mechanism, I discuss the main features of the CSS in association with planning, production and growth, consumption, investment, money and banking, pricing, profit, state budget and fiscal policy , domestic and foreign trade, and finally, labour and wages.

1. Planning

The term 'planning' had a very broad meaning in the former Socialist countries. It is defined as "the system of managing economic processes involving production, investment and consumption. Its essence consists of determining economic targets and the methods of their implementation, in particular the allocation of the means of production and of labour to different uses. As such, planning is an instrument of economic strategy to achieve the optimum growth of national income or the maximum satisfaction of social needs"[9].

The system presupposed the existence of a central planning authority, usually known as the State Planning Commission (SPC), whose chairman was a member of the Cabinet. The main responsibilities of the SPC were; (1) determination of the criteria of economic calculation underlying planning decisions; (2) determination and quantification of the targets to be reached in the planned period; (3) co-ordination of the targets to ensure the internal consistency of the plan; (4) determination of appropriate methods to ensure plan fulfilment; (5) and finally, current revision of targets according to changing conditions[10].

The intellectual forerunners of the CSS saw planning as one of socialism's great advantages. The details of the plan were naturally worked out in close collaboration with the different ministries. The role played by the operational level (enterprises and branch associations) differs according to the degree of centralisation. In the extreme case of 'hierarchical' planning, the plan was simply imposed from above by the SPC, and the different administrative organs and individual economic units had no influence on the plan (beyond supplying basic information to higher authorities)[11].

The national economic plan was used to cover every aspect of activity in the economy. Under the CSS, implementation of the plan was compulsory. The most difficult problems facing planning were motivation of leaders in the economic bureaucracy, inner conflict and the problem in information flow[12].

Therefore, one can understand that under Socialism, the market mechanism was superseded to varying degrees by planning. Markets for the means of production in the socialised sector were virtually eliminated. But elsewhere, markets never completely disappeared, and even under Stalinist 'command' planning and administration they had to be tolerated. They had always existed for certain consumer goods and services, such as privately grown produce, fish and wild animals caught privately, services and articles made by tradesmen in their spare time and placed in local markets at (relatively) free prices according to local supply and demand.[13]

In fact, the extension of the role of the market in a planned economy was justified on three major grounds; the **first**, being based on **Marxian** ideas, Socialised economies had traditionally concentrated on macroeconomic issues, but they have failed at the microeconomic level. A substantially free operation of the market mechanism was a device to overcome the undesirable consequences of central planning in the micro sphere of production and consumption not lending itself to remote central control in order to produce the best results. The delegation to the market of the working out of microeconomic details also relieves central planners of unnecessary routine work, so that they can concentrate on long-term macro problems. **Secondly**, the market mechanism was necessary for the continuous verification and correction of planned decisions. **Thirdly**, the market provided a salutary discipline in the form of competition, so that production and distribution were constantly being adapted to buyers' preferences, and carried out in the most efficient manner. Lack of competition contributed to the persistence of sellers' markets, noted for shortages and inflationary pressure, a low quality of products and services, a weakening of incentives, speculation and various other abuses. In brief, the Socialist economic system which was almost completely governed by the market mechanism is known as *market socialism*- an idea put forward by **Oskar** Lange (of Poland) in the Thirties- and developed and improved by such economists as **Brus** (of Poland), **Erdos** (of Hungary), **Kaganov** (of the former USSR), **Sik** (of the former Czechoslovakia), and **Sirotkovich** (of the former Yugoslavia). During the Communist era, market socialism was adopted only in Yugoslavia and Hungary[14].

To sum up: in the advanced stages of the Socialist economic development, the majority of economists agreed that whilst economic planning must be retained, an extension of the role of the market was possible, indeed imperative, as it can[15]: (**i**) ensure adaptation of production to buyers' needs and thus lead to the development of buyers' markets; (**ii**) evolve and maintain rational price structures conducive to the optimisation of production and distribution; (**iii**) create conditions for rapid technological progress; (**iv**) and finally, accelerate growth in labour productivity[16].

2. *Production and growth, investment (accumulation), and consumption*

a. Production and growth

According to the official classification of the CSS, material production fell into six major divisions: industry, construction, agriculture, transport, trade, and other material production. Of course, this list indicates the descending order of importance attached to the different branches of the economy. The classification of industry was broadly understood. It includes mining, quarrying, and manufacturing. Forestry, fishing, hunting and gathering were also 'productive'. They might be included under 'industry' or 'agriculture', or sometimes treated as separate divisions, or included in the last (residual) division[17].

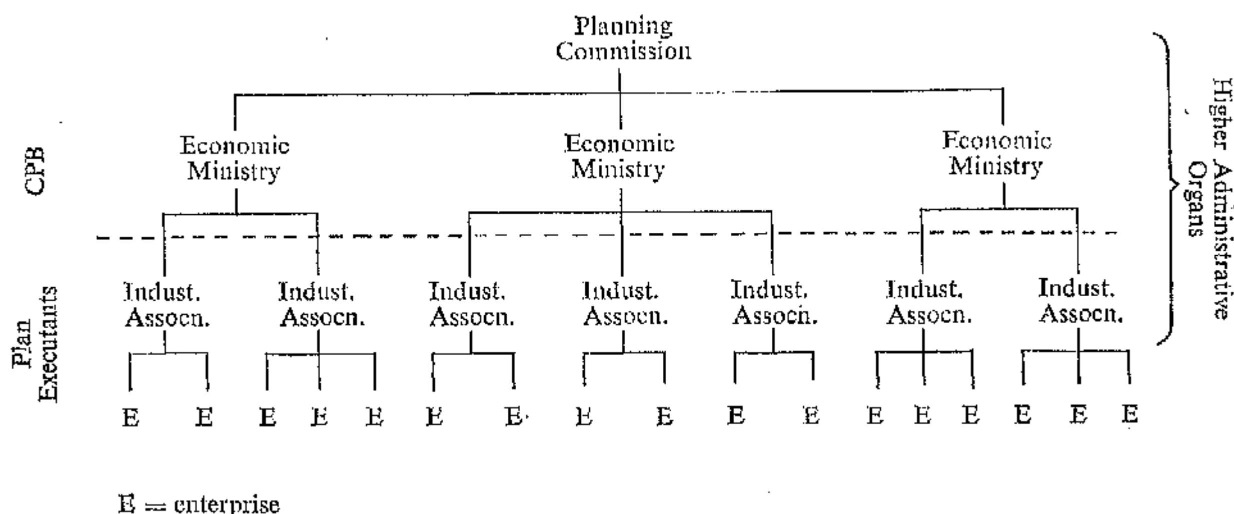
The remaining forms of activities constituted the 'unproductive sphere'. These are usually classified under eight groupings: (**i**) public administration and justice; (**ii**) education, science and culture; (**iii**) health, social welfare and culture; (**iv**) finance and insurance; (**v**) local government and housing administration; (**vi**) defence; (**vii**) political, social and religious activities; (**viii**) and other services[18].

In former Socialist economies, national income was calculated to comprise material production only, and was based on: (**i**) *net* value of production, i.e. excluding depreciation; (**ii**) *domestic* production, i.e. as attained within the country, irrespective of who ultimately received it; (**iii**) *realised* prices (not factor cost), i.e. including indirect taxes (called 'turnover taxes') but disregarding subsidies[19].

The economic administration in the former Socialist countries was centralised, in spite of considerable decentralisation attempts associated with the reforms during the history of the Socialist system. Typically, five levels of administration can be distinguished: the Council of Ministers; the State Planning Commission; economic ministries; 'intermediate' administrative bodies (branch, or economic associations, regional authorities); enterprises (including workshops, farms, etc.). The *Council of Ministers* (the Government) was responsible for carrying out the general goals laid down by the Communist Party. The *State Planning Commission*, in addition to working out the national plan, was also responsible for determining the channels of its implementation, and the rest was then left to the respective economic ministries. Hence, the role of the government in any former Socialist country was much greater than in a market economy. *Intermediate administrative agencies* assumed different forms- 'industrial branch association' (in Czechoslovakia, East Germany, Hungary, Poland, and the former USSR), 'industrial associations' (in Romania) or 'economic associations' (in Bulgaria). In Poland, 'agricultural circles' played an important role in the countryside. *Productive enterprises* can be conveniently divided into six categories: state industrial and trading enterprises; co-operative enterprises; state farms; collective farms; agro-industrial undertakings; and the private sector[20].

Figure (1.1)

Levels of Administration in a Typical CSS



Source: Montias, 1962:28.

The most characteristic features of the Socialist rates of growth were likely to embody an upward bias. That is very clear because, first, the success of the enterprises was largely judged by the targets attained and overfulfilled. The management, in providing statistical returns, had a vested interest in overstating production achievements. Secondly, targets were usually defined in quantitative terms. The poor quality or even sheer uselessness of some production was not reflected in the rates. Moreover, there is a general agreement amongst a large number of Western economists (such as Bergson, Campbell, Cohn, Kaplan, Nove, and Nutter) that the official socialist growth rates were exaggerated[21].

b. Investment (accumulation)

Under the CSS, the investment process was far more strictly centralised than day-to-day production. The national economic plan of any country distributed investment funds among the various ministries in the course of the planning and decision-making process. The investment rate was not a product of micro decisions dependent on anticipated demand and profitability, but was determined by the central authority in advance. The rate of economic growth in a given period of time depended on the investment made in the preceding period, and its efficiency. In former Socialist countries, the role of investment in economic growth was very high and direct.[22]

Some priorities in the allocation of investments were applied. These are the following: (1) priority of investment good: the sectors developed are primarily those that directly cause an increase in fixed capital, that is, the production of investment goods. (2) priority of domestic production over imports: the development of the sectoral structure is stamped by the pursuit of autarky. (3) priority of the production sphere: a distinction was made in Marxian political economy between "productive" and "non-productive" activity, as explained above. The productive sphere must have an investment advantage over the non-productive, in other words, the production of material goods over services. (4) priority of class-one production: Marxian political economy made a further important distinction, between class-one and class-two production. The former created the means of production and the latter consumer goods. The priority: class one must enjoy an investment advantage over class two. (5) priority of industry: industry was considered to be the engine of growth. The strategy of forced growth primarily meant fast industrialisation. The priority: industry must have an investment preference over all other branches of the economy. (6) priority of heavy industry: the industrialisation preference must be given primarily to heavy industry, and within it to machinery and steelmaking. (7) priority of the arms industry: the investment demands of the armed forces, including both the army and the police, receive unconditional priority over civilian development tasks. The establishment of factories for purely military purposes received particularly close attention when investment funds were allocated. (8) priority of new installations. Moreover, there were other types of priorities concerning the

development of the microstructure. These are priority of new installations; priority of big installations; and products and investment projects.[23]

c. Consumption

Under Socialism, consumption was centrally planned in advance, because it constituted an integral part of the national economic plan. In working out the consumption model, the Central Planning Authority (CPA) made a distinction between the preferences of consumers in their capacity as private individuals and as members of society. The CPA endeavoured to meet consumers' private preferences up to the point where they did not interfere with the interests of society. When that conflict arose, the CPA would make value judgements, usually in favour of the long-term interests of society as a whole, in accordance with the principle known as the *primacy of macrosocial preferences.*

When it came to the realisation of the plan, the CPA might find either that it had gauged consumers' preferences incorrectly, or that some unexpected developments had occurred on the production side. In such cases, three options were open to the authorities; (1) no attempt was made to restore equilibrium in the consumer goods market by changing either demand or supply, which could lead to either shortages or rationing. (2) steps were taken to adjust demand to the existing supply by the process called *consumption steering.* (3) supply was adjusted to demand, by the CPA providing for larger stocks of finished goods and raw materials, creating excess capacity through additional investments and perhaps allowing more imports of consumer goods[24].

Under Socialism a good deal of importance was attached to the distinction between 'private' (or individual), and 'social' (or collective) consumption. Private consumption consisted of those goods and services which were purchased out of the consumer's own earnings on the basis of free choice. Social consumption included public child care, education at all levels, health benefits, pensions, housing, communal feeding, special holidays, transport, entertainment and cultural services. What is interesting to note is the fact that these benefits were provided completely free, or at charges well below

actual costs, on a far wider scale than even in the most affluent Western countries. Social consumption was financed from the state budget, and social insurance funds, communal resources and enterprises' and farms' profits were earmarked for the purpose.

The role of the consumer in the economy could be judged by the extent to which he used to influence production. In an extreme case of centralised planning, consumption patterns were simply imposed on the consumer from above by means of specific, non-transferable, fixed-period validity rationing. Under such conditions, there was no consumer's choice and it was the planners who were sovereign. Absence of consumer choice was usually associated with tight, centralised command planning . This situation existed in the former Socialist countries up to the early 1950s. After that a liberal form of consumer's free choice existed. Under the new form, the CPA had to exercise a dual system of control. This assumed the form of a two-tier price system, whereby producers' and retail prices of consumer goods could move independently. Thus the price received by producing enterprises could be manipulated to regulate profitability, and consequently production, whilst retail prices were regulated to influence consumption. By this insulation, production did not necessarily have to respond to consumers' preferences, unless the CPA decided otherwise. Hence, planners could ensure equilibrium on the market. The deviations of retail from producers' prices (apart from trade margins to cover distribution costs) was an indication of the extent to which the CPA controlled consumption, by manipulating retail prices rather than allowing them to respond to consumers' changing preferences. It must be mentioned, however, that there were some prices of consumer goods which were 'free' prices, determined in the market according to supply and demand[25].

3. *Money and banking*

a. Money

The formal feature of the CSS is that it was a monetised economy, but in fact it was a semi-monetised system, since the role of money in the economy was weak or secondary. Traditionally, the Marxists have always been negative about money, largely a reaction against Capitalism, where money reaches its peak of development and influence. Two distinct spheres of monetary flows can be distinguished: a 'passive' one and an 'active' one. In all of the transactions between enterprises and all government units cash was not used. All government units must hold accounts at an allocated branch of the state banking system, so their accounts were automatically debited and credited, as was decided by the plan. This type of transaction was called 'passive' money. Whereas, all cash payments from the state sector to the population in the form of, for example, wages, salaries, payments for agricultural procurements and taxes, were termed 'passive' money spheres[26].

The overall objective of the monetary policy was to provide a financial basis conducive to plan fulfilment and monetary equilibrium in the economy. Before reforms, the scope for monetary policy was pretty limited, as money performed a passive function. Under the new system, basic proportions in the economy were still centrally determined, but otherwise, enterprises had a good deal of freedom in deciding on the details and methods of fulfilling the plan. Directives and prohibitions were largely replaced by financial incentives and disincentives administered flexibly by monetary authorities. The most important financial instruments consisted of differentiated credit terms, which affected enterprises' profits and consequently incentive payments to their personnel[27].

b. The banking system

The banking system was entirely owned by the state. It consisted of several organisations: the central bank, and various specialised banks (such as investment bank, a foreign trade bank, a savings bank for the public). Although the specialised banks

were nominally independent, they received instructions from the central bank; in effect operating as its agents. The overall banking policy in the former Socialist country was laid down by the Ministry of Finance in close co-operation with the State Planning Commission and the State Bank[28].

The banking system in formerly Socialist economies could not pursue its activities independently, and the banking operations were subordinated to the needs of the economic plan, in which the overall and major structural developments were predetermined. In fact, the banking policy was in a sense a powerful weapon, because there was no short-term money market, no stock exchange and no 'fringe' banking institutions (hire purchase companies, personal loan establishments, development financiers, building societies, etc.). All these functions were performed by the banking system, and regulation provided an air-tight control over the flow and distribution of finance[29].

Under Socialism, economic development was never allowed to be hampered by a lack of finance. If there were physical resources available and if the production was socially desirable, it went without saying that the means of financing would be provided. The economic plan had a counterpart in the credit plan, which was worked out by the central bank in co-operation with other banks. The total amount of credit and the proportions allowed to different branches were centrally fixed according to the planned needs of the economy. But the microeconomic distribution was left to the judgement of the banks and enterprises concerned. Loans were extended on the conditions of good management, and the soundness of the purpose for which credit was sought[30].

A distinction was made between short-term ('turnover' or 'production') and long-term ('investment') credits. Short-term credits, particularly on commodity turnover, were not as important as in capitalist countries. Trade credits on commodity turnover were extended only by banks, not by the selling enterprises. Consumer credit, which was extended only by savings banks and consumer co-operative shops, was as yet of smaller importance than in the Capitalist countries. To ensure financial discipline, banks had considerable powers of control over the users of banks funds. In cases where credits

were not applied for the approved purpose or the project was not completed on time, or if credits were not repaid on maturity, banks could apply some kind of sanctions. They could charge penalty interest for the period originally approved; require the repayment of the credits before maturity; withhold the funds for wage and salary payments, especially for material incentives; and refuse credits in the future[31].

4. Pricing

The philosophy of Socialist prices was based on the Marxian concept of value, i.e. the cost of live and materialised labour plus a micro-social mark-up proportional to prime costs. Therefore, rent, interest (to some extent), utility and scarcity, as well as fluctuations in supply and demand, were not considered as contributions to value. The actual price fixing was highly centralised in each country in the hands of the State Price Planning Commission, with the most crucial matters of pricing reserved for the Council of Ministers[32].

Prices were set by the authorities according to certain specified principles. These principles are the following: prices must reflect the socially necessary costs; they should be the means by which the economic management encourages producers to perform specific tasks; they ought to be stable to maintain the purchasing power of the incomes of the individuals; they must be set so as to influence the demand of the population in the way those running the country consider desirable; the determination of consumer prices should be used for the purpose of income redistribution[33] (i.e., there should be special taxes to raise the prices of luxury goods, while prices of basic goods should be lowered through subsidies)[34].

In each former Socialist country there was a two-tier price system; producers' (or wholesale) prices and retail (consumers') prices. Producers' prices were, as a rule, based on the 'average cost of production' of the branch of industry. But these costs did not include rent and capital charges. Moreover, these prices were fixed in advance before the desired combination of resources and the structure of production were worked out in the plan, and they remained fixed for long periods. The prices for

agricultural products payable by the State differed according to 'compulsory' and 'above-compulsory' deliveries, and were further differentiated according to regions. In the construction of the central plan, the allocation of resources was not guided by prices, but by material balances expressed in physical terms.

Retail prices usually bore little relation to producers' prices, as the overriding objective in fixing the former was to ensure an equilibrium in the market for consumer goods by adjusting demand to the planned supply. Even the same product was often assigned different prices according to the type of article, its purpose and the class of user. In effect, the prices of retail consumer goods were insulated from producers' prices by substantial and highly differentiated turnover taxes or subsidies. Consequently, consumers' preferences had hardly any influence on the size and structure of production until they were acknowledged by central planners prepared to make appropriate adjustments to producers' prices and the allocation of resources.[35]

Under Socialism, the stability of prices was considered favourable. Up to about the mid-1960s, Socialist price systems were rigid. The prices of producer goods remained unchanged for long periods, usually five to ten years, and even the retail prices of the most important items entering the cost of living were not changed frequently. However, to meet the challenge of intensive growth, the former socialist countries have introduced some elements of price flexibility.[36]

In their trade with the Capitalist countries, former Socialist countries normally used the prices prevailing in world Capitalist markets, and transactions were carried out in Western currencies. In individual cases, however, prices were often negotiated, and they might depart considerably from current world market prices. In intra-Socialist foreign trade up to 1958, there was no systematic basis for determining prices. They were negotiated between trading partners, but apparently used only for reference. In 1958, the member countries of the Council for Mutual Economic Assistance adopted what has come to be known as the 'Bucharest Agreement'.[37]

5. *State Budget*

The State budget in Socialist countries differed from that of the capitalist system in the formal features of the items, rather than in their relative size. The main items of expenditure were: administration, the armed forces, state investment, subsidisation of firms, subsidisation of consumer prices, and financing of free public services. Whereas, the main items of the revenue side were : the revenue generated by SOEs; tax payment by co-operatives; taxes paid by individuals, and loans by the budget.

Under the CSS, 'soft budget constraints'[38] were applied. In this case, if a SOE's spending exceeded its budget constraint, the constraints would be adjusted to a repeated overspending. This enterprise received regular external assistance, like soft taxation, soft credit, and soft administrative pricing[39].

The Socialist budget performed three basic functions: (1) the control and co-ordination of physical economic processes through financial discipline, (2) the promotion of economic activities through fiscal incentives and disincentives to achieve the targets postulated in the economic plan, and (3) the redistribution of national income in conformity with the 'law of planned proportionate (or balanced) development' of the entire economy.

The importance of budgetary planning under Socialism derives from the size of the budget and its focal position in relation to different facets of the economy, and from several peculiarities of the economic and social conditions: (1) because of the direct participation of the State in the economic and social life of the country, the scope of the public finance was naturally great. (2) the State budget is a financial expression of the economic and social tasks laid down in the overall economic plan. The budget was the key element in economic planning and growth, and it linked the requirements of the plan with the production and financial plans of the enterprises. The plan and the budget would be worked out simultaneously (by the State Planning Commission and the Ministry of Finance respectively) and would be presented to Parliament annually at the same session. (3) the importance of the budget was further enhanced by the fact that it was integrated with other financial plans, viz. the cash plan, credit plan, personal wage

fund, and the financial plans of the enterprises. (4) the role of the budget had been increased after the introduction of the reforms, where directives had been largely replaced by sophisticated forms of fiscal and financial instruments. On the other hand, the new emphasis attached to self-financing and bank credits as sources of enterprises' ways and means had tended to reduce the proportion of funds passing directly through the State budget.[40]

6. External economic relations

Under the CSS, all kinds of foreign trading activity were a state monopoly, and firms were strictly forbidden to have direct relations with their partners abroad. The exclusive right to conduct import and export transactions and maintain relations with foreign partners belonged to specialised organisations, in most countries the so-called Foreign Trade Organisations (FTO). Each corporation usually had the exclusive right to export and/or import a defined class of goods[41].

Regarding exchange rates, all the Socialist countries administered multiple exchange rates-up to seven different rates. In addition to the official basic rate(s), there was usually a tourist rate(which might be further differentiated according to the currency area and the amount of the foreign currency exchanged) and a remittance rate (hard currency transmitted to private persons in the Socialist country in non-commercial transfers). All these rates were unilaterally fixed by the government, and they still differed from an equilibrium rate (i.e. the black market rate)[42].

The only tangible step towards integration between the classical Socialist countries was the establishment, in 1949, of the Council for Mutual Economic Assistance (COMECON). Through this agreement each member of the COMECON countries had bilateral clearing accounts with the other members of the COMECON. These accounts, together with the policy of state monopoly of foreign trade, guaranteed the relative equilibrium of the BOP on current accounts in each individual country[43].

7. Labour and wages

a. Labour

Labour was less subject to directive planning than other facets of the Socialist economy. Generally speaking, economic planning was compatible with the individual *freedom of the choice of carrier and of the place of work.* Moreover, Socialist countries have traditionally been committed to continuous *full employment.* The concept of *full employment* under Socialism lacked precise definition. In the 1950s and the early 1960s, it was generally assumed that the only unemployment that can be tolerated was of the frictional type, which owing to economic planning should not exceed 1% of the total work force- compared to 2-3% in the Capitalist countries. In the late 1960s, many Socialist economists (such as Fick, 1969; and Laski, 1966), especially in Poland and the former Yugoslavia, have argued that optimal employment was in fact below maximum employment, as the latter might in fact lead to lower national income.[44]

Trade unions in Socialist countries were a curious survival from the past and modern adaptations to the needs of the State. Trade unions had been described by Lenin as "schools for Communism" and "transmission belts' for the Party economic programme to the working masses. The trade unions were organised on a vertical, industrial basis, i.e. according to the branches of industry, although there was also regional co-ordination. The membership of unions was voluntary, and it included both workers and persons of managerial status. The unions' funds were derived from members' contributions and from State grants. The State control of trade unions was assured.[45]

The work of the local trade union typically included various responsibilities, among which were; (1) to devise rules for work discipline, and to teach the workers how to protect socialised property; (2) to participate with the management in working out the details of output norms, work incentives and the distribution of various enterprise funds; (3) to take up individual members' grievances against the management concerning such matters as qualifications allowances, bonus payments, dismissals, etc..[46]

The degree of workers' participation in the management of enterprises differed from one Socialist country to another. For example, in the former Yugoslavia, the system of workers' participation was described as 'workers' self-management', and had been in the hands of workers' Councils since 1950. A similar system was introduced in Poland in 1956, as we shall see in the next section.[47]

b. Wages

Under Socialism, the determination of wages was highly controlled and centralised. The total amount of wages to be paid, and the production counterpart to support the wage fund, depended on the division of the national income between accumulation and consumption and, further, of consumption between the 'social consumption fund' and the 'wage fund'. The wage structure embodied considerable differentiation according to occupations, industries and regions. The main aims were; to encourage greater performance, and to promote vertical (from less to more skilled jobs) and horizontal (between enterprises, industries and regions) mobility of labour, according to planned priorities.[48]

In the absence of private ownership of the means of production, little private enterprise, and with virtually no unemployment, and a granted social security, incentives under Socialism were differently ordered; moral incentives, which were based on a workers' social consciousness in contributing to society's welfare, on his interest in his occupation, his sense of satisfaction from the work performed and pride status were important; in addition there were material incentives, which consisted of rewards in money or kind. Of course the final aim of both types of incentives was to increase enterprise labour productivity, on which the workers' total pay was dependent on.[49]

2. Why did the Classical Socialist System fail?

Before highlighting the main factors responsible for the collapse of the CSS in Central and Eastern Europe, it is of interest to mention that the CSS was successful in terms of growth rates, although relatively inefficient and not competitive according to Western standards. The state of the Soviet and Eastern European economies on the eve of the 1989 revolutions and their accomplishments should not be underrated, and could be summarised as follows:

(1) *"They achieved impressive, although declining growth rates after WWII. During the 1970s growth rates declined from 3 to 5% a year to about 2%, approaching zero in the late 1980s."*[50]

(2) They are middle-income countries, and several of them are in fact on a par with the least well-off EEC member countries.[51]

(3) *"They are heavy resource consumers, but inefficiencies in the use of resources are well documented. Energy consumption per unit of output is two or three times Western European levels, and the amounts of pollution are higher than current Western levels, although they are comparable to the Western level of a few decades ago".* [52]

(4) *"Macroeconomic imbalances increased, and so did the excess of consumer purchasing power over supply of consumer goods at prevailing prices; incentives for management and workers were distorted by unrealistic prices, political infiltration and employment guarantees regardless of productivity; but unemployment was negligible, and public services like health care and education were provided in high quality and quantity compared to other countries' development, even if both declined in recent years together with these services' share in GNP."* [53]

Considering the above listed facts one can conclude that the Central and Eastern European countries were not poor by international standards. It appears that the former planned economies of Eastern Europe and the USSR, excluding Albania and Romania,

belonged to the top 27% of the world population with regard to GDP per capita, and to the top 24% with regard to the human development index.[54]

The question that should be answered at this stage (of analysis); "What are the main factors responsible for the collapse of the CSS in the late 1980s?."

The literature[55] summarises the main factors that led to a failure of the CSS in the late Eighties as follows:

1) The debilitating domination of the state over economic activities, alongside the relative absence of private property rights in almost all aspects of production. It is commonly argued that under large-scale state ownership, little interest was shown, either by management or workers, in improving the efficiency of production. The state, via its central planning mechanism, required obedience from enterprises to ensure the fulfilment of the overall economic plan for the economy. Enterprise losses were therefore almost automatically underwritten by the state, and the presence of the bankruptcy sanction, which has provided such a spur for enterprises in western market economies to improve economic efficiency, was all but *absent*. Equally, there was no threat of take-over to displace inefficient management, either. Enterprises in the former Socialist countries thus faced what Kornai terms the 'soft budget constraint'. There was no incentive to pay any attention to such goals as economic efficiency or profitability in their day-to-day activities.[56]

2) The adoption of what Kornai (1980) termed 'soft budget constraint'. This meant that (1) the majority of firms were not price-takers but price makers, i.e. price was not exogenous for most firms; (2) the tax system was soft, that is the formulation of tax rules influenced by the firms; the firm might be granted exemption or postponement as an individual favour; and taxes were not collected strictly; (3) free state grants, which meant that firms could get various favours: contributions to investment expenditures, without repayment obligations; permanent subsidies paid continuously in compensation for a lasting loss or to encourage some activity over a long period; and *ad hoc* non

recurrent subsidies to counterbalance an occasional loss or to encourage a special activity. (4) the credit system was soft, i.e., it did not follow "orthodox" and 'conservative' principles. The firm was granted credit even if there was no full guarantee of its ability to repay it on schedule from its proceeds from sales. Credit was not strictly an "advance payment"; its granting was not closely related to expected production and sales. The firm was permitted to fail to fulfil its repayment obligations undertaken in the credit agreement. Moreover, the firm was allowed arbitrarily to postpone payment, without previous agreement with the seller. (5) external financial investment at soft conditions, which is the same as condition number 3 above, in the case of SOEs. Regarding privately owned enterprises (POEs), owners invested money from their own resources in the firm - not in order to develop and enlarge it, but to help it out of its financial difficulties.[57]

The consequences of these conditions were the growth and survival of unhealthy firms, living in a high degree of uncertainty, under conditions of imperfect competition, and absence of market signals. Therefore, any kind of reform, obviously, led to failure, because no significant improvement on economic efficiency had occurred in comparison with what was happening in the industrialised economies.[58]

3) Market reform in socialism could not succeed, because the main frame of economic planning was not changed, and certain (limited) price reforms could not provide allocative efficiency. Besides, state-owned monopolistic firms usually did not make investment decisions on the basis of market (price) signals. Distorted signals came from foreign trade (mainly distorted prices in COMECON).

4) The totalitarian political system adopted in Soviet type economies in the late 1940s, under pressure from what used to be called the Soviet Union, which was based on highly centralised decision-making and overwhelming state control of the economy. The main aim of that system was to accumulate capital and create social control, in order to change the structure of the economy from one based on agriculture to another based on industry, ignoring the criteria of optimal allocative efficiency.[59]

5) The reform programmes displayed numerous conceptual and operational flaws, among which was the belief that the market mechanism can be consistently introduced without actually removing the so-called fundamentals of the socialist system, i.e. single-party rule, command planning and state ownership of the means of production. [60]

6) The adverse effect of the international environment (or the so-called "soviet factor" which had less influence (since 1985-6) on the willingness and ability of consecutive governments to implement genuine reforms.[61]

7) The fact that the state still owned the huge majority of the means of production, and would give priority to politics over economics in its decision-making process.[62]

8) The fact that during those reforms, the party and state authorities kept a watchful eye on all changes, so as to prevent them from crossing structural boundaries and to keep the economy socialist.[63]

9) The *inefficiency of the state owned sector,* which failed to invest or produce rationally; squandered material inputs, labour, and energy; and did not innovate.[64]

10) The disorder of investment and foreign imbalances.[65]

11) Finally, since all the reform attempts were unable to create a market economy with real competition, they ended in failure.[66]

The CSS was reform-resistant, or at least its structural framework was too rigid, therefore it needed a radical transformation. In the next section, I analyse the main economic characteristics of the Polish Socialist System during the period 1945-1989. The final aim is to highlight the main economic features of the legacy of that system in Poland in the late 1980s. This enables us to have a clear picture of the Polish economic situation at the starting point of the transformation process, and to understand why there was a need to transform the Polish economy from a Socialist, centrally planned, to a Capitalist, market orientated economy.

Endnotes:

[1] This term is used in this study to have the same meaning as 'Socialist System', 'Soviet-Type System', 'Centrally Administrative Economy', 'Centrally Planned Economy', 'Command Economy', 'State Socialism', 'Traditional Model'.

[2] Wilczynski, 1970:22-23; Bornstein, 1965..

[3] Kornai, 1992:76.

[4] Ibid:71-77.

[5] A small handicraft existed in many CPEs, and in Poland the agriculture sector was mainly in private hands. However, it did not function on the basis of market signals, as land was not traded.

[6] Ibid:83-86.

[7] Ibid:109.

[8] In this study co-ordination is used to mean allocation.

[9] Willczynski, 1970:33.

[10] Ibid:33-34.

[11] Ibid.

[12] See Kornai, 1992, ch.7, for more details.

[13] Ibid.

[14] Wilczynski, 1970:42-43.

[15] As we shall notice below, these were precisely the spheres in which centralised planning and management have failed.

[16] Ibid:45-46.

[17] Ibid:60.

[18] Ibid:61.

[19] Realised prices cover producer goods transmitted from one State enterprise to another (where there was no market), while black market prices were not taken into account, therefore the concept of 'market prices' is avoided (Ibid).

[20] Wilczynski, 1970:67; Montias,1962:76-114.

[21] Ibid.

[22] Wilczynski, 1970:78; Kornai, 1992:171-80.

[23] See Kornai, 1992:171-80, for excellent detail.

[24] Wilczynski, 1970:89-97.

[25] Ibid.

[26] Kornai, 1992; Wilczynski, 1970:141; Peebles, 1991:40.

[27] Ibid.

[28] Ibid.

[29] Wilczynski, 1970:146; Kornai, 1992:131-2.

[30] Ibid.

[31] In fact, until the early 1960s, a large proportion of the enterprises' investment needs in the European Socialist countries was met by interest-free non-payable grants from the State budget. Starting from the mid-1960s, annual capital charges were introduced. (*Wilczynski, 1970:147-8).*

[32] Ibid.

[33] It is worth remembering that the authorities had more direct means to influence incomes.

[34] Kornai, 1992:145-55.

[35] Wilczynski, 1970:131-134.

[36] Ibid:134-135.

[37] For more details on this issue, see Knyziak, Z. (1968) 'Socialist Integration: The role of Price System in Foreign Trade', Economic Life, Warsaw.

[38] This concept will be discussed below.

[39] Ibid:140-2.

[40] Wilczynski, 1970:152-53.

[41] Wilczynski, 1970:152-53.

[42] For example, in 1976, there were five different exchange rates for the zloty to US$ 1.00, in Poland; the official basic rate- 3.32, the 'special'commercial rate-19.92; the tourist rate-33.20; the remittance rate-80.00; and the black market rate, which oscillated around 100.00 (*Wilczynski, 1970:181*).

[43] Ibid:341.

[44] Some Socialist countries, such as Poland and Yugoslavia, have experienced unemployment (*Wilczynski, 1970:100*).

[45] For example, the election of union officials was usually arranged by the Communist Party, and higher positions at least were mostly occupied by Party members (*Ibid:101*).

[46] Ibid:102.

[47] Ibid.

[48] Ibid:103-112; Zielinski, 1964:132.

[49] Ibid.

[50] Aage, 1994:17-18.

[51] Ibid.

[52] Ibid.

[53] Ibid.

[54] Ibid.

[55] See for example, Ash, Hare and Canning, 1994:214; Kornai, 1980; Blazyca & Rapacki, 1989; Rosati, 1991a; Lipton & Sachs, 1990; Kalecki, 1990; Eysymontt, 1987; Myant, 1993; Staniszkis, 1987; Bergson, 1991; Ellman, 1989; and Estrin, 1994; Sirc, 1994.

[56] Ash, Hare and Canning, 1994:214.

[57] Kornai, 1980.

[58] Ibid.

[59] Blazyca & Rapacki, 1989; Rosati, 1990a; Lipton & Sachs, 1990; Kalecki, 1990.

[60] Ibid.

[61] Ibid.

[62] Eysymontt, 1987; Myant, 1993; Staniszkis, 1987

[63] Ibid.

[64] Bergson, 1991; Ellman, 1989; Estrin, 1994.

[65] Sirc, 1994.

[66] Lipton & Sachs, 1990:106.

SECTION (2) THE ECONOMIC FEATURES OF THE POLISH SOCIALIST SYSTEM (1945-88)

The main purpose of this section is to discuss the different economic development stages that Poland has passed through during the period 1945-88, and to highlight the legacy of the Polish Socialist economy in the late Eighties. The aim is to point out the main factors behind the urgent need for a radical economic transformation programme in the late 1980s, in which privatisation was one main element.

1. Stages of Economic Development in Poland (1945-1988)

The history of Poland goes back more than one thousand years. The Polish Kingdom was powerful and prosperous, but declined in the 17th and 18th centuries. Between 1795 and 1918 it was ruled by foreign powers. Poland came into being as an independent state in November 1918.[1]

Polish independence ended at the outbreak of WWII on September 1, 1939. The country was invaded by Germany from the West on September 1, and by Soviet troops on September 17.[2]

During the period between the two world wars, Poland was mainly agrarian, and one of the poorest countries in Europe. According to the 1931 census, nearly two thirds of the population worked in agriculture and forestry [3]. The national income per head in 1938 did not surpass $250 of the 1960 purchasing power. Poland was one of the less industrialised European countries, distinctly lagging behind its neighbour, Czechoslovakia. Its main natural wealth consisted of abundant bituminous coal deposits, from which an output of 36 million tons was extracted in 1937, or 2.8% of the world output of coal at the time. [4]

Following WWII, the map of Poland changed, and the character of the Polish economy changed fundamentally. During the following four decades after WWII, Poland adopted Socialism as its economic, political and social system, and has passed through different stages of economic development, and adopted many economic reform programmes. In 1989, the whole CSS collapsed and all Central and Eastern European countries (including Poland) decided to abandon that system.

To analyse the main different *stages of economic development* of Socialist Poland during the period 1945-88, it is of interest to divide the period under discussion into four sub-periods, relating them to the Polish political and social set up during the time. These sub-periods are: **(1)** the Gomulka and Bierut Era (1945 - 56), during which the CSS was imposed, and Poland adopted a strategy for reconstructing its economy after WWII; **(2)** The Gomulka Second Era (1956-70), during which the Polish economy moved from an agrarian to an industrialised one; **(3)** The Gierek Era (1970-80), during which Poland adopted a 'new development strategy', based on heavy borrowing from the West; **(4)** The Kania's and Jaruzelski's Era: (1980-1989), during which Poland lost its creditworthiness, and a new system of management for state owned enterprises (SOEs)- the so-called the 3-Ss, was introduced.

a. The Gomulka and Bierut Era (1945-1956): (The Imposition of CSS and Reconstruction)

This period corresponds historically to the years of reconstruction (The Three Year Plan of Economic Reconstruction, 1947-49), and the imposition of the CSS on the Polish economy. During the first two years after WWII (1945-46), the role of the legal person was sustained by independent firms (*Zaklady*). In the years 1947-49, this legal status was forced upward to the level of associations and chief administrations. Between 1949 and 1952, the next shift in the legal status appeared when branch ministries began to function as independent basic economic units. Then, during the highly centralised period 1953-55,, the economy became a single huge enterprise with ministries as organisation divisions.

During the years from 1945 until the beginning of 1947, the Polish economy was multisectoral, with co-operative and private (largely non-industrial) firms functioning alongside state enterprises.[5] Following the 19 January, 1947 Parliamentary elections, when the Communist-led bloc managed to secure more than 80% of the votes,[6] questions about the role of the private and co-operative sectors were quickly settled with Stalinist resolve[7]. From the start, the new regime was split between the Stalinists, led by Bierut, who returned to Poland in the baggage of the Red Army, and the partisans, led by Gomulka, who had remained inside the country throughout the horrible years of occupation. Gomulka became secretary-general of the Polish Workers' Party and presided over a great expansion of that organisation: by 1948, it had over one million members and had eliminated its rivals. In that year, it merged with the Socialist Party to form the Polish United Workers' Party (PZPR). By then, Stalin had decided to impose his own brand of Communism on Poland. Gomulka was against the idea, and so was replaced by Bierut, who was the Head of the State[8]. The new leadership of the Polish Communist Party, assisted by the Soviet Stalinist regime, imposed upon the country a totalitarian (Stalinist) system of extreme mono-centerism and repression in socio-political life, and bureaucratic centralism within the economy.[9] In other words, the government shifted all the legal rights of private enterprises upward to the level of ministries. Hence the macro-management decisions started to be taken by the government, and the economy was run on the basis of commands. The economic system established in Poland at the end of the 1940s was basically a CSS- as analysed in the previous section.

The PZPR leaders saw in planning and socialisation of large-scale industry, steps towards socialist economy, while some of the non-communist parties saw nationalisation as transitional.[10]

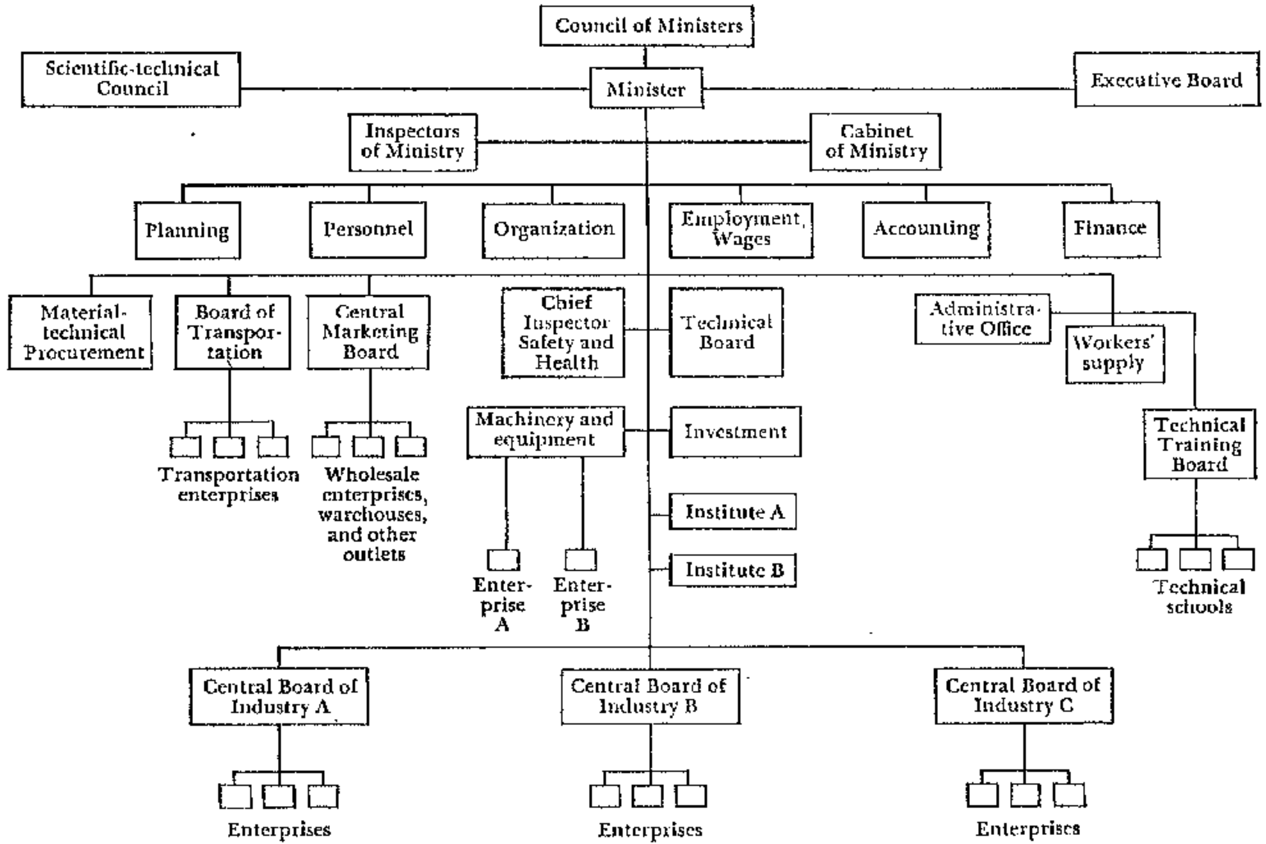
The reconstruction period officially ended in the early 1950s, when national income reached its pre-war level.[11] The process of centralisation took ten years after WWII to take root[12]. In 1946, the state sector accounted for nearly 85% of the total employment in the manufacturing sector for units with over five workers. Industry was almost fully

nationalised by the early 1950s.[13] Every priority was given to iron and steel production: the ancient capital of Poland, Krakow, was overwhelmed by the enormous steel plan at Nowy-Huta, one of the largest and most polluting in Europe. The mines and industries of Silesia, inherited from the Germans, were developed without any regard to the environmental consequences, and a large shipbuilding industry was built up along the Baltic, at Gdansk, Gdynia and Szczecin.[14] In agriculture, family farms were subjected to the pressure of collectivisation after WWII. The banking and financial systems were nationalised in the late 1940s. Foreign trade was controlled by the State, and prices of most consumers and producers goods were fixed by the State. Although statistics from this period are of notoriously poor quality, estimates show that the number of legal private farms declined by 41% between 1947-1953; the share of private shops in the retail trade fell from 78% in 1946 to 18% in 1950; the wholesale private trade was practically eliminated; and output from private enterprises was reduced from 21% in 1946 to 6% in 1950. [15] By the first half of the 1950s, the economy had become a single huge enterprise, with ministries as organisation divisions.[16]

Figure (2.1) shows the typical organisational structure of 'industrial ministries', responsible for the operation of large-and medium-scale nationalised enterprises in their sector.

Figure (2.1)

The Structure of Industrial Administration (1955)



Source: ***Montias, 1962:80.***

In fact, planning was centralised in the hands of the State Commission for Economic Planning and became compulsory and comprehensive. The number of industrial ministries swelled from one in 1948 to six in 1949 and ten in 1954, reflecting the increasing bureaucratisation of economic decision making. Political control over the economy was exercised by the party *'nomenclature'*, through its appointments of managers, planning officials, and trade union leaders. Trade flows were reoriented away from the Western trading partners toward the former USSR and the COMECON countries.[17]

In 1956, three years after Stalin's death[18], **Khrushchev** made his anti-Stalin speech to the 20th congress of the Communist Party of the Soviet Union. After a month, the Polish Communist Party leader **Bierut** died. These events spread chaos through the Polish Party; the hard-liners were purged, the last Polish prisoners were released from Siberia and returned home, and for a few months, Poles hoped for better things, including economic reform. **Gomulka** returned to power in October 1956 without consultation with Moscow.[19]

b. The Gomulka Second Era (1956 - 1970): (Decollectivisation of agriculture and a move from agrarian to industrialisation economy)

In October, 1956, **Khrushchev** arrived in Warsaw, together with leading members of the Soviet government. In a very short period of time, **Gomulka** managed to convince the Soviets to allow the Polish government and the Party more autonomy in domestic policy. Collective farms spontaneously dissolved, but there was no money to modernise the farms; workers' councils were established and took key state enterprises; a special Economic Council of blue-ribbon economists, including Oskar Lange, Kalecki, Brus, and others, was established to advise the Council of Ministers on possible changes in the economic 'model'.[20] This was a great victory for Poland- it became know as 'The October'- and the Poles believed for a while that they had at last recovered their independence.[21]

At the time, intellectuals opting for cultural independence and political change attacked the doctrinaire Party leadership. Industrial workers in Poznan protested against revised production norms that reduced their take-home pay.[22] There was a very strong call, mainly from workers, for 'essential reforms', in contrast with the minor revisions made each year in the official books of instructions compiled by the central authorities.

1. Reasons for the reform

Generally speaking, economic reforms became necessary because previous socio-economic policies resulted in a very unsatisfactory economic performance, which had important and negative political and ideological consequences. This can be seen in three basic spheres: growth, efficiency and standards of living.

Table (2.1)

Basic Indices of the Polish Six Year Plan (1950-55)

Indicator	Planned for 1955	Actual 1955
National Income	212	175
Total Investment	240	262
Gross Output of Industry	258	270
Gross output of Agriculture	150	113
Employment	160	156
Real Wages	140	104

Source: ***Zielinski, 1973:4.***

In the case of Poland, however, the 1956 attempt at reform was triggered not by growth considerations- growth had been very rapid by any standards- but by gross inefficiencies of the system and the prices paid for it in terms of complete failure to raise real wages. As can be seen from Table (2.1), investment and employment figures were close to those planned. However, the results in terms of national income and real wages were much lower. In fact, the Polish six-year Plan growth strategy lacks the

balance between investment and consumption, between Sector I (production means of production) and Sector II (producing consumer goods), and among the different branches of the economy. It assumed a very high rate of growth and favoured not only investment at the expense of consumption but also investment in heavy industry at the expense of investment in the consumer goods industry[23]. The result was a drop in real and peasant income with accompanying disincentive effects; severe shortages of consumer goods and agricultural investment goods; decapitalisation of the consumer goods industry; and a number of disequilibria within the priority heavy-industry sector and the economy as a whole.[24] Besides, the Polish party policy towards growth, planning process, agriculture, and non-socialist economic sectors outside agriculture (private manufacturing and building enterprises employing up to fifty people; private retail and wholesale enterprises; private service sector: restaurants, barbershops, laundries, etc., all kinds of artisans) was too taut[25]. Therefore, a need for reforms existed.

The main changes the 1956 economic reforms called for were: **(1)** a drastic reorganisation of the administration and management of the economy, emphasising decentralisation and the financial independence of individual enterprises. **(2)** an injection of quasi-market conditions into the relations between state enterprises and wholesale and retail distribution. The basic overall aim was to substitute "the profit motive and other economic incentives for administrative directives as the mainstream of economic activity". **(3)** the dismantling of the bureaucratic superstructure of the economy. The basic economic unit was to be the self-governing and fully independent enterprise. Each of these independent economic units was to operate according to the principles of cost accounting, and the highest possible degree of profitability was to be the main concern of its director (acting together with the workers' council, which had at that time full rights of co-management). **(4)** all forms of state-subsidised production were to be discontinued.[26]

What happened exactly was this: in order to offer some kind of decentralisation, a new system of the so-called branch associations within each industry took on the role of the

government ministries. At the same time they were still subordinated to the ministries, and had to adhere to the requirements of the plan. But they were endowed with some discretion to allocate the available funds among their constituent enterprises, to enable them to introduce some badly needed flexibility into the productive system. Moreover, Workers' Councils were established on 19 November, 1956[27]. The Councils were given a few unequivocal rights: **(1)** with due regard for the directors' opinion, they could adopt decisions concerning the sale of surplus machines and installations; **(2)** they were entitled to settle the distribution of the enterprise Fund or of the share of profits due to be paid to employees; and **(3)** they were to work out the internal regulations of the enterprise. The Council's power to determine work norms, wage tariffs, and rules for the granting of bonuses was not so clear-cut. Decisions had to be made in consultation with the factory councils, on which management and Party were heavily represented; they were also supposed to conform to the collective agreement signed by workers and management as well as to the (undefined) 'rights of the enterprise.' The director, who was an *ex officio* member of the Council, was to be appointed and recalled 'by the appropriate state organisation in consultation with the workers' councils. The latter was free, however, to put forward motions bearing on the appointment or dismissal of the enterprise's chief executives'[28].

Strong pressure from the former Soviet Union was then put on the **Gomulka** regime to 'stop playing with fire'. By mid-1958, the traditional elements in the party leadership had regained the initiative and were able to frustrate all attempts to implement the reforms advocated by the Economic Council and approved in principle by the Polish government[29]. Therefore, after 1958, the Polish economic policy returned to the orthodox priorities.

The result was that the 1956-7 attempt at reform led to short-lived measures of decentralisation and workers self-management. Hence, this attempt at reform failed to create a new structure to manage the economy, and enhanced bureaucratic control over individual enterprises[30]. Only a permanent reversal of collectivisation in major parts of the agricultural sector had occurred.

One can conclude that the first attempt at reform has given the Polish economy the features of a mixed economy, at least in the agriculture sector. But was the agriculture private sector efficient enough to enhance the performance of the whole Polish economy, during the Communist period?. In fact, the high restrictions that were imposed on private farming, such as; land cannot be traded; an upper limit on private ownership; and compulsory deliveries of main agricultural products (grain, meat, potatoes, milk) at low, state-fixed prices, had a negative impact on the performance of the agriculture sector[31].

By the early 1960s, the reform process had come full circle, and the pre-1956 status quo had been essentially re-established. This circle constituted communist Poland's first 'reform cycle'. **Gomulka** survived challenges from every direction until the end of 1970. He suppressed the 'revisionists', and outmanoeuvred the 'Partisans'[32]. How was the economic performance during the period 1955-1970?.

As can be seen from Table (2.2), the annual growth rate of the national income produced (in 1977 prices) averaged approximately 3%, 7%, and 6% during the periods 1955-60, 1960-65, and 1965-70, respectively[33]. The share of the labour force engaged in industry and construction increased continually, while that in agriculture continued to fall, during the period 1955-70. Available statistics show that rates of labour and capital productivity growth fell throughout this period. Declining capital productivity meant that progressively larger shares of the national income had to be devoted to investment in order to maintain economic growth rates; declining labour productivity growth meant that increases in employment often had to exceed planning rates in order to provide enterprises with the requisite labour force. Investment's share of national income rose from below 15% in 1956 to 23% in 1970, and the growth of consumption continued to lag behind that of national income[34]. The share of agriculture in NMP declined by around 20%, but increased by 17% for industry. One can observe that the policy of industrialising the Polish economy had been successful. But, the question that should be asked is; "Was the whole process efficient enough?."

Table (2.2)

Selected Economic Indicators in Poland (1955-70)

Indicator	1955	1960	1965	1970
National Income Produced (NMP) (1970=100)	40.4	55.5	74.9	100.0
Gross Industrial Production	28.2	44.8	67.0	100.0
Gross Agricultural Production	57.2	68.8	79.0	100.0
% of labour force engaged in				
Agriculture	48.2	43.3	39.1	34.0
Industry	30.8	32.0	34.3	36.4
Share of NMP produced by				
Agriculture	42.3	34.5	29.7	22.7
Industry	37.8	44.8	49.1	55.7

Source: ***Slay, 1994:31, based on data from the Central Statistical Office, Warsaw, Poland.***

Generally speaking, the economic situation in Poland during the 1950s and the 1960s brought spectacular achievements.[35] Poland was among the World's ten most rapidly industrialised countries[36]. This was thanks mainly to an acceleration of investment projects completed during the expansion, which managed to alleviate consumer disequilibrium[37]. As a result, Poland's position in the world's economy definitely changed, and her share increased in the world's production of electricity, coke coal, sulphur and sulphuric acid, cement, etc.[38] The high growth of industry was accompanied by a relatively slower progress in agriculture, although the Polish agricultural production increased by the same average of the world farm growth rate as a whole[39]. Growth rates of the Polish economy during the 1950s and 1960s created an impression that central planning could generate sustained economic development.

Despite the overwhelming achievements during the second half of the 1950s and in the 1960s, Poland had to face two serious problems: protecting its 'infant industries',[40] and finding sufficient demand for the products produced by these new 'infant' industries[41]. The first problem was solved through the state monopoly of foreign trade. State monopolies for foreign trade[42] protected the Polish 'infant industries' from external competition. The second problem was also solved because Poland, as a member of the Council for Mutual Economic Assistance (COMECON)[43], did not have to worry about selling its new industrial goods, because of the endless demand from the Eastern

European market, especially the Soviet. The Soviet Union used to pay for goods in kind (raw materials and energy), thus guaranteeing the supply of these products to the COMECON area. More than half of Poland's foreign trade was with COMECON countries[44].

On December 12, 1970, strikes and demonstrations sparked in Gdansk and then all over Poland, as a result of the increases in prices instituted by **Gomulka's** regime. These events weakened **Gomulka's** regime, as he was unable to develop a general and an effective economic policy that would provide the hope of an improved standard of living for the Polish people.[45] **Gomulka** resigned on December 20, 1970, eclipsing his great achievements[46].

Edward **Gierek** (the provincial party leader in Silesia), the new Party leader, from Katowice had to pick up the pieces.

c. Gierek's Regime Era (The 1970s): (New Development Strategy)

Like any new leader, **Gierek** had to pursue a new package of policies and abolish some old ones, but at the same time keep the basics of the Socialist system as they were. **Gierek** started strengthening party relations with the workers, by adopting a 'listen-to-them' policy. This policy was widely welcomed by workers, as they found a sincere and honest leader who understood their problems. As a result, he attracted more members to the party, hence, the party's legitimacy became more acceptable.[47]

Gierek's 'New Development Strategy' was based on an idea of modernising the Polish economy, by increasing living standards, consumerism, and increased integration into the world economy[48]. That was because of the fact that the 'dual protectionism' policy within the COMECON area deprived the Polish economy of the chance to keep up with the technological progress of the rest of the world.[49]

The philosophy of this strategy was that part of Poland's manufacturing capacity would be transformed into industries which would subsequently earn the hard currency needed to pay off the loans along with the interest. The remaining portion of the loans would be used to stimulate what was called accumulation (i.e. investment), and domestic consumption[50].

Gierek's strategy (of 'import-led' growth) became the foundation of the Five Year Plan (1971-75). Therefore, Poland borrowed relatively large sums during the Five Year Plan, allowing investment to continue growing at a high rate in 1974-5[51]. Foreign borrowing allowed Polish planners to prolong the expansion of the early 1970s. As a result of the heavy borrowing in the first half of the 1970s, a number of modern factories in heavy and light industry (like, Iron founding in Katowice; Computer equipment; Ursus tractors; Fiat cars; Berliet (Buses); Thomson (TVs) and Textile factories) were established. Moreover, the infrastructure was modernised, and new transport facilities were built. On the other hand, 'bottlenecks' in construction appeared, and the number of unfinished investment projects increased. Simultaneously, the expansion of heavy and light industries (which were not competitive in the world market) caused problems with the repayment of foreign credits[52].

Meanwhile, in 1970/71, **Gierek's** regime embarked on a programme of reform, which was another attempt at revision. **Gierek** took a step toward decentralisation by setting up 'large economic organisations', the so-called WOG (*Wielka Organizacja Gospodarcza*), as intermediate agencies between the individual plants and the economic ministries. The main purpose of those associates was to assist in planning investments and production, and in allocating resources. In this attempt economic power spread away from both centre and enterprise to the intermediate level of so-called 'WOG'. That is to say an amalgamation of horizontally integrated enterprises, organised as independent corporations and designed to maintain the centre's grip on the economy through the monitoring and control of a small number of large units, in spite of their greater exposure to market signals. Institutional innovations included greater flexibility of the enterprise wage funds, linked to value-added indicators rather than being

centrally fixed, and the retention of a small fraction of currency earnings by exporters[53]. **Gierek**'s regime raised the purchase price that the government paid private farmers for their agricultural goals and abolished the system of farmers' compulsory deliveries to the state. His aim was to improve the standard of living of the working class.

In the first half of the 1970s, gross industrial output, labour productivity, the rate of investment, and agriculture production rose rapidly. For example, real investment grew at an annual average of nearly 11% during the period 1970-75, and as a result industrial production showed a 9% annual average increase during the same period[54]. At the same time, external debt increased from US$ 1.0 billion in 1971 to a US$ 8.4 billion in 1975. The trade balance with West worsened dramatically, and reached US$ 1.5 billion deficit by the end of 1973, compared with a surplus of US$ 109.0 million in 1971[55].

In the second half of the 1970s, the Polish economic situation showed a reverse direction growth in comparison to the last two decades. This was because the sources of growth (large-scale investment in heavy industry and the absorption of labour from the rural sector) were being exhausted[56]. **Gierek**'s policy that Poland could repay the external credits by exporting the manufactured goods produced by the new plants, did not work.

Table (2.3) shows that the trade balance went sharply into deficit, peaking at nearly US$ 3.0 billion in 1975. Net Material Product fell by 2.3% in 1979 and by 6% in 1980; net Western debt, which had been negligible in 1970, reached US$ 23.5 billion, or 40% of GDP, in 1980, compared to US$ 7.6 billion in 1975; annual inflation steadily increased from 2-3% in 1971-5 to 7% - 9% in 1978-80.

Table (2.3)

Macroeconomic Indicators for Poland (1975-80)

Indicator	1975	1976	1977	1978	1979	1980
National Income Produced	9.0	6.8	5.0	3.0	-2.3	-6.0
Gross Investment (% change)	10.7	1.0	3.1	2.1	-7.9	-12.3
Consumption (% change)	n.a.	7.8	58.7	0.8	2.4	1.2
Gross Agricultural Production (% change)	-2.1	-1.1	1.4	4.1	-1.5	-10.7
Retail price inflation (%)	2-3*	4.0	4.5	8.4	7.4	8.5
Imports from non-socialist countries (% change)	12.2	11.4	-10.1	-2.0	-4.5	-7.2
Exports to non-socialist countries (% change)	5.8	12.3	4.0	2.9	2.1	5.0
Trade Balance ($ billions)	-3.0	-2.8	-1.8	-1.5	-1.9	-0.7
Net western debt ($ billions)	7.6	11.2	14.3	16.9	20.7	23.5
Debt service ratio (%)	26.3	34.4	45.6	60.8	75.0	83.2

Source: Slay, 1994:44, based on data from the Central Statistical Office, Rocznik Statystyczny, Different Issues, Warsaw, Poland; and Poznanski, 1986:461. **Note: Data in rows 1-4, 6, and 7 are in constant prices. * Average for 1971-75.**

The Government had lost control of the economy. It made a half-hearted attempt to reassert its economic authority by announcing an "economic manoeuvre" in December, 1976 which would supposedly guide the economy from frenetic expansion to more balanced growth. The new policy aimed for balanced trade with the West by 1980, a cut in investment spending, and moderate wage growth[57]. It was partly successful as can be seen from Table (2.3). Investment spending was curtailed and imports were curbed. But reduced imports availability made production more difficult; the growth declined and an export drive was mounted.

1. Critique on Gierek's Strategy

A review of the development of 'economic development strategies' all over the world during the Seventies, indicates that **Gierek**'s modernisation strategy was not wrong, as it was in an era when creditors were extremely cheap and easy to obtain. In fact, many developing countries followed this path quite successfully. In the case of Poland, **Gierek's** strategy accelerated the decay of State socialism by bringing about total crisis-political, economic, demographic, ecological, etc.. The crisis was not only the result of

import-led modernisation strategy; it was also caused by the **Gierek** regime's inability to assure social compliance and stability through noneconomic measures. The most negative point in the opening strategy was that wide doors were opened only to imports; it was not accompanied by changes in the economic system to make firms responsive the stimuli of international markets.[58]

The major assumptions of import-led strategy were incompatible with what was institutionally feasible. **Gierek's** modernisation strategy was flawed on several counts. **First**, it did not include institutional changes that would provoke the best response from economic actors. The dominant view of the new policy among the ideologues was that wage increases would provide a strong motivation to increase productivity. A simultaneous expansion of consumption and investment would thus guarantee rapid growth in productivity; economic growth would be consumption led. The basic flaw was the lack of reasons to suppose that increased wages would indeed boost labour productivity unless the rewards were unambiguously linked to an improved performance beneficial to the economy as a whole. **Second**, the strategy designers realised that any growth in labour productivity was conditioned on both work intensity and on technology. This was to be accomplished through the increased imports of Western "know-how" and capital equipment. The **Gomulka** regime policy of keeping hard currency imports in line with hard currency export revenues was to be discarded. Thus the development was to be import led until a viable export sector was established. Yet the economic system remained both fused and closed. **Third**, the relaxation of controls over the economy distinguished the policies of **Gierek's** regime from the other state socialist countries. **Gierek** seemed to believe that a major obstacle to economic growth was rooted in laws that defied economic rationality and in the shortages of inputs caused by **Gomulka's** excessively deflationary policies. He failed to grasp that all these constraints were 'substitutes' for decentralisation, competition, and economic discipline. In the absence of markets, less coercive methods of governance than those of the **Gomulka** regime produced a 'centrally planned anarchy.' **Fourth,** the success of **Gierek's** strategy of indebted development hinged on the development of an internationally competitive industrial sector. Yet no significant changes had been introduced in the institutional system, which was incapable of competing effectively in

the international markets for manufactured goods, although credits were used to improve industrial competitiveness. In other words, the closed system logic turned out to be incompatible with the increased imports from the West. Therefore, the blame for the lack of focus on export promotion in investment policy could be put not only on flawed policies but above all, on the institutional limitations of state socialism[59].

In addition, one could say that the investment strategy failed to encourage inter-sectoral specialisation, and did not lead to the formulation of a pro-export investment strategy focused on a few branches of the economy, or to a significant redesign of the organisational structure of foreign trade. Moreover, the rapid expansion of energy-intensive industries (such as metallurgy and heavy engineering) coincided with neglect in the fuels and energy-producing sectors. Planners tended to give preference to large-scale, energy-intensive projects such as the prefabricated house industry, or to the expansion of cement and nitrogen fertiliser production. Despite warnings from experts that the energy production sector was underinvested, maintenance was neglected, and its capital equipment, increasingly outdated and worn-out, was subject to growing breakdown rates. Finally, there was a bias against the private agriculture sector, which provided another limit to economic growth by exacerbating disequilibria[60].

As a result of the collapse of the general economic situation in the late 1970s, and the increases in prices initiated by **Gierek**'s regime in August, 1980, strikes started on 14 August, 1980, in the Lenin Shipyard in Gdansk, and in the next few days became the catalyst for other cities all over Poland. The response of the Party leadership to the hopeless situation was to dismiss **Gierek,** and to make public the details of corruption and economic mismanagement of the **Gierek** years[61]. **Kania** became the new Party leader. The new leadership, for the first time, agreed to negotiate, and some concessionary social contracts with workers were signed. The contracts resulted in the emergence of the '**Solidarity**' trade union of the Gdansk shipyard, in August, 1980[62].

d. Kania's & Jaruzelski's Regimes Era (1980s): (The rise of Solidarity, New Management System for SOEs, and Martial Law)

In fact, the economic downturn that began in 1979 accelerated in 1980-82. As can be seen from Tables (2.3) and (2.4), national income produced (in real terms) declined by 23.6% from 1979 to 1982; investment fell by 44.9% and consumption by 2.0%. These declines were driven by a catastrophic 54% fall in the volume of the hard-currency imports on which the Polish economy had come to depend and were accompanied by a 169% increase in retail prices. Combined with the PZPR's lack of credibility in Polish society, internal pressure from Solidarity and external pressure from the former USSR and Poland's Western creditors created an environment for the design and implementation of economic reforms unprecedented in the Soviet bloc. That was the 1980-81, new official economic reform programme[63].

Table (2.4)
The Economic Collapse of 1980-81

Indicator	1981	1982
GNP (% change)	-5.3	-0.6
NIP (% change)	-12.0	-5.5
Gross Investment (% change)	-22.3	-12.1
Consumption (% change)	-5.2	-12.3
Gross Agricultural Production (% change)	-3.8	-2.8
Retail Price Inflation (%)	18.4	109.4
Imports from non-socialised countries (% change)	-31.5	-24.2
Exports to non-socialised countries (% change)	-22.1	0.9
Net western debt ($ billion)	25.5	25.4

Source: ***Slay, 1991:53, based on data from the Central Statistical Office.***

At this stage, it is of importance to mention that the PZPR's disarray in 1980-81 led the government, first under **Kania** and then under **Jaruzelski,** to adopt a conservative attitude towards economic reform, in which primary emphasis was placed on maintaining control over the official reform debate.[64] The size and clumsiness of the official Committee for Economic Reform were consequences of this attitude. The

committee was a Leviathan of 500 members, with fourteen separate working groups that took more than a year to produce the official reform blueprint (*Kierunki reformy gospodarczej* 1981). This official reticence stood in sharp contrast to the more radical plan completed by **Balcerowicz's** group in November, 1980, as well as other unofficial reform projects proposed in 1981[65].

The official reform programme, which can be considered the first attempt of a radical breakthrough systemic reform, aimed to reduce considerably the extent of direct controls over the economy, and to replace them with a variety of indirect economic measures, working through the market mechanism. The main achievements of the 1980-1 ERP were the following:

a) Central plans became forecasts, rather than instruments to determine the structure and volume of production[66].

b) Enterprises were to be self-managing, self-determining and self-financing, or the so-called the 3-Ss. According to the new 'Law on Socio-economic Planning' of 26 February, 1982, enterprises were freed from compulsory targets imposed from above and allowed to set their own production and sales programmes. They were also given limited powers to decide on the distribution of profits and incomes. Firms were to cover costs with sales revenues, and inputs were to be available through regular commercial transactions, thus breaking with the traditional rationing system[67]. According to the 3-Ss slogan, enterprise managers and workers' councils (to which the managers were supposed to be accountable) were to design their own production plans and arrange their own supply and distribution networks without obligatory physical targets from the central authorities. Managerial and worker incentive systems were to be linked to yearly enterprise profitability. The compliance of enterprises with the central plan was to be influenced through financial instruments whose magnitudes would be determined both administratively and by market forces; this element implied major changes in the role and scope of central planning. Direct-planning targets for enterprises could be issued only to meet COMECON trade obligation, for national defence production, or for national emergencies. Approximately 75% of total

investment was to be decentralised to the unfinished central investment projects left over from the 1970s[68].

c) Administrative price controls were indeed lifted for a majority of products, but important restrictions remained, covering among others, coal, fuel, energy, steel products, cement, fertilisers, basic consumer goods and services, as well as procurement prices for agriculture products paid to private farmers. Some other prices, the so-called 'regulated prices', although not directly fixed by the government, were subject to indirect controls and still could not be set freely by producers.

Moreover, prices for primary goods were supposed to be fixed at the level corresponding to international prices, but this did not happen until 1990[69].

As a result of the deregulation of the prices of the above mentioned products, and the maintenance of the so-called soft financing of state enterprises, i.e. easy access to external sources of funds, Poland witnessed, for the first time since the imposition of the socialist system, a phenomenon that until then was unknown in the socialist countries, namely, open inflation. Double-digit inflation appeared in 1981, when prices rose by over 20%, and by 200% in 1982. The Polish authorities managed to reduce these rates to 30% in 1987, but they rose to 73% in 1988[70].

d) As for foreign trade, the most important change that occurred in the first half of the 1980s was that 'state monopoly of foreign trade' was relaxed, and that all public and private enterprises could apply for a licence to export or import provided that certain conditions were fulfilled[71].

e) A new exchange rate regime was established, in which the zloty was pegged at the sub-marginal level ensuring the profitability of 75% to 85% of exports. In fact, convertibility was the ultimate goal. Moreover, exporters were permitted to retain a 2-5% of their export earnings in hard currency, which became an important incentive for export expansion[72].

However, a number of factors constrained the implementation of this attempt at reform designed in 1980-81. Some of these factors included; "*the lack of competitive market and entrepreneurial traditions; industrial-policy decisions made before the 1980s,*

favouring such sectors as shipbuilding, mining, and energy production, which created favoured sectors with strong lobbies able to perpetuate industrial structures incompatible with strong emphasis upon enterprise self-financing and profitability; the lack of hard currency, which prevented the appearance of any thing more than symbolic import competition; conflicts inherent in trying to reconcile greater enterprise autonomy and an emphasis on profitability with the bureaucratic nature of COMECON trade; and the desire to prevent enterprise bankruptcy and the appearance of open unemployment".[73] Besides the imposition of 'Martial Law' on 13 December, 1981, which interrupted the self-government movement that had been gaining momentum in the second half of 1981, especially in big industrial plants[74].

As a result of the above taken measures and the slight modification in the systems of both taxes and subsidies, the Polish economy witnessed a significant improvement in the late part of the first half of the 1980s. National income produced increased in real terms by almost 16% between 1982 and 1985; open inflation during that time was reduced from triple-digit to near double-digit levels; and after three years of hard-currency merchandise trade deficits, Poland posted surpluses starting from 1982 (see Table 2.5).

In the mid-1980s, the economic situation started to deteriorate as a reaction to the growing imbalances and slowdown in the Polish economy (see Table 2.5). Therefore, the Polish Government decided to launch 'another stage of reform' in late 1986. In 1986, a new five-year plan for 1986-90 was prepared, and approved by the Parliament after an extensive discussion among economists and policy makers. In April, 1987, the government of **Messner**, presented in the 'Polish Diet' the ' implementation programme', comprising, initially, a package of bills which introduced among other things, the long-postulated transformation of the structure of the so-called Centre, or the central state administration, primarily the economic administration[75].

Table (2.5)
Macroeconomic and External Trends, 1983-89

Indicator	1983	1984	1985	1986	1987	1988	1989
National Income Produced (% change)	6.0	5.6	3.4	4.9	2.0	4.9	-0.2
Gross Industrial Production * (% change)	6.6	5.6	4.1	4.4	3.4	5.3	-0.5
Gross Agricultural Production (% change)	3.3	5.7	0.7	5.0	-2.3	1.2	1.5
Retail Price Inflation	21.4	14.8	15.0	17.5	25.3	61.3	243.8
Labour productivity (% change)	6.9	5.7	3.0	4.8	2.6	5.8	0.7
Hard currency Merchandise Trade Balance ($ bln)	1.44	1.53	1.06	1.07	1.23	1.01	0.77
Net hard currency debt ($ bln)	25.2	25.5	28.1	32.1	37.6	37.3	39.3
Net Ruble debt (TR bln)	3.5	4.5	5.3	6.3	6.4	6.3	5.3

Source: ***Slay, 1994:80, based on data from the Central Statistical Office, Annual Statistics, different issues.*** **Note: data in rows 1-3 are in constant prices. * gross industrial sale.**

An examination of the macroeconomic indicators (Table 2.5) shows that the 'second stage' of reform of 1986-7 could not eliminate the major drawbacks of the previous reform programme of 1980-1, and in the late Eighties, the whole system came to an end. See Section Three below for a detailed discussion on the events of 1989.

To sum up: the 1956-7, 1971-2, 1980-1, and the 1986-7 attempts at reform aimed at variously conceived decentralisation and marketisation, and were concerned almost exclusively with improving the Decision-Making processes, but not at transforming the economy. These reforms were imposed from above, programmed and implemented by the government and the ruling party, with distinct pressure from the unfavourable economic situation, and from a dissatisfied society, which demanded a better standard of living. Therefore, these attempts at reform could not manage to improve the performance of the Polish economy. Hence, the Polish economy fell into a vicious circle of cyclical behaviour. Each cycle ended with more violent and widespread protests. Periods of accelerated growth, fuelled by extensive programmes and

implemented at the cost of stagnation or declining consumption, were followed by periods of rapidly growing economic disequilibria and social discontent.

What was the legacy of the CSS in the late' Eighties?. The next part of the section summarises some key aspects of the macroeconomic situation in Poland in the late 1980s. The main aim is to give an idea of the macroeconomic indicators which are used in Section Four to assess the performance of the Polish economy during the period 1990-95.

2. The Legacy of the Socialist System in Poland in the late 1980s

Poland's legacy from the CSS was mixed. On one hand, the country suffered from severe macroeconomic imbalances as it was drifting into hyperinflation, with major shortages, a huge external debt in default, nearly exhausted international reserves, and virtually no external or domestic credibility of economic policy making. On the other hand, Poland did have some experience with market-type solutions, as most of her agriculture was noncollectivised, and small businesses had been allowed to operate for some years.

a. Share of the private and the public sector in GDP and Employment

As can be seen from Table (2.6), in 1989, State-Owned and Co-operative industry, which together comprised the socialised or public sector, accounted for about 81.0% of GDP and 65.0% of the total employment in the Polish economy. Divided by economic activity, the highest share of the Socialised sector was in the industrial sector, which accounted for about 84% of industrial value added, and about 71% of employment. The most important branches are engineering, food processing, and fuel and energy, which together account for over 60% of sold production in Socialised industry (Table 2.1 in the Appendix). Thanks mainly to the Party's policy of controlling the most vital economic sector in Poland. The lowest share of the Socialised sector was in agriculture. In 1989, it accounted for only 22.4% of the total value added of the

agricultual sector. Thanks mainly to Gomulka's strategy of decollectivisation of most of the agricultural sector in 1956. What do the above figures indicate?. In fact, these figures do not clearly define the rights of state ownership. These rights are very well defined in Western thought; the right to determine the resources use; the right to the eanings of the resources; and the right to dispose of the resource. In Poland, as in other Eastern and Central countries economies, the ownership structure was ill-defined. Those rights were rather vaguely distributed among the workers, managers, and state bureaucracies. The philosophy of central planning was that the State should maintain all ownership rights. Each SOE had a "founding body", usually a branch ministry, which maintained formal oversight of the enterprise. The function of the enterprise was determined by the annual central plan. After the 1980-1 reforms, the situation in Poland became highly muddled, because the reforms could not manage to create hard budget constraints for the enterprises. State enterprises in Poland had been decontrolled, but without introducing real competition at the same time. The result, a worsening of financial discipline of the firm and eventually, of the macroeconomy. The state enterprise system did not rely on the capital market to allocate credit. Investment spending was typically negotiated between enterprises, the relevant government ministries, and the central planning commission. Once approved, investments were paid for by various reserve funds set aside by an enterprise, centrally allocated investment funds from the national budget, and loans from the national bank. No adequate assessment of investment prospects was required for these funding sources.[76]

The total share of the private sector in GDP and employment in 1989 was 19%, and 35%, respectively (Table 2.6). The highest share of the private sector in production and empoyment by economic activity was in the retail trade (59.3% and 72.7%, respectively). The lowest share of the private sector in both production and employment was in transportation; 11.5% and 14.3%, respectively. The share of the private sector in industrial production and employment was 16.2%, and 29.1%, respectively. These shares are small by any standard. But they are fascinating when compared with most of the countries in the region.[77]

The private economy has survived in Socialist Poland, in two forms: one is legal private activity in such areas as garden plots, or farms, and small service or manufacturing firms; the second is unofficial or illegal activity in 'the second economy' and on 'the black market'.[78]

Table (2.6)

Share of Private Sector in Output and Employment, 1989 (%)

Economic Activity	Private sector	Public Sector
Total		
GDP	**19**	**81.0**
Employment	**35**	**65.0**
Industry		
Output	16.2	83.8
Employment	29.1	70.9
Agriculture		
Output	77.6	22.4
Employment	n.a.	n.a.
Construction		
Output	33.0	67.0
Employment	37.4	62.6
Transportation		
Output	11.5	88.5
Employment	14.3	85.7
Retail Trade		
Output	59.3	40.7
Employment	72.7	27.3

Source: ***The Central Statistical Office, 1995, Monthly Statistical Bulletin, No.52.***

The factors responsible for the survival of the private sector in Communist Poland during the past 4 decades can be summarised as follows: **(1)** the economic crises that hit the Polish economy in 1956, 1970, 1979-82, led the leaders of the Polish Communist Party to decide to give the private sector some shares in the economy, especially in the sectors that were considered strategically unimportant for a very long time, like agriculture, small service or manufacturing workshops. **(2)** the appearance of the foreign debt crisis since the late 1970s, has forced the authorities to encourage the creation of the so-called 'Polonia firms' and 'Joint Ventures'. **(3)** in some sectors, such as housing, the crisis has increased the importance of the private sector simply as a result of the decline in socialised provision of the state and co-operative housing to individuals. **(4)** the reforms of 1986/7 allowed socialised enterprises to enter into economic relations with the private sector, in the form of customers as well as

suppliers, thanks to the 'revisionist wing' leaders like **Messner** and **Mazowiecki,** who were far less ideological than the 'hard-liners' like **Bierut**. (5) in the 1980s, '*market socialism*' as an ideology has become bankrupt in Poland. Many of the '*nomenclature managers*' no longer believe that Socialism is either just or effective. **(6)** the importance of services has been growing in all advanced countries, and indeed, though at a slower rate, in the socialist countries. Thus, as the demand for services grows, the cost of restricting the private sector increases. Unless restrictions are imposed, the general presumption that private economic activity should be permitted in services will of itself lead to increases in the size of the private sector as demand increases. **(7)** finally, the most important factor behind the growth of the share of the private sector in Poland is that the *effectiveness of the Centrally Planned System has become unacceptably low* to the ruling elite. The Polish authorities had no other alternative but to encourage the growth of the private sector.[79]

b. Sources of output and employment

As can be seen from Table (2.7), divided by economic activity, the highest share of GDP and employment came from the industrial sector, as it generated more than 40% value added, and employed more than 40% of the labour force in Poland, in 1989. The lowest share was from transportation and telecommunication, as it generated less than 5% of the total value added, and employed less than 6% of the total labour force. As noted above, more than 80% of the output of the industrial sector has been generated by the Socialised sector. The high share of the industrial sector in GDP and employment indicates that it is the most important in Poland. Therefore, the crucial question that should be answered is; "Was the industrial sector economically efficient during the Socialist period?."

Table (2.7)
Sources of GDP and Employment by Economic Sector (%)

Indicator	1988		1989	
	GDP	Employment	GDP	Employment
Industry	41.7	28.8	44.1	28.6
Construction	10.7	7.9	8.2	7.7
Agriculture & Forestry	13.1	28.1	12.9	27.3
Transportation and Telecommunication	5.6	6.1	4.4	5.7
Trade	13.7	8.7	16.3	8.5
Other	15.2	20.4	14.1	22.2
GDP	100.0	100.0	100.0	100.0

Source: ***The Central Statistical Office, 1990, Rocznik Statystyczny, Warsaw, Poland.***

c. The effectiveness of the Industrial Sector in Socialist Poland

Many studies have been conducted to assess the effectiveness of the Polish industrial sector during the 1960s, 1970s, and 1980s.[80] At this stage of analysis, I would like to discuss the findings of one of these; the World Bank/Konovalov (August, 1989) study. The World Bank/Konovalov (August, 1989) survey study on 88 industrial enterprises, covered 191 product activities. The main purpose of the study was to measure the competitiveness of industrial activities in Poland, during the period 1961-1986. The study was based upon three interrelated approaches to assessing economic efficiency and distortions in prices in Poland. These approaches are: **(1)** The Total Factor Productivity[81] (TFP). TFP was used to provide an outline of structural change and dynamic efficiency of the industrial sector over the period 1960-85. This approach analyses performance at branch level. **(2)** The Domestic Resource Cost[82] (DRC). DRC compares the use of resources (capital and labour) in Poland against value added in world prices. **(3)** Distortions in traded goods prices were assessed from a more macroeconomic perspective. The extent of the tax and subsidy elements of various policy interventions in the trade sector were assessed. This was done by expressing the taxes and subsidies as a proportion of the total values of the appropriate trade flows (exports and imports). The main findings of the study are:

1. Based on an extensive survey in mid-1987, only about 30% of Poland's industrial structure was economically efficient (at official exchange rates). These include

subsectors such as engineering, textiles, metal products, and precision instruments. However, after making allowances for the over-valuation of the exchange rate, it appeared that about 60% of the industrial sector could be internationally competitive. The overall results were adversely influenced by the poor performance of the main activities within the ferrous metallurgy, food processing and transport equipment subsectors. These activities were in the heavy and more traditional industries. The food processing sector stands out particularly as lacking competitiveness. For this latter sector, the value of input exceeds that of output. The lack of competitiveness of these industries was largely responsible for the inefficiency of sample on average.

2. The DRC estimates have argued that efficiency gains were more likely with a shift to more indirect and market oriented means of resource allocation[83].

3. The estimates suggested that there was a need for restructuring operations to be undertaken in conjunction with policy reform. These would be directed towards improving the underlying technical efficiency of subsectors such as ferrous metal and agro-industry, and a reallocation of resources out of these less productive subsectors to more productive uses.

4. It appeared that larger enterprises were, on average, less efficient than small enterprises. This might be because larger enterprises tended to be more monopolistic, and face fewer competitive pressures, and that increasing costs of managing large enterprises tended to outweigh any economies of scale. Small enterprises were easier to manage; resources at their disposal could be more easily reallocated; and there were lower costs of operation, energy or transport.

5. The TFP results were consistent with the well known stages of Polish economic development since 1960. The results confirm that in the 1960s and 1970s, the pattern of growth in Poland was very extensive. In other words, output growth was driven by growth in factor inputs. In the crisis period of 1979-82, the TFP analysis again highlights the extent of the crash, and also which sectors have been able to weather the storm better than others. Those sectors which relied heavily on imported inputs did not

do too well during the crisis, while those sectors with less reliance on imports managed to stay afloat and continue growing. The recovery since 1982 strongly reflects increases in capacity utilisation levels. With the exception of the crisis period, the TFP results for Poland were not all that bad, and despite the problems inherent in the statistics, the story seems to be consistent and coherent. However, the TFP results were much below those in the more dynamic Asian countries, which have undertaken export-led growth. Moreover, there were two worrisome aspects of recent performance. First, there appeared to have been very little structural change since the early 1980s, with significant resources being allocated to inefficient activities. Secondly, output was being generated from increasingly obsolete machinery.

6. The study concluded that in order to achieve sustained progress, major components of a reform programme should include the following elements; paying labour according to its productivity, increasing interest rates to positive real levels, allowing both capital and labour to be allocated by market signals, and removing impediments to capital and labour mobility.

Combined with these results, the other macroeconomic variables give clear evidence about the economic crisis that hit the Polish economy in the late 1980s (Table 2.8). The remainder of this part of the study highlights the main features of some of the Polish macroeconomic economic indicators in 1988 and 1989.

d. Other macroeconomic indicators

As can be seen from Table (2.8), the inflation rate was 73.9% in 1988, and increased to 640% in 1989, mainly as a result of liberalising most of the prices of the consumers and producers goods. The current account deficit reached 2.7% of the GDP. The gross external debt reached 40.6 US$ in 1989, or about 60% of GDP expressed in US$, and over 5 times the annualised average monthly level of exports in the first seven months of 1989.[84] International reserves (gross official reserves) were only US$ 2.5 billion in 1989, or equivalent to 15 weeks of imports.[85] At the same time, Poland had full employment. The ratio of fiscal deficit to GDP was around 6%. The ratio of subsidies

to GDP decreased from 16% in 1988 to 10.6% of the GDP, reflecting the decline of subsidies, which was initiated in the economic transformation programme of 1989/90. The most significant changes were those concerning the taxation of enterprises profits. It decreased from 12.7% in 1988 to 7.9% as a percentage of GDP, thanks to the amendments to the tax legislation passed in January, 1989. See Section Four for details of these changes. Finally, Table (2.8) shows that most of the Polish foreign trade, in the two years 1988-89, was conducted with East and Central European countries, thanks to the COMECON agreement.

Table (2.8)
Polish Macroeconomic Indicators in 1988 and 1989

Indicator	1988	1989
Real GDP Growth Rate (%)	4.1	0.2
CPI Inflation Rate (%)	73.9	640.0
Unemployment Rate (%)	0.0	0.0
Current Account Balance (in % of GDP)	-0.8	-2.7
Current Account Balance (US$ Billion)	-0.6	-1.8
Gross External Debts (US$ billion)	39.1	40.6
Gross Official Reserves (US$ billion)	n.a.	2.5
Fiscal Deficit (% of GDP)	-1.4	-6.1
Total Subsidies (in % of GDP)	16.0	10.6
Total Revenues (in % of GDP)	35.6	25.1
Personal Income Tax Revenues (in % of GDP)	0.0	0.0
Corporate Income Tax Revenue (in % of GDP)	12.7	7.9
Imports (%)		
EEC	25	31
East & Central Europe	41	34
Other	31	34
Exports (%)		
EEC	24	28
East & Central Europe	42	37
Other	33	35

Source: ***The Central Statistical Office, Annual Report and Statistical Bulletin, Different Issues.***

e. Foreign direct investment (FDI)

Foreign firms were prohibited from investing in Poland until 1976. In 1976, new legislation concerning foreign investors was passed, and opened the door for private foreign commercial property.[86] The 1976 legislation allowed the establishment of medium and even large, private firms in Poland. These firms were called 'Polonia Firms', because they were owned by people of Polish origin not resident in Poland. In 1977, the first three firms were registered; by the end of 1980 their number had increased to only 46, employing 1,560 people. In 1981, there were 117 such firms, but they employed only 3,478 workers. By 1986, there were 670 firms, employing 61,619 people (i.e. an average of 90 employees per firm, with the largest employing 800 people in 1988). In 1986, employment grew by only 7,330.[87]

In 1986, legislation making **Joint Ventures** (JVs) with Western capitalist firms was passed. This kind of JVs was based on the principles of commercial law, and known as Commercial Law Companies with foreign capital. One of the greatest weaknesses of the legislation was the banning of participation of 'Polonia firms' in JVs. An expression of the authorities' desire to fragment the private sector, it prevented large Western firms from taking advantage of Polonia firms' knowledge of conditions in Poland, one of the factors which, together with the existence of suppliers and service firms independent of the state, could give Poland a considerable advantage over other East European countries in the competition for joint venture capital. This stagnation in the development of JVs makes the appearance since the mid-1980s of private and public limited companies all the more important. By mid 1987 there were some 400 such companies registered, and many more awaiting registration. Some 4,000 people worked for , or were partners in the new companies, and employment ranged from 2-75 persons, while the average was 10 (five times that in the non-agricultural private sector as a whole, and one ninth that of the Polonia firms). Most of the firms are engaged in services, and particularly in software and computers, marketing, and technical and scientific consulting. A whole group of such firms, dealing in software and mainly servicing socialised sector enterprises, have established themselves in Gdynia, in what one might call Poland's 'silicon bay'. The location is due to easy access to personal

computer hardware, via the port, and to the skilled personnel of Gdansk Polytechnic. Most of the owners of limited companies are relatively young (30 to 40 years) and with a university degree.[88]

f. Capital markets and banking

Regarding capital markets, they were absent in Poland, like other countries in the region, during the whole period of Socialism. However, it is of interest to mention that, in Poland, the Stock Exchange market was originally founded in 1817, and closed in 1939.

As for the banking system, prior to WWII, the Polish banking system was relatively well developed. In 1938, Poland had a modern central bank, 3 large state banks, 27 private banks operating as joint-stock companies (including 4 under foreign ownership), 28 finance houses, 19 credit unions, 353 savings associations, 975 local savings-and-loan associations and 5,597 credit co-operatives. Immediately after WWII, all private banks were wound up, and a new banking system was created to correspond to the new economic ideology.[89]

In 1946, the government began to centralise the system. The National Bank of Poland (NBP) became the main lender to key sectors of the economy, assuming the role played by the biggest pre-war private banks. With the passage of time, the NBP took over more and more of the banking institutions. This process continued uninterrupted until the mid-1970s, when the last of these mergers took place, with a large bank - *Powszechna Kasa Osczcednosci*- being incorporated into the NBP. The old system reduced the role of banks to a minimum, turning the banking sector into nothing more than a conduit for centrally allocated funds. For years, banking operated in a non-competitive environment. Its activity was subject to central administrative decision, as regards both the permissible scope of operation, and commercial lending policy.[90]

At the beginning of the 1980s, the Polish banking system was composed of the following banks (in addition to the NBP, directly responsible to the Ministry of Finance (MoF, with the President of the NBP serving as Under-Secretary of State at the MoF)): *Bank Gospodarki Zywnosciovej* (BGZ); *Bank Handlowy w Warszawa* SA; *Bank Polska Kasa Opieki* SA. In 1982, a new Banking Act was adopted. The NBP became independent of the MoF. From that time on, the President of the NBP was to be appointed in the same manner as other members of the Cabinet (i.e. by Parliament, at the recommendation of the Prime Minister). The NBP was also given a greater role in developing monetary policy. The new legislation opened up the possibility of creating banks as joint-stock companies, including ones with foreign equity participation. Decisions in this matter were still to be taken by the Government, however. In fact, no new bank was created until 1987, when Bank *Rozwojn Eksportn* SA (the Export Development Bank) was set up.[91]

3. Conclusion: (An urgent need for a radical transformation programme)

In the late 1980s, the Polish economy, like other economies of the communist countries, was deteriorating. It can be described as inefficient, permanently in disequilibrium, and non competitive in the World Market. At that time, all the Eastern European governments decided that the time of CSS was over, and it should be consigned to history, and a new era of economic development should be started. This happened 'peacefully' in the mid and late 1980s all over East and Central European countries, including Poland.[92]

The governmental planners of the Central and Eastern European countries started searching for a more humane and efficient economic system. The main dilemma facing those planners was whether to choose an economic system existing in some developed capitalist countries, or to look for a 'third way'. After a long and deep discussion, the planners refused to experiment with a newly-devised 'original' economic system which would be appropriate in the post-socialist situation. They opposed the idea of searching

for economic development which would be neither socialist nor capitalist. It was reluctantly decided by many of these governmental planners to take the road to a market economy- or what was understood by them to be a market economy. Poland was no exception. Thus, in 1989 a radical *economic transformation programme* was developed, to transform the Polish economy from a socially, centrally planned economy (CPE), to a capital, market economy (ME).

It was possible at that specific period of time, in my opinion, due to *four main factors*: ***first***, the disappearance of the political factors that had constrained change in the past 45 years[93]; ***second***, the severe economic crisis that hit the Polish economy in the late 1980s; ***third,*** the support that Poland received from the international community, represented by the International Monetary Fund (IMF), the World Bank (WB), the International Finance Corporation (IFC), and the OECD, as well as the Western countries' governments[94]; and ***finally***, the lack of political will among the ruling Party leaders in the former Soviet bloc to continue with the same Socialist system. To summarise the above mentioned four factors, one can say that there was a global consensus that the Socialist system should be consigned to history.

In the next section, I shall discuss how economic theories and the experiences of other countries help in leading the way from a CPE to a ME. Then, I shall investigate how Poland chose its radical economic transformation programme. Also, I shall discuss the main elements of that programme, in order to investigate how much its elements resemble those of the theoretical ones, and the experiences of other countries.

Endnotes:

[1] Ruane, 1982:xii.

[2] Weydenthal, 1986:34

[3] Montias, 1962:50.

[4] Ibid.

[5] Slay, 1994:22.

[6] The results of the Parliamentary elections of 1947 were as follows:

Party	Number of Seats
Polish Workers' party	119
Polish Socialist Party	119
Peasant Party	103
Democratic Party	43
Polish Peasant Party	28
Labour Party	15
Other	17

Source: Weydenthal, 1986:231.

[7] Although the Communist leaders announced that they were building and creating an economic system which is neither Socialist nor Capitalist (*Aslund, 1985:21*), in practice, however, one can observe that there was a gulf between the proclaimed policy of the PPR and the actions of Soviet forces and the Polish communists.

[8] Gomulka was arrested in 1951, and imprisoned until 1955 (*Brogan, 1990:52-54*).

[9] Mujzel, 1991:31.

[10] Polish communists were well aware of the anti-communist and anti-Russian feelings of the vast majority of Poles. The early PPR programme called for a broad national coalition with moderate Socialist demands. Overtly, there was little difference between the positions of the major Polish political parties in 1943. They agreed that key branches of the economy should be nationalised and land reform carried out. In fact, demands for the extension of co-operative movements were universal, as in many Western countries (*Aslund, 1985:20-21*).

[11] Charemza and Gronicki,1988:4

[12] During this period, many political and economic agreements were signed between the European part of the Soviet bloc. For example, in 1949, the COMECON agreement was signed between the eight Soviet bloc countries. On May 14, 1954, representatives of the governments of the Soviet Union, Poland, Czechoslovakia, East Germany, Hungary, Romania, Bulgaria, and Albania signed the Warsaw Pact. The Pact's aim was to legitimise Soviet intervention in the national and international affairs of the people's democracies (*Karpinski, 1982:36*).

[13] Solimano, 1991:16

[14] Brogan, 1990:53

[15] Aslund, 1985:232; Charemza and Gronicki, 1988:4.

[16] Jermakowicz and Follis, 1988:123.

[17] Slay, 1994:23-24.

[18] One could argue that the death of Stalin gave some degree of freedom to politicians and economists in Central and East European countries. However, very little changed concerning the principles of the Socialist system until 1989.

[19] Brogan, 1990:54-55.

[20] Slay, 1994; Brogan, 1990:55-57

[21] Brogan, 1990

[22] Andrews, 1985:14.

[23] Zielinski, 1973:10-11.

[24] Ibid.

[25] Ibid:10-14.

[26] Gamarnikow, 1968:24-5.

[27] Montias, 1962:307-8; Rybicki, 1964:196-7.

[28] Ibid. By the end of 1957, there were 5,619 councils, representing workers in the great majority of the medium- and large-scale enterprises industry. On December 20, 1958, the Act on Workers Councils of November, 1956, was replaced by the Workers' Self-Governance Conference Act (*Nuti, 1981:56-7; Rybicki, 1964:201; Kramer, 1995:74*).

[29] Ibid:26

[30] Frydman & Rapaczynski, 1994:48-9; Winiecki, 1988:4.

[31] Slay, 1994; Zielinski, 1973:12.

[32] Brogan, 1990

[33] These periods reflect the first, the second, and the third, Five Year Plans respectively.

[34] Slay, 1994:32-33.

[35] There was some exaggeration in the Polish statistics during the whole era of the CSS (*Lipton & Sachs, 1990; Tiusanen, 1991:14*).

[36] Pawer & Bozyk, 1975:20

[37] Aslund, 1985:234

[38] Thanks to the successful geological investigations made in the Fifties, on one hand, and to the high level of investments in heavy industry, on the other (Charemza & Gronick, 1988:5).

[39] Ibid

[40] This was fashionable then and even, in the developing countries, until the 1970s, but then economists seem to have given up the "infant industry" argument.

[41] Some people do not consider this as a problem, but a feature of the CPEs.

[42] For almost four decades, more than half of Poland's foreign trade was with COMECON countries, on the basis of bilateral export-import lists and prices fixed by the governments. Foreign trade administratively controlled and subordinated to a central plan. Most of this trade was cleared in transferable Rubles and the former Soviet Union was Poland's largest trade partner (*WB, 1994:9*).

[43] In 1949 the six Soviet-type economies STEs formed the Council for Mutual Economic Assistance (COMECON). This organisation was set up to co-ordinate the economic development of its members. This created a base for further, more or less successful, economic co-operation among the socialist countries (Ibid).

[44] Ibid.

[45] During that time different economic reform proposals had been formed by different Polish economists, but were all refused by Gomulka. Meanwhile, countries like the former Czechoslovakia and Hungary attempted relatively far-reaching economic proposals. Czechoslovakia was halted by the Soviet Stalinist regime intervention in August, 1968, whereas a New Economic Mechanism (NEM) was implemented on January 1, 1968, in Hungary (*Andrews, 1985:15*). For more details on these crises see: Karpinski J, 1982 Countdown: *The Polish Upheavals of 1956, 1968, 1970, 1976, 1980* (NY:Karzcohl).

[46] One of the other main achievements of Gomulka's regime was the treaty with West Germany recognising Poland's western borders. This treaty was signed two weeks before his resignation (SLAY, 1994:335).

[47] Andrews, 1985.

[48] Slay, 1994.

[49] Tiusanen, 1991; Andrews, 1985.

[50] Antowska-Bartosiewicz, 1991:6.

[51] Winiecki, 1988:24. Some other developing countries (such as South Korea) adopted similar strategies.

[52] Besides that, the problem was also that credits were badly assimilated.

[53] Charemza & Gronicki, 1988:6.

[54] Lipton & Sachs, 1990:103

[55] Antowska-Bartosiewicz, 1991:7.

[56] Many investment projects were still unfinished.

[57] EIU, 1994-5:4; Andrews, 1985:18-20.

[58] Kaminski, 1991:101-105-6.

[59] Poznanski, 1986:4850; World Bank, 1988:23; Brada and Montias, 1984:405; Kaminski, 1991:101-105-6.

[60] Ibid.

[61] Slay, 1994:51

[62] This union was independent of the government and ruling party. That union had its own economic strategies, and was always ready for the time when it rules Poland (*Jarski, 1990:13; Mujzel, 1991:32*).

[63] Slay, 1994:51.

[64] It is of interest to mention that starting from 1981, a big role began being given to the Prime Minister. That is because one of the main consequences of Martial Law was that the Party Leader was at the same time The President of Poland, and the Prime Minister. Starting from the mid-1980s, the Prime Minister, as we shall notice in Section Five, started having a major role in conducting the economic policy in Poland.

[65] Slay, 1994:53-54

[66] Other instruments have been used, although on a much smaller scale than under the CSS. These are the so-called operational programmes and government orders. For more details see Eysymontt ,1989:31-42).

[67] Rosati, 1991a:22; Wallace, 1989:139

[68] Slay, 1994:54-55

[69] Rosati, 1991a:23. More detail on the changes in the price system in the period 1982-6 is contained in IMF, 1986, SM/86/248. Sup.1; and IMF, 1986, SM/88/184.

[70] Wyczanski, 1993:12

[71] Rosati, 1990a:23-24.

[72] Ibid.

[73] Slay, 1994:55-59

[74] Martial Law was withdrawn in June 1983. Solidarity was banned on 13 December, 1981, and was formally outlawed from October, 1982, until 1989, when the first constructive dialogue and compromise between the communist authorities and Solidarity took place, at the 'Round Table' talks. Meanwhile, the underground activity of Solidarity continued. (*Mujzel, 1991:33; Eysymonnt, 1989:29; Slay, 1994:55-59*).

[75] Eysymontt, 1989:42; Rosati, 1991a:26; Myant, 1993:62.

[76] Lipton and Sachs, 1992:29-30; Nuti, 1985:60-61. See the discussion on the main reforms of the 1980s early in this section.

[77] For example, the share of the private sector in GDP and employment was 7.2%, 5.9%, and 4% and 1.2% in Bulgaria and the Czech Republic, respectively (EBRD, 1993).

[78] Wilkin, 1989:61.

[79] Rostowski, 1989:204-207

[80] See for example, Kemme D M, (1987), "Productivity Growth in Polish Industry", *Journal of Comparative Economics*, 11, PP 1-20; Terrell K, (July, 1987), "Western Capital and Productivity in Polish Industry", memo, Department of Economics, University of Pittsburgh; World Bank, (1987), "*Poland: Reform, Adjustment and Growth*", World Bank Report, No.6736-Pol.; Zolkiewski Z, (January, 1988), "*Total Factor Productivity Change in Polish Industries: 1961-85*", the Central Statistical Office, Warsaw, Poland; and The World Bank/Konovalov (August 1989), "*Poland:*

Competitiveness of Industrial Activities: 1961-86", The World Bank, Internal Discussion Paper, Report No. IDP-0048.

[81] Theoretically, the analysis of TFP growth is based on the economic theory of production and cost. Assuming a well-specified production function, TFP growth is estimated as the shift of the production function over time. The approach used in the World Bank study is a deterministic approach- i.e. TFP is estimated as a residual of output growth less inputs (capital, labour, and material). The other major approach to estimating TFP growth is a stochastic approach- i.e. an econometric estimation of the production function. Both methodologies are widely used, and both are associated with some drawbacks. The formulation used in the World Bank (1989) study is as follows:

TFP = % change in output - output elasticity of capital * % change in capital
- output elasticity of labour * % change in labour
- output elasticity of materials * % change in materials.

Potentially, the major drawback of this approach is that in using the factor shares in output as estimates of the output elasticities, it is assumed that there is profit-maximising behaviour in competitive product and factor markets. This is obviously not the case in Poland. For this reason, the study assessed the sensitivity of the results to different output elasticities (*World Bank/Konovalov, 1989:90-92).*

[82] The DRC is a cost-benefit ratio used to compare relative levels of international competitiveness. It measures the economic cost of the domestic factors employed in order to produce net output worth one unit of foreign exchange.
The DRC ratio is:

$$\frac{\text{Capital + labour}}{\text{Value added in world prices}}$$

If this ratio exceeds one, it suggests that the activity is inefficient and the economy would be better off if resources were shifted instead to more competitive activity (*World Bank, 1989:102-103*).

[83] This result reconfirmed the conclusion of the World Bank's Country Economic Memorandum (CEM) on Poland (August, 1987), which states that to achieve an adequate growth path and to drag itself out of the debt morass, Poland's economy needs to become more market-oriented (*World Bank/Konovalov, 1989:i*).

[84] IMF, 1990:67.

[85] Ibid:68.

[86] Rostowski, 1989:202; Ciechocinska, 1992:224.

[87] Rostowski, 1989:202-3; Aslund, 1985:116; Gomulka & Jasinski, 1994:219.

[88] Ciechocinska, 1992:. It is of interest to mention that a law on creating Joint Ventures was passed in 1979 but never used (*Gray et al , 1991: 9*).

[89] Polish Development Bank, 1994:19.

[90] Ibid.

[91] Ibid.

[92] Tiusanen, 1991:5

[93] The first signal of possible change came from Gorbachev and his policy of Perestroyka (*PPRG, 1991:2*).

[94] For example, the visit of Bush (the ex-President of the USA) to some Eastern European countries in 1990, is evidence.

PART TWO: THEORETICAL BACKGROUND ON ECONOMIC TRANSFORMATION AND THE POLISH EXPERIENCE IN 1989/90, AND THE NEW ECONOMIC SYSTEM IN POLAND (1990-95)

SECTION (3) THEORETICAL BACKGROUND ON ECONOMIC TRANSFORMATION AND THE POLISH EXPERIENCE IN 1989/90

The main purpose of the first part of this section is to discuss how economic theories, and the experiences of other countries, can help in formulating a reasonable economic transformation programme to transfer an economy based on central Planning, to a modern market orientated one. The purpose of the second part of the section is to investigate how Poland managed to adopt its economic transformation programme of 1989/90, and analyse the main assumptions and components of the Polish programme. In addition, the major economic policy changes are also discussed. The main aim is to investigate how much the Polish economic transformation programme of 1989/90 resembles other theoretical models and the experiences of other countries that have gone through similar transformation processes. Also, to discren the role of privatisation as an element in the whole transformation process.

1. Theoretical background on economic transformation

Economic theories say little on how to transform an economy from a socialist to a market orientated one, though offer some models for stabilisation, which suggest that private ownership, if accompanied by a high degree of economic liberalisation and competition, is the most efficient of the different forms of ownership.[1] There is no empirical experience to guide transitions of the magnitude of the Central and East European countries, but there are some real experiences in other countries that have attempted to stabilise or transform aspects of their economies, to learn from. Therefore, the task of designing a transitional scenario for the Central and Eastern European countries represents an especially challenging task for economists and political leaders alike. (1) the problem was new: "no country prior to 1989 had ever abandoned the communist political and economic system"; (2) the experience to date indicates that countries attempting transition face a number of common problems and difficulties.[2] However, there are important differences in the inherited situations, as well as the choices deemed appropriate by the governments of these countries. The similarities in

the problems that Poland, among other CPE countries, faced, and the difficulties encountered suggest that there was a logic to the transition process. (3) "the absence of any close historical parallels and the limited experience of the economies in transition offer an opportunity and a challenge for the development of normative transitional scenarios." [3]

The development of an economic reform scenario required not only a profound knowledge of the mechanism of the market economy, but also an understanding of how the elements of any economic reform programme should be structured, and how the elements should be sequentially linked. In fact, the task was not an easy one for economists at the start of the transition process. From the beginning of the transformation process, economists- for example, Clague, 1992, thought that the full benefits of a market economy are not realised unless most of its key features are in place. That was believed to be the case because Central and Eastern European countries attempted only partial market-orientated reforms that produced either small benefits or even negative results.

Development in economic theories affects the way governmental planners look at the whole process of transformation. For instance, from the 1930s to the 1970s, the key advantage of the market economy was perceived by the majority of economists to be its approximation of the rules of allocative efficiency. These rules relate to marginal rates of transformation and substitution across goods, consumers, producers, and time.[4]

In recent decades, many economists have returned to the Schumpeterian view that the advantage of the market economy lies more in its facilitation of innovative activity, than in its allocative efficiency. The experience of the Central and Eastern European countries in the past 45 years illustrated that the socialist, centrally planned system was surely deficient in both respects, but its shortcomings, as Murrell (1990) argues, seem to be much greater in the area of innovation than in allocative efficiency. Williamson (1985) argues that innovative activity usually carries a high risk of failure, because bureaucracies are normally reluctant to engage in behaviour that induces entrepreneurial attitudes. While innovation normally generates large externalities in any economy,

many economists (for example, Olson, 1992; Cooter, 1992; and Stiglitz, 1992) would contend that a well-functioning capital market, with clearly defined property rights over organisations and ideas as well as goods and factors of production, has been essential for increasing a return to innovative activity above what it would be in a society with poorly developed market institutions.

Other economic theories have paid increased attention to the motivation of government officials, both legislators and bureaucrats. In the 1950s and 1960s, much economic analysis focused on market failures, and government action to remedy these failures, under the implicit assumption that governmental planners would follow the rules laid down by higher authorities.[5]

Clague (1992) argues that these theoretical considerations have been reinforced by the experiences of those ex-socialist economies which have attempted reform through decentralisation of decision-making under public ownership. The result was that decentralised decision-making, under 'soft budget constraints', led to worse results than central planning itself.

One can conclude from the above discussion that transforming a CPE into a market economy requires complex and untested novel reform approaches. Grigory Yavlinsky[6] described the process of transformation from market to plan as, making fish soup from an aquarium, but the reverse transformation , i.e. from plan to market, like trying to build an aquarium out of fish soup.[7]

Despite the previously discussed difficulties, some economists have proposed some *transformation models* to assist the Central and Eastern European countries in their transition process.

a. Theoretical transformation models

The most important economic transformation models are those proposed by Kornai, 1990; Lipton & Sachs, 1990 and 1992; Fischer & Gelb, 1991; Clague, 1992; Summers, 1992; Murrell, 1992; Olson, 1992; Hanson, 1992; The World Bank, 1991; and the WB/IMF/EBRD/OECD, 1992.

A summary of the main elements of these models of reform is illustrated in **Boxes (3.1-8)**, below:

Box (3.1)

Elements of *Economic Reform Model* Proposed by Fischer & Gelb (1991)

1) Macroeconomic stabilisation and control
implementation of stabilisation programmes
creation of tools and institutions for indirect macroeconomic control, monetary and fiscal
measures to harden budget constraints
dealing with existing problems (monetary overhang, financial system, bankruptcies)
Social Safety Nets (at first on an emergency basis)

2) Institutional reforms: Human capital and administrative capacity
legal and regulatory institutions
business management, including the financial sector
government decision-makers and administrators
information systems (accounting and auditing)

3) Price and market reform
domestic price reform
international trade liberalisation
distribution systems for products
creation of market for housing
wages
interest rates

4) Small- and large-scale enterprise restructuring and *privatisation*
management systems
allocation of property rights
agricultural land
industrial capital
housing stock
social protection and insurance rights for individuals

5) Development of financial markets and institutions
banking systems, other financial markets

Source: Fischer, S & Gelb, A (1991) Issues in The Reform of Socialist Economies, In *Reforming Central European Economies: Initial Results and Challenges*, edited by V Corbo, F Coricelli, and J Bossak (Washington:WB).

Box (3.2)

Elements of *Economic Reform Model* Proposed by Lipton & Sachs (1990)

1) **End Excess Demand**

2) **Create market competition, based on**
   deregulation of prices
   free trade (removal of trade barriers)
   full liberalisation of private sector
   demonopolisation of the state sector

3) **<u>Privatisation</u> (taking many years)**

4) **Introduction of labour market policies**
   unemployment insurance
   job retraining
   credit allocation to individuals who start businesses

5) **Promoting foreign direct investments**

Source: **Lipton & Sachs (1990) Creating a Market Economy in East Europe: The Case of Poland,** ***In Kennetti D, and Lieberman M, 'The Road to Capitalism: Economic transition in East Europe and Former Soviet Union', (HBSC:NY).***

Box (3.3)

Elements of *Economic Reform Model* Proposed by Kornai (1990)

1) ***<u>Extensive privatisation</u> and special protection for the private sector*;**

2) ***Economic discipline of the state sector, subjecting it to strict social control;***

3) ***Stabilisation operation suppressing inflation, restoring budgetary equilibrium, controlling macro-demand, introducing a uniform rate of exchange and convertibility of the currency;***

4) ***Accumulation and maintenance of humanitarian and economic rescues to endure the period of transition.***

Source: ***Kornai, J (1990)The Road To A Free Economy: Shifting From Socialist System, The Case of Hungary, Clarendon Press, Oxford.***

Box (3.4)

Elements of *Economic Reform Model* Proposed by Summers (1992)

1) Macroeconomic stabilisation
tightening fiscal and credit policies
addressing internal and external imbalances

2) Price and market reform
removing price controls
liberalising trade
creating competitive market

3) Enterprise reform and restructuring
private sector development
establishing and clarifying property rights
facilitating entry and exit of firms
restructuring of enterprises

4) Institutional reform
redefining the role of the State
legal and regulatory reform
establishing a social safety net
reform of government institutions (tax administration, budget and expenditure control, monetary control).

Source: **Summers, L (1992) The Next Decade in Central and Eastern Europe, *in* Clague & Rausser G. (1992) (ed.) *The Emergence of Market Economies in Eastern Europe* (Basil Blackwell:Cambridge).**

Box (3.5)

Elements of *Economic Reform Model* Proposed by Hanson (1992)

1) Financial Stabilisation

2) The decontrol of prices and quantities, accompanied by demonopolisation when necessary

3) The transfer of assets from state ownership to a variety of identifiable proprietors

4) Opening up the economy to competition from imports in the product market and to foreign investors in the capital market.

Source: **Hanson, P (1992) Elements of Economic Reform, in Clague & Rausser G. (1992) (ed.) *The Emergence of Market Economies in Eastern Europe* (Basil Blackwell:Cambridge).**

Box (3.6)

Elements of *Economic Reform Model* Proposed by Clague (1992)

A) Creating A New Set of Rules

1) Setting up a legal infrastructure for the private sector
commercial and contract law
antitrust and labour law
environmental and health regulations
rules regarding foreign partnerships and wholly foreign-owned companies
courts to settle disputes and enforce the law

2) Devising a system of taxation for the new private sector
defining accounting rules for taxation purposes,
organising an internal revenue service to collect taxes from the private sector

3) Devising rules for the new financial sector
defining accounting rules for reporting business results to banks and investors
setting up a system of bank regulation

4) Determining ownership rights to existing real property
devising laws relating to the transfer of property
laws affecting landlord-tenant relations
resolving the vexatious issue of restitution of property confiscated by communist governments

5) Foreign exchange
setting rules under which private firms and individuals may acquire and sell foreign exchange and foreign goods
setting rules in the same area for the not-yet-privatised enterprises

B) Managing The Economy:

1) Reforming prices
2) Creating a safety net
3) Stabilising the macroeconomy
managing the government budget to avoid an excessive fiscal deficit
managing the total credit provided by the banking system

C) Privatisation

1) Small-scale privatisation
releasing to the private sector trucks and buses, retail shops, restaurants, repair shops, warehouses, and other building space for economic activities
establishing the private right to purchase services from railroads, ports, and other enterprises which may remain in the public sector.

2) Large-scale privatisation
transferring medium and large-scale enterprises to the private sector
managing the enterprises that have not yet been privatised

3) Financial reorganisation
clearing the existing state banks of uncollectable debts and recapitalising and privatising these banks
Managing these banks before they are privatised, including arrangements for loans to new businesses.

Source: ***Clague, C (1992) The Journey to a Market Economy*** **in Clague & Rausser G. (1992) (ed.)** ***The Emergence of Market Economies in Eastern Europe*** **(Basil Blackwell:Cambridge).**

Box (3.7)

Elements of *Economic Reform Model* Proposed by The World Bank (1991)

1) Macroeconomic stabilisation

2) Markets:

a) Goods and services

prices: liberalise most prices (including some necessities, such as housing)
trade: remove quantitative restrictions (adjust tariffs to modest levels)
distribution: privatise and demonopolise

b) labour market

deregulate hiring and firing
liberalise wage bargaining

c) Financial Market

restructuring and development
liberalising and privatisation

3) Ownership structure

small enterprises: develop and privatise
large enterprises: evaluate, restructure and privatise
foreign investment: revise regulations

4) Government:

Legal framework: reform property law, commercial law and taxes
Institutional framework: reform legal and regulatory institutions and fiscal administration
Social Safety net: meet emergencies, and institutionalise

Source: The World Bank (1991) *Form Central Plan to Market,* World Development Report (WB:Washington).

Box (3.8)

Elements of *Economic Reform Model* Proposed by The World Bank/IMF/EBRD/ OECD (1992)*

1) Fiscal Policy:

get rid of the turnover tax
introduce a realistic and simple income tax with non-punitive marginal rates
phase out subsidies for food, intermediate goods and other services
curb social expenditure
introduce bond with attractive real interest rates
retain most of the taxing power at the centre, and share revenue downward.

2) External Economic Policy

dispense with multiple exchange rates, and establish a realistic single rate
agree on a division of responsibility of external debt and foreign exchange reserves between union and republics

3) Incomes Policy

index wages to only 50-70% of inflation

4) **Prices**

announce timetable for conversion to world prices

Introduce an export tax on energy and mineral products until domestic prices have been raised to equal world prices

use a rationing device, probably stamps, to ameliorate shortage problems in the consumer sector during the transition.

5) **Ownership:**

auction off small enterprises in retail trade, and wholesale trade, and during transformation

put large enterprises in state holding companies with equity shares (held by state initially).

preparation to sell off the shares to the public

to end any preference in access to materials for publicly-owned companies

to end production monopolies, except where they are 'natural' (such as electricity supply)

6) **International trade**

to establish a single exchange rate

to introduce a new 30% universal tariff

to liberalise further to match the lower levels in other nations

7) **Foreign direct investment**

reform of the legal and fiscal structure

any screening of foreign investors must be transparent and non-obstructive

explicit protection for foreign capital against confiscation and expropriation is required

establishment of credit market

8) **Banking**

convert state banks to joint stock banks and commercialise them under prudent banking standards

9) **Social security**

reform social security

10) **Labour**

abandon tariff wages

get government out of the process of wage determination in the long run, but the transition problems require an incomes policy in the short- to medium-term.

11) **Legal Reform**

create a system of property rights

end all union and republic laws that criminalise behaviour that is both rational and economically beneficial (such as speculation).

12) **Accountancy**

introduce a standardised western system; this is a priority for technical assistance, since the valuation of industry prior to privatisation requires standardised accounting.

13) **Environment**

14) **Distribution of goods**

privatisation of the distribution network

15) **Transportation**

raise rail rate and mass transit fares to provide funds for modernisation

16) **Telecommunication**

create regional monopolies and reform tariffs in the central network;

access to modern telecommunications is a high priority in creating a favourable business environment.

17) **Agriculture**
liberalise all prices
reform land tenure arrangements with guarantees of permanency
defer any new investment in collective agriculture until all reforms are in place
reduce waste of agriculture by introducing food processing

18) **Energy**
restore output oil, gas and electricity
invest more to augment electrical generation capacity
reform energy prices to bring them in line with world prices

19) **Mining and extraction**
stop over-capitalisation in this industry
raise prices of output sold to domestic enterprises
increase prices to give incentives for recycling and hence help the environment

20) **Manufacturing:**
end monopolies
privatise through the intermediary stage of holding companies
harden budget constraints
improve accounting

21) **Housing:**
reform property rights
facilitate sale of property and leases
create financing opportunities for purchase by individuals
foster competition in housing supply

22) **The role of western assistance**
primary focus must be technical assistance for legal reform, creating markets and fiscal and monetary policy
food aid will be required in the transition
project assistance should be a priority to retailing and small-scale wholesaling, transportation and distribution networks, telecommunications and food processing.

Source: Kennett, D. (1992) Elements of Economic Reform, ***in Clague & Rausser G. (1992) (ed.) The Emergence of Market Economies in Eastern Europe*** **(Basil Blackwell:Cambridge).**

* **Note:** This is a summary of a study done by the leading multi-lateral economic agencies- IMF, IBRD, OECD, EBRD- after a request from the heads of the Group of Seven (G7) countries. The aim was to provide recommendations for the reform of the Former Soviet Union (FSU) economy, and to establish criteria by which Western economic assistance could effectively support such reforms. It is important to note that this study was done within a period of four months.

Most of the proposed models agreed that the following broad elements of any comprehensive economic reform scenario must be in place for the reforms to be considered successful: (1) macroeconomic stabilisation; (2) microeconomic liberalisation; (3) enterprise restructuring and *privatisation*; (4) institutional reforms; (5) development of financial markets and institutions; (6) and a new system of social

security. All the above discussed models suggest that privatisation is a very necessary element, for any economic transformation programme to be successful. In fact, each element has its own set of prerequisites, and each is linked to the others in a complex web of logical and practical interconnections. After agreeing on the general components of any reasonable reform model, the crucial question that follows is: "How should the sequencing of the reform models be structured?"

b. Sequencing of economic reform

The sequencing of economic reform has only recently emerged as a topic of theoretical analysis.[8] The World Bank (1991) distinguishes between two schools of thought. One school of reform (for example, Kornai, and Friedman[9]) puts change in ownership at the head of the sequence, before or alongside changes that address macroeconomic stability and markets. The rationale is partly political. With early privatisation, there is less risk that the economy will remain state-controlled, and greater pressure for complementary market-orientated reforms. The other school of thought (for example Sachs, the World Bank, and Nuti) begins with macroeconomic and market-building reforms. It leaves privatisation -at least for large state enterprises- to a second stage. Under both proposals some agricultural, retail and residential assets would be privatised early. The rationale is that private ownership requires financial institutions, experience, and expertise that do not yet exist in the transitional economies. Without this infrastructure, rapid privatisation could lead to widespread corruption, and economic and political chaos.[10]

Lipton & Sachs, 1991; Summers, 1992; Fischer & Gelb, 1991, all argue that the more fundamental reason for sequencing the reforms is that some changes are preconditions for others. For example, macroeconomic stabilisation is needed if price reform is to be successful. The systems and skill, which have to be in place for the markets to work, need to be developed. So, financial liberalisation is extremely risky, unless a sound system of accounting, auditing, prudential regulation and supervision is in place, and unless the macroeconomic convey is reasonably stable.

It can be concluded that a linear sequence of individual policy changes is not likely to succeed. In addition, no single reform sequence will fit all the transitional economies. The details of the reform path any country would follow, therefore, depend on the state of the economy, on the tolerance of the population to reform, and on the prevailing political situation and the speed with which these new institutions can be established.[11]

As stabilisation strategies are among the main elements of any transformation programme, it is of importance at this stage of my analysis, to investigate how economic theories, and the experiences of other countries, can assist the researcher or political leader in designing a macroeconomic stabilisation strategy. This gives the opportunity to relate the Polish experience to existing macroeconomic stabilisation theories.

c. Alternative stabilisation strategies

Economic theories offer two alternative stabilisation strategies, referred to as the ***orthodox approach***, and the ***heterodox approach***. The first is based on elimination of the budget deficit and the use of money or the exchange rate to anchor the prices level (s). With this approach, there is money and exchange rate-based stabilisation, depending on which of these variables is used as the nominal anchor. Whereas the second is, in effect, a version of the orthodox exchange rate- based stabilisation, initially supporting the fiscal adjustment with price and wage controls to deal with the inertial aspects of inflation.[12]

1. The Orthodox Approach

This approach has been effective in stopping hyperinflation episodes in low-inflation countries. It has been effective in chronic high-inflation cases, especially in the short run, in some of the Latin American countries.[13]

Money-based programmes: There are few examples of money-based stabilisation programmes in chronic high-inflation countries. The Chilean stabilisation programme of 1974-75 is one of the few.[14] It was a comprehensive effort that combined a major

fiscal adjustment with a monetary crunch aimed at stopping inflation.[15] The effect on inflation was disappointing. Despite major anti-inflation effort, the rate fell only marginally between 1973 and 1975. This disappointing outcome was accompanied by a dramatic rise in unemployment (from 4.6% in 1973 to 16.8% in 1975), a large fall in GDP (exceeding 14% in 1975) but, an improvement in the current account. In early 1990, Argentina and Brazil were pursuing monetarist programmes to stop their hyperinflation. In both these cases, inflation fell initially- monthly inflation dropped at the beginning to one-digit level- but the success only lasted for several months: inflation later bounced back to rates above 20% a month in both countries. As in Chile, both programmes were recessionary and led to an improvement in the current account.[16]

The sluggish response induced by money-based programmes to reduce inflation, and their high costs in terms of output and employment, explain why this approach is seldom used in chronic high-inflation countries. In most cases where money-based programmes have been adopted, the monetarist phase has been short, with the authorities eventually shifting to a strategy that uses the exchange rate as the nominal anchor.[17]

Exchange Rate-based stabilisation: This is a programme designed to reduce inflation by combining a package of fiscal adjustment with the exchange rate as the nominal anchor. The exchange rate rule can take the form of a fixed exchange rate (as in Chile in 1980) or a pre-announced rate of devaluation (as in the *tabilets* in the late 1970s in Argentina, Chile and Uruguay).[18]

Experience shows that exchange rate-based stabilisation is usually more effective than money-based stabilisation in bringing down inflation. In Chile, for example, the combination of a tight fiscal stance and the announcement of a schedule of future daily values of the exchange rate embodying decreasing rates of devaluation, was more effective in reducing inflation than was the monetarist phase. Nevertheless, inflation was very persistent, remaining above the pre-announced rate of devaluation for a prolonged period. As a result, the real exchange rate appreciated, and in the end the economy was stuck with an overvalued currency, difficulties in the external sector and the threat of a Balance of Payments (BOPs) crisis.[19]

2. *The Heterodox Approach*

Heterodox stabilisation programmes are those that supplement Orthodox measures- namely tight fiscal and audit policies and a fixed exchange rate- with income policies. They are usually the first stage in a long-term stabilisation effort. The distinctive feature of these programmes is the initial and temporary use of price and wage controls and a fixed exchange rate to achieve a rapid reduction in inflation. Once the controls are removed, the programme essentially becomes an orthodox exchange rate-based stabilisation programme. Most *orthodox* programmes start with a period of tight money before they switch to the exchange rate as the nominal anchor-one difference between *Orthodox* and *Heterodox* programmes.[20]

Experience shows that few programmes satisfy the definition of *heterodox*. There were just two examples in the 1980s[21]: The Israeli programme of 1985, and the Mexican programme of 1987-88. Both programmes initially used income policies to achieve a rapid reduction in inflation. In both cases, the exchange rate was the main nominal anchor and was fixed at the beginning, and both maintained the fiscal adjustment throughout. There were differences in the degree to which the two countries applied controls. In Israel, the controls were economy-wide, while in Mexico, the Government opted to allow a large number of prices to be determined freely. However, these differences were ones of degree and not substance. Basically, the philosophy behind the two programmes was the same.[22]

One feature of heterodox programmes is the ease with which they bring inflation down during the early phase of the programme. This initial fall in inflation, however, is not an indication of success, because this outcome is common to both successful and unsuccessful programmes (the latter include those that imposed price-wage controls but did not persist on the fiscal side). A second feature is that the initial costs of bringing inflation down are not very large (as opposed to under money-based orthodox programmes). In Israel, unemployment went up marginally for just two quarters, while

in Mexico there were no indications of costs in terms of unemployment and output growth as a result of the stabilisation efforts.[23]

The first stage is the easy part of a *heterodox* stabilisation programme, but it is followed by more difficult steps later. By using the heterodox approach, policy-makers tend to postpone many of the problems that appear early on in money-based *orthodox* programmes. The use of controls does not remove the credibility problem which *orthodox* programmes face in chronic high-inflation countries, and this difficulty has to be confronted later, when prices and wages are liberalised (the stage in which flexibility is created). This stage is the more difficult one in a *heterodox* programme, since only then do policy-makers have to rely on traditional nominal anchors (either money or the exchange rate) to bring inflation down. The typical problems in the flexibility stage are a resurgence of inflation, an increase in real wages, high interest rates, an appreciation of the real exchange rate and a deterioration in the current account.[24]

I have already discussed the main economic transformation programmes proposed by different economists, the main stabilisation strategies, and the experiences of some countries. The following part is devoted to answering the following questions: "What kind of reform programme did Poland adopt to transform its economy from CPE to an ME?"; "Who decided to adopt that programme?." "How did the Polish authorities formulate their economic reform programme of 1989/90?." "What are the main elements of that programme?." "Which strategy did Poland adopt to stabilise its economy?." And finally, "How much did the Polish economic reform programme and stabilisation strategy resemble any of the theoretical models, and stabilisation strategies, discussed above?."

2. The Polish economic transformation programme of 1989/90

One cannot understand what happened in Poland in the late 1980s, unless one has some knowledge of the political, social, and economic environment at the time. In fact, Poland adopted a radical programme to transform its economy from a CPE to a market one, because the economic, social, and political wills began to converge in the late

1980s. That was the case because, without unambiguous political agreement on decision-making by consensus, a credible reform programme is all but impossible. This is particularly relevant to East European countries in general and to Poland in particular, where the old political structures had lost popular legitimacy, but new mechanisms of decision-making by consensus were not yet in place. This question may also be relevant for Poland, where the democratic process had been semi-established in 1989, and fully established in 1990/91, but may still be vulnerable to possible economic set-back. Even if the project of moving to a market economy receives political backing and wide popular support, circumstances may force policy-makers to pursue other goals which may conflict with a rapid move towards a full market economy. Thus, a commitment to increase economic efficiency, as in Poland, will tend to contradict with the rapid setting up of a market economy. While such decisions about relative priorities are intrinsically political, economists drawing up suggested blueprints for reform should be aware of the difficult political choices which their proposals may involve.

Once most of the political difficulties of economic transition have been overcome, a broad social consensus needs to be reached on the steps to be taken. Even if such social agreement is attained initially, there is no guarantee that such a consensus can be maintained once the costs of the adjustment begin to emerge. A market economy is expected to yield considerable benefits to the population. It was very important that reformers made clear the magnitudes of potential benefits, and the likely time scale for their emergence, in order to obtain the widest possible support for the transformation process. Qualitative benefits from the move to a market economy which were likely to appear quickly (such as more individual freedom, increased choices, and the disappearance of queuing) should be stressed. Similarly, the prospects for increased independence through the secure, individual ownership of wealth may be important for constructing and maintaining a social consensus behind the reform programme. Even in the oldest democracy, where the rules of decision-making by the majority are widely accepted, there is still considerable uncertainty about the socially acceptable limits of changes in policy. Indeed, increases in inflation or unemployment, or substantial cut-backs in subsidies or government services, have frequently led to changes in governments. There is no reason to believe that the new eastern democracies will find

it easier to deal with such (hopefully short-run) economic problems, whatever the longer-term benefits of the market economy may turn out to be. An especially important question here is whether it is true that economic chaos leads to a social consensus in favour of "shock therapy" or "big bang" adjustment policies, as adopted in Poland in 1990 and Yugoslavia in 1989, in contrast to the more gradualist approach taken by Hungary for over two decades. However, even if such a consensus in favour of shock therapy exists, whether implicitly or explicitly, there is no guarantee that this support can be sustained as the costs of the transition increase. There may, therefore, be an apparent reversal in reform policies, which is perfectly logical, given the social and political context. On the other hand, if a gradual process is adopted, central planning may collapse, with no replacement in sight at all. Informal co-ordination mechanisms, such as black markets, will tend to emerge, instead of the expected gradual transition to the open market. Increasing inequality, open inflation and a rapid increase in unemployment, may lead to disenchantment with the incomplete reform process, and result in the adoption of a policy of shock therapy. But whether this will help in reaching the necessary social and political consensus remains to be seen. How did an economic, social, and political *consensus emerge* in Poland?.

a. Political developments

As noted in the previous section, past attempts at economic reform had failed because they were implemented under the umbrella of the Classical Socialist System. In the Eighties, the *'reformers wing'* in the Communist Party started to predominate, because they realised that the Polish economic system was deteriorating at a rapid pace, and that dissatisfaction among the general population could no longer be ignored. The ruling party and its government could not rely on Western countries for financial support, as the Polish State increasingly lacked financial and political credibility. The convergence of all these factors prompted the Communist authorities to seek some form of accommodation with the opposition[25].

The first attempt towards a compromise taken by the *wing of reformers* of the Communist Party in Poland was led by the Interior Minister, **Kiszczak,** when he met

with **Lech Walesa**[26] in August, 1988. At that meeting, the proposition for the so-called 'Round Table' Debate was formulated, sending out a signal that the Party was ready to negotiate with the opposition.[27]

The second attempt towards compromise was the television discussion between Lech Walesa and **Alfred Miodowicz,** the head of the Union, which took place in November, 1988. Its original purpose was to discuss the future of trade unions, but it quickly expanded into a general debate on the whole situation in Poland.[28]

Political discussions between the Ruling Party and the opposition, accompanied by labour strikes, led to the resignation of **Messner's** government in September, 1988. A new government was formed by **Rakowski**, in October, 1988. This government favoured the acceleration of some reforms by promoting a more central role for the private sector. At the same time, it tried to weaken the opposition (party), by announcing the liquidation of its birth place, the Gdansk Shipyard[29]. However, due to political, social, and economic pressure, the 'Round Table' Debate began in February, 1989, and ended in April, 1989, with the 'Round Table' Agreement between the ruling authorities and the opposition Solidarity trade union, other official trade unions and some other interest groups.[30] This led to a new political situation in Poland, and a semi-free[31] election took place on June 4, 1989. Solidarity members won 99 seats in the Senate and all freely elected seats (161 seats) in the Sejm (The Polish Parliament). General **Jaruzelski**[32] was elected to the post of State President on 19 July, 1989, and **Rakowski** was nominated to the post of First Secretary of the Communist Party. Besides that, **Kiszczak** (the former Interior Minister, who made the first attempt towards compromise with the opposition (party)) was appointed to the post of Prime Minister.[33]

At the time, Polish intellectuals and leaders of the opposition (party) understood[34] that this was a very clear signal from the Ruling Party to take the chance to join them in the 'new' political and economic systems. In fact, the leader of the opposition party (**Lech Walesa**) grasped that chance and took another step forward. He established a parliamentary coalition from the United Peasant Party (ZSL), the Democratic Party

(SD), and Solidarity. Due to this coalition, **Kiszczak** (the appointed Prime Minister) failed to form a government, and resigned on 17 August, 1989. Hence, a new coalition government (i.e. from Solidarity movement members, the SD, the ZSL and PZPR) was formed on 16 September, 1989, by Solidarity advisor, **Mazowiecki.**[35]

A look at the new Cabinet explains why it was possible at the time to form a radical economic reform programme: Solidarity members took Portfolios of nearly all of the 'economic' Ministries, including the Ministries of Finance (**Balcerowicz**), Industry, Construction, and Agriculture, while Communists still kept the most important 'political' ones (i.e. the Ministry of Interior and the Ministry of Defence).[36] With responsibilities divided in such a fashion, how could political compromises be achieved?. How would the politicians let the economists achieve their goals?.

b. Economic issues

In his address to the Sejm on 13 September, 1989, **Mazowiecki** announced clearly that political and economic changes would be designed not to improve the previously existing system, but to change it radically towards a market economy and western-style parliamentary democracy. He indicated that in the short-run, the highest priority would be given to fighting inflation, which had turned into hyperinflation following the removal of price controls in August, 1989. The Sejm's vote of confidence for the ***first non-communist-led government*** and its economic plan provides evidence that Parliament realised that there was no other alternative.[37]

It was the responsibility of the Ministry of Finance, in fact the task of **Balcerowicz,** who had been an ardent advocate of economic reforms since the late Seventies, to formulate a radical reform plan. How did he and his team[38] accomplish that task?. The team encountered dilemmas over the character of the plan itself. At the beginning, the main dilemmas which faced them before embarking on the plan were the following:

(1) whether to choose a 'big bang' (shock therapy) or a gradual step-by-step approach;

(2) whether a larger or smaller scope of government intervention in the economy should be chosen;

(3) whether priority should be given to the stabilisation programme, or to the systemic transformation process; and

(4) whether the Polish economy should be open to international competition.[39]

The challenge, therefore, was unique in its system-wide scope, its political, economical, and historical context, especially when we know that Poland was one of the first countries to discuss the issue of transformation cum economic liberalisation[40]. One can thus argue that Poland did not have the guidance that could be gleaned from theoretical economic models. The transformation in Poland happened before other economic reform programmes appeared in 1990. Poland was already embarking on its radical economic reform programme of 1989-90. The Polish economic reform programme served rather as one of the first examples for systematic theoretical debates about such reform programmes, and this was subsequently widely disseminated. The importance of analysing the Polish experience, therefore, as mentioned in the introduction to the study, lies in providing others with a model for economic reform in general, and privatisation in particular.

Bear in mind that **Balcerowicz** belongs to the *'younger generation of Polish economists'*, and was one of those who formulated the best, most complex, and theoretically-advanced ideas to reform the Polish economy in 1980-81. His project at the time called for the replacement of central planning mechanisms with market mechanisms. Predictably, it was rejected by the Communist regime at the time.[41] Therefore, one can readily accept the fact that on October 6, 1989, less than a month after the vote of confidence by Parliament, the first non-communist government prepared the *'first approach'* of its radical economic reform programme.[42] And after two months, on 17 December, 1989, **Balcerowicz** presented to the Sejm a balanced budget, and a package of eleven laws designed to lay the foundations of the Polish economy for the next five years.[43]

c. External influences

Why did **Balcerowicz** and his team opt for a very radical type of reform, a "big bang" approach, not a "step-by-step", gradual approach?[44] From the point of view of the IMF team and Sachs (who were members and advisors in the team), *"piecemeal changes cannot work, since each part of the overall reform has a role in strengthening the other parts. Financial control of the public sector requires active competition. That in turn depends on free trade, and free access to foreign exchange."* [45]

The team also opposed the idea of strong governmental intervention in the economy, and voted for free market solutions. **Balcerowicz** confirmed several times the declaration of his Prime Minister, that the goal "is to establish an economic system similar to that of highly-developed Capitalist countries."[46]

From the above discussion, one can conclude that the decisions were made by the Poles with the help of a group of foreign experts on whose goodwill Poland depended to receive the money to transform the country.[47]

d. A two-stage programme

In fact, the Government decided on a two-stage programme. The first phase, until 1989, was to prepare the ground for the main stage, which was to begin on January 1, 1990.[48] The first phase was called 'emergency measures', introduced in the last quarter of 1989 to arrest the deterioration of the economy.[49] These measures included the removal of many price controls, aimed at preparing the ground for major price liberalisation in January, 1990; intensified credit restraint to curb excessive money creation, which was another major cause of inflation, along with the budget deficit; accelerated tax payments and expenditure cuts, a rapid depreciation of the Zloty, and 100-200% taxes on excessive wage increases (increases exceeding 80% of the monthly rise in the cost of living).[50]

The **Plan** had two packages: (1) a macroeconomic ***stabilisation*** and microeconomic ***liberalisation*** package, aimed at bringing down inflation and restoring market equilibrium in the commodity market, and equilibrium of the current account balance; and (2) an ***institutional (systemic) transformation*** package, aimed at creating a modern market economy of the type prevailing in the West. The Plan was later termed *'The Balcerowicz Plan'* by the Media.[51] **Box (3.9)** shows the main components of the Polish Economic Reform Programme of 1989/90.

The Polish *economic reform programme* includes the main broad elements suggested by the proposed models discussed above. Therefore, one can argue that the Polish *economic reform programme* deserves to be described as "*Poland's most comprehensive and radical attempt to date to stabilise and set the stage for transformation into a market economy, and certainly stronger than Yugoslvia's and Hungary's programmes.*"[52]

It is of interest, but no surprise, to mention that the Polish *economic reform programme* was approved by the IMF, and its basic points were set down in the Polish Government's Letter of Intent[53] to the IMF; and Letter of Policy[54] to the World Bank.

The main **assumptions** of the *stabilisation package* are: budget balance would be quickly restored by a sharp cut in subsidies and investment spending. The growth of net domestic credit of the banking system would be tightly controlled, partly through a sharp increase in interest rates in the banking system. The exchange rate would be devalued and made convertible, and then stabilised at the new depreciated rate. The nominal wage would be limited through a tax-based policy designed to limit the rate of increase in the wage bills of State enterprises. Prices would be liberalised, except in certain regulated sectors, (such as public utilities) where there would be a sharp, one-time adjustment.[55]

Box (3.9)

The Polish *Economic Reform Programme* of 1989/1990

1) **Stabilisation & Liberalisation Package:** This package includes:

a) the *freeing*, in January, 1990, of almost all remaining *administrative price controls*, coupled with the *increase of official coal and energy prices* by 400% to 600%, and other prices by roughly 100%;

b) the *'internal convertibility'* of the zloty, i.e., the unification of the market for foreign exchange for most current transactions, accompanied by a sharp official devaluation of the zloty by 31.6% from zl 6500/1 US $, to zl 9500/1 US $, with the aim of maintaining the fixed exchange rate for at least six months;

c) the *limitation of wage fund growth* in enterprises to a small fraction of the price inflation (0.3 in January, 0.2 in February-April) through a very restrictive, tax-based income indexation policy;

d) the *elimination of the budget deficit* and attainment of approximate fiscal balance by the (general) Government in 1990, through major cuts in food and commodity subsidies, reductions of public investment programmes and defence and internal security expenditures, coupled with substantial increase of taxes, custom duties and other fiscal charges paid by the enterprises; and

e) a major *tightening of credit* and monetary policy, a strict limitation of the rate of domestic credit expansion to government and non-government sectors, together with a sharp increase of interest rates, making them positive in real terms

2) **Systemic package:** This package includes:

a) enterprise restructuring, ***privatisation*** and the development of the private sector

b) reform of the financial sector

c) the establishment of a Social Safety Net.

Source: ***Rosati, 1991a:28; Jones, 1992:103; Kolodko, 1992:132-35; Rosati, 1991b:228-9; PPRG, 1991:7-9; Nuti, 1993:383; Thumm, 1991.***

The ***components*** of the *structural adjustment or systemic package* are: (1) enterprise restructuring, the privatisation and development of the private sector, with appropriate legislation to impose financial discipline, the establishment of an adequate institutional framework for enterprise restructuring (including strict environmental standards) and

preparation of the ground for privatisation. (2) financial sector reform, with emphasis on improved banking regulation and supervision, the introduction of adequate accounting and auditing standards (also for non-financial enterprises), and the strengthening and phased restructuring of the banking system; and (3) the establishment of a Social Safety Net, with emphasis on adequate unemployment benefits, employment services, training, and a programme of minimum social assistance and improved health policy.[56]

It is of interest to mention that the team, after advice from the IMF staff and the Western experts, put its main emphasis on the whole package of measures aimed at the stabilisation of the Polish economy, especially those measures aimed at fighting inflation. The team argued that stabilisation is a prerequisite for any systemic reforms. Success in stabilising the economy would give new non-communist governments in Poland legitimacy and support for their deep structural reforms.[57] That is why it took the first non-Communist government more than six months to announce the Law on Privatisation (in July, 1990), more than nine months to establish the Ministry of Privatisation (MoF), and more than twelve months to announce the official goals of privatisation, as we shall see in section Six. Nevertheless, the most crucial point to emphasise is that ***privatisation*** is one of the main elements of the Polish *economic reform programme* of 1989/90.

e. Comparisons with economic theories

It is of interest at this stage of my analysis to relate the Polish macroeconomic stabilisation and microeconomic liberalisation experience, to economic theories.

The stabilisation programme, which was one of the main elements of the "big bang" programme that was launched on January 1, 1990, can be defined as ***heterodox,*** with *two nominal anchors*, the *nominal wage* and the *exchange rate,* and *fiscal and monetary* tightening.[58]

The wage policy consisted of a lagged indexation of the wage bill with low coefficients. As can be seen from Box (3.9), the wage bill was indexed to the changes in prices in the preceding month according to the coefficient 0.3 in January, and 0.2 in February-April. In practice, the latter was ultimately maintained through June, and became 1 in July and 0.6 thereafter. The wage ceilings were to be enforced through a steeply progressive tax penalty.[59]

The *exchange rate* of the Polish Zloty was frozen at 9,500 zloty per US$1, after the unification of the parallel and official markets, and the decreed 'internal' convertibility of the zloty (for current account operations, but not for capital account operations). The freeze of the exchange rate was preceded by a sharp depreciation of 31.6%, and the measure resulted in a significant overshooting of the parallel market rate prevailing on average in December (about 30%). It was expected that the exchange rate would be defended by a special fund (of US$1 billion) to be made available by foreign governments, as well as by the interest rate policy.[60]

The *fiscal components* relied on a balanced budget, to be achieved in 1990. An increase in revenues of about 4% of GDP and a small reduction in expenditures of around 1% of GDP were to produce an adjustment in the budget.[61]

The *monetary components* relied on tight credit conditions in the first quarter of 1990, that were partially loosened in the following three quarters of the year. Net domestic assets were expected to grow by about 20% in nominal terms in the first quarter, a level that implies a real decline of 30%, and to grow at an average quarterly rate of 7-8% in the rest of the year, a level that is above the expected rate of inflation. This policy would have guaranteed a small real increase in net domestic assets by the end of the year. The credit ceilings were complemented by an interest rate policy geared to maintain positive real rates throughout the year. Given expected inflation of about 30-35%, the Government set the financing rate of the National Bank of Poland, which was to serve as a sort of leading rate, at 36% in January.[62]

As noticed in Box (3.9), fundamental liberalisation measures accompanied the above macroeconomic policies. The *price system* was liberalised almost entirely- only 5% of goods sold at the retail level remain subject to price controls- and simultaneously the administered prices of energy products were raised more than 400%, in order to reduce subsidies. The *trade system* was liberalised by abolishing quantity controls on imports, and replacing them with tariffs, and by reducing the quotas for exports of basic commodities. In addition, the *tax system* was revised.

The ***remainder of the section*** analyses these major policy changes, and outlines their consequences on the privatisation process. In addition, it outlines the main elements of the 1994 *Strategy for Poland* Plan, which was the first official policy since *The Balcerowicz Plan* of 1989/90.

f. Major policy changes

1. Price Liberalisation

Generally speaking, the authorities in any country are influenced by a number of considerations when they set price paths, including the need to reduce inflation and social concerns. For example, in the case of Poland, complete and immediate liberalisation in the energy and housing sectors has been resisted, given the importance the energy sector has as an input for other sectors, and given the social consequences that higher rents and utility charges would have for the poorest members of Polish society.[63]

The idea behind price liberalisation was to create the right price signals to Polish enterprises, so that only those enterprises with good economic and financial standing could survive, and compete in the international market.

The process of price liberalisation could be said to have passed through two phases. The first took place in 1990, when prices were decisively liberalised. The second, during 1991-93, when price liberalisation was consolidated, a new system of price

control emerged, and administered prices settled into a pattern of gradual-but faster than Consumer Price Index (CPI) or Producer Price Index (PPI)- increases.[64]

The scope of price liberalisation performed when the package was launched in January, 1990 was very limited, since the movement to a new system of price control began as early as 1982, when a three-part system of prices (administered, regulated, and contract prices) was introduced. Administered prices were set directly by the authorities, regulated prices were closely monitored, while contract prices were theoretically free.[65]

In 1992, a new system emerged, whereby all prices were market determined except for a core of official (administered) prices, set directly by the authorities and published in the budget document for the year ahead, plus a set of prices which was influenced by the authorities through taxes. The former included electricity, gas, central heating and hot water, basic medicines, rents in housing belonging to local administrative units, television fees, and spirits; the latter included fuel for engines, beer, wine, and cigarettes.[66]

By 1993, as measured by their weight in the CPI, 12% of prices was officially set, while 8% was tax controlled. In general, the authorities aimed at official (administered) price increases that outpaced inflation.[67]

Toward the second half of 1993 and early 1994, three occasions are worth noting where specific government actions influenced price behaviour. The first such development was a temporary increase in retail prices, which was not justified by cost or tax increases, and which was prohibited for a period of three months following the introduction of value-added tax (VAT) in July, 1993. Second, the Ministry of Finance issued a list of products[68] and a list of 'monopolistic' state enterprises[69] which would have to provide a three-week notice to Tax Chambers of any planned increases in prices. Third, a scheme of variable import levies in agriculture was devised that would have the effect of increasing domestic prices.[70]

2. *Trade Liberalisation*

Trade liberalisation started long before the 1989/90 reform programme. The few elements of the State monopoly of foreign trade had been eliminated by January, 1990, allowing unrestricted access to external trade activities for all economic agents. However, a license from the Ministry of Foreign Economic Relations was still required to trade in transactions involving radioactive materials, weapons and arms, and trade in a few selected services, such as franchising.[71]

Regarding the tariff system, a new tariff was introduced in January, 1990, based on the Harmonised Commodity Description and Coding System recommended by GATT. In addition, imports, like domestic sales, were subject to turnover tax, as a transitory measure. This was then replaced by a uniform value added tax. Moreover, all quantitative restrictions on imports paid in convertible currencies were eliminated. Until 1991, imports and exports from and to COMECON countries were still regulated by intergovernmental protocols. After the collapse of COMECON, this trade was also liberalised.[72]

Trade liberalisation was expected to support the transformation process in three ways:

(1) Removing import restrictions and export barriers raises economic welfare[73]. **(2)** Import liberalisation could expose the tradeable sector to competitive pressure from the world market such that the lack of dismemberment of giant state firms, or a slow pace in privatisation and in the formation of new enterprises, would not result in as much monopolistic pricing as otherwise. Imported intermediate goods and capital goods should also allow firms to effectively take advantage of international specialisation, and thereby reduce costs and improve product quality or diversify both for domestic and foreign markets. **(3)** Export liberalisation could not only allow the exploitation of static economies of scale but also the possibility to take advantage of dynamic scale economies in research and development intensive industries, in which high price cost margins are sustainable in world markets.[74]

3. Exchange rate regime

During the Communist era, the zloty was not freely convertible, and there were many exchange rates to the Polish currency linked to various types of international transactions. During that period, one of the main characteristics of the Polish economy was the existence of the dollar black market.[75]

After the collapse of the CSS, the main issue the first non-communist Government had to resolve was which exchange rate regime Poland should adopt. Economic theory suggests that the selection would depend upon many factors, such as the country's particular economic objectives, the initial conditions, as well as the sources and nature of the shocks affecting the economy[76].

When Poland started its economic reform of 1989/90, the question which arose was not only how to achieve full currency convertibility and how to maintain a stable exchange rate regime; but whether exchange rate stability would lead to a situation that sets a reliable framework for international trade and capital flows? Private investors need guidance for world markets, but without clear international relative price signals, privatisation as well as foreign economic liberalisation, would yield limited benefits in the transforming economies.

Therefore, in the preparatory phase to the shock therapy, throughout 1989, the zloty underwent a series of small, step-by-step devaluations which raised sharply the official zloty price of the US$ from around zl 300 to zl 6500 by the end of 1989. As of January, 1990, the decision of the Polish authorities was to adopt a fixed exchange rate, to brake the emerging hyperinflationary pressures, while fixing the parity at a level which would restore and maintain international competitiveness. Indeed, the adoption of a fixed exchange rate was very strongly affected by the lack of an organised foreign exchange market.[77]

Starting from January 1, 1990, the zloty was devalued by 31.6% from the December, 1989 rate of zL 6500/ 1US$ to zL 9500/ 1US$. At the same time, the zloty was made 'internally convertible'[78].

In May, 1991, the zloty was devalued again to zL 11,100/1 US$. The Polish authorities planned to move to fully fledged zloty convertibility when economic conditions permitted. In October, 1991, Poland switched to a pronounced 'crawling peg' exchange rate policy (the continuous devaluation of a currency in small increments). As a result, the zloty was devalued in February, 1992 and in August, 1993, and the exchange rate stood at zL 23,8567/ 1 US$ in November, 1994.[79]

On January 1, 1995, the zloty was redenominated, and the scope of its convertibility was extended. These decisions were designed to boost confidence in the national currency and expand its use in business transactions.[80]

On May 16, 1995, a new exchange rate system was introduced. It allows for floating adjustments of the zloty exchange rate in the domestic inter-bank market within the band of fluctuations around the average rate, which is determined on the basis of principles that were applied hitherto. As of May 16, 1995, this average rate is called the Central Parity Exchange Rate (CPR). Apart from the CPR, which is announced in the morning, the NBP fixes the closing rate at the end of each day (Fixing Exchange Rate FER). It is an official rate used for statistical and accounting purposes. It reflects the level of exchange rates in the inter-bank market better than the previous average rate and the present CPR. Both CPR and FER are expressed in two currencies: US dollar and Deutsche Mark. The central parity exchange rate is based upon the hitherto level of zloty devaluation against the basket of currencies (i.e. 1.2%). At the end of December, 1995, the average monthly fixing rate was US$ 1/zl **2.5139.**

4. Tax System

Many changes have been introduced into the tax system. The major reforms were: (1) the introduction, in 1989, of an Enterprise Income Taxes (EIT)- a uniform tax on the income of legal enterprises. In January, 1991, certain amendments on the EIT law were made, and in January, 1992 a new EIT law was introduced. Moreover, other amendments on EIT were made in June, 1992; January, 1993; July, 1993; and January,

1994.[81] **(2)** the introduction, in 1990, of a 2% tax on the gross payroll of enterprises, to finance the newly established unemployment insurance scheme administered by the Labour Fund. **(3)** the introduction, in 1992, of personal income taxation (PIT)- a comprehensive tax on PIT to replace the income tax of 1972, the wage tax of 1949, the wage equilibrium tax of 1983, the wage fund tax of 1982 paid by employers, and part of the agricultural income tax of 1984. Several amendments to the PIT were made in January, 1993 and January, 1994. **(4)** the introduction, in 1993, of VAT at a standard rate of 22% and a reduced rate of 7%.[82]

g. Major political changes with virtually the same economic policy

Although there was a major political change in Poland after September, 1993, when the ex-Communists returned to power, one notices that this change did not have a major impact on the general outline of the Polish economic transformation process, as alarmists had expected. However, there was a slight shift of emphasis in the new government's economic policy.[83]

In June, 1994, the first **ex-Communist** Government, led by **Pawlak,** produced a programme called ***'Strategy for Poland'.*** This strategy was the first medium term policy framework to be produced since January, 1990. It was formed by Kolodko, the Deputy Premier and Finance Minister.[84]

The central theme of *Kolodko's Strategy* was to boost economic growth while containing inflation. Two crucial features for the programme can be distinguished: first, the commitment to continue the transformation process, and second, to reduce the social costs of the reforms.[85]

As can be seen from Table (3.1) the strategy aims for single figure inflation (8.7%) by 1997. It promises that real interest rates will remain stable and positive to encourage savings, stimulate investment, improve labour efficiency and make products more competitive. This would also lead to an increase in the accumulation abilities of State owned and private enterprises through an increase in real profits, and lower the cost of

public services, both domestic (thanks to a decrease in interest rates) and foreign (by slowing down the rate of creeping devaluation). Moreover, the exchange rate would be managed (depreciated) in line with inflation and, more important, inflationary expectations. These, Kolodko believed, needed to be 'talked down', although differing views on inflation held by the Finance Ministry and the National Bank made this difficult.[86]

Table (3.1)

Strategy for Poland: Major Economic Indicators (%)

Year / *Indicator*	1994 *Strategy*	1995 *Strategy*	1996 *Strategy*	1997 *Strategy*
GDP	4.5	5.0	5.2	5.5
Consumption	3.1	3.3	3.6	3.6
Investment	6.0	7.0	8.0	8.0
Exports	6.0	7.0	8.0	9.0
Imports	2.5	4.0	5.2	6.0
Real Earnings	1.5	2.8	3.0	3.1
Prices (%)	23.6	16.1	12.0	8.7
Unemployment end year (%)	17.2	16.7	15.6	14.0

Source: ***Ministry of Finance, (1994), Files.***

The *strategy* predicted, and most observers agreed, that this is over optimistic, consumer price inflation falling from 23.6% during 1994 to 16.1% for 1995, 12% for 1996 and 8.7% for 1997. Moreover, the plan predicted that GDP would grow by just over 5% over the period 1994-97. Consumption would grow significantly more slowly, at 3.5% per annum. Investment growth would be fast however, at just under 8% each year. Exports growth was expected to be in line with investment at 8% per annum. Imports growth, at just over 5% per annum, was expected to be fast, although less fast than exports and very much in line with the GDP.

Moreover, the *strategy* aimed at a gradual limitation of the budget deficit, from over 5% of GDP in 1992 and c.4% in 1994, to c.2-3% by 1997. Debt reduction will be accompanied by reform of the public expenditure system, which is expected to allow the Government to make the needed structural changes. Public debt reduction will include swapping some parts to equity in privatised State Owned Assets (SOAs). The

access of foreign entities to this programme was conditional on making additional financial investments by foreign funds, both in cash and/or in the form of commitment to future investment. Thus, this process was expected to result in an intensification of structural changes, and a flow of new foreign investments into the country. The Government's foreign trade policy, including international contracts, aimed at gradually balancing the current account and the trade balance. Its goal is to bring the still negative current account balance to the level of c.1.5% of the GDP in 1997.[87]

The **social core** of *Kolodko's Strategy* was the improvement of living standards. It was planned that the successful implementation of this strategy would allow for an almost 11% increase in average real wages and salaries during the years 1994-97. It was hoped that the unemployment reduction programme which was adopted by the Government would reduce the unemployment rate from 16% in 1994, to less than 14% by the end of 1997.[88]

Finally, it is of interest to mention that this Strategy enjoyed IMF support and provided a basis for a 19 month Stand-By Agreement (SBA).[89]

What kind of economic system did the above discussed transformation programme create in Poland?. In the next section, I highlight the broad lines of the structure of the *new economic system* which emerged in Poland during the period 1990-95. It is expected that the newly emerged market economy was a result of the changes in all of the elements of the economic reform programme of 1989/90, including, of course, privatisation.

Endnotes:

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[1] World Bank, 1992; Winiecki, 1992; Jackson & Price, 1994; Yarrow & Vickers, 1988.

[2] Summers, 1992:25-27.

[3] Clague, 1992:2.

[4] Ibid:2-3.

[5] Ibid.

[6] One of the authors of the radical 500-day plan for the Soviet Economy.

[7] Kennett & Lieberman, 1992:348.

[8] See Edwards, 1990, for excellent details on the issue of sequencing of economic reform.

[9] During his visit to Poland, Milton Friedman said that the Poles would have to do three things: privatise, privatise, and privatise. Somebody from the floor asked; "Well, but which one of them would come first?" (*Wilkin, 1993:24-25*).

[10] **At the beginning of the 1990s,** there was a **shift** in World Bank thinking concerning ownership. The World Bank started emphasising privatisation and ownership changes at the beginning of the 1990s. In the 1980s, the conclusion which emerged from the debate on performance and ownership was that gains in efficiency performance were more likely to result from an increase in market competition, than from a change in ownership. This conclusion was drawn from the following arguements: (1) the evidence from empirical studies comparing the performance of private firms to public enterprises on a 'like for like' basis indicated that economic efficiency could be achieved under either type of ownership (*Millward, 1988*). (2) there were reservations as to the applicability of theories arguing in favour of private ownership when account was taken of their stringent conditions and assumptions. The potential for generating performance improvement while retaining ownership in the public sector was recognised by the World Bank in the early part of the 1980s: "The key factor determining the efficiency of an enterprise is not whether it is publicly or privately owned, but how it is managed" (*World Bank, 1983:50*). This was reflected in the concentration of public enterprise reform, rather than privatisation, in the Bank's lending conditionality during this period (*Mosley, 1988*).

The World Bank's **current views** reflect the conviction that even if competition is important to generate efficiency gains, it alone is not enough, and ownership therefore matters. In its latest review of experiences with privatisation, it intimates that privatisation is superior to public enterprise reform for three reasons: "(1) *public enterprise reform is technically and politically more difficult to implement than privatisation.* (2) *undertaking a full public enterprise sector reform programme may be unworkable owing to the enormous difficulties with co-ordinating the relationships that are required between government agencies, financial institutions and the enterprises themselves.* (3) *previous attempts to reform public enterprises have not been entirely successful because reforms have been introduced in periods of crisis. Once the crisis has passed, the reforms have usually faltered, and performance improvement has not been sustained.*" (*Cook & Kirkpatrick, 1995:23).*

More clearly, the World Bank now argues that profitability could even be higher with privatisation. Therefore, 'corporatisation' can only be considered as a stepping stone towards eventual privatisation. The World Bank's argument is reinforced by its insistence that while corporatisation may provide short-tern gains, it will encounter longer-term problems (*World Bank, 1992:5*).

[11] World Bank, 1991; Lipton & Sachs, 1992; Summers, 1992; Fischer & Gelb, 1991.

[12] Kiguel & Liviatan, 1991; Bruno, et al, 1988; Ramos, 1986.

[13] Ibid.

[14] Keguel & Liviatan, 1991:85-100.

[15] Ramos, 1986; Corbo, 1986; Edwards & Edwards, 1987; Corbo & Solimano, 1990.

[16] Kiguel & Liviatan, 1991.

[17] This sequence was observed in the Chilean programme previously discussed, as well as in the 1959 and 1976 stabilisation programmes in Argentina (*Kiguel & Liviatan, 1991:98*).

[18] See *Corbo & De Melo, 1985; and Ramos, 1986,* for detail.

[19] Keguel & Liviatan, 1991.

[20] Ibid.

[21] There were also a number of *heterodox* programmes in the 1960s in Latin America. The Brazilian stabilisation programme of 1964-67 is an example of a successful one (see *Simosen, 1974; Cardoso & Fischer, 1990*).

[22] Kiguel & Liviatan, 1991:95.

[23] Ibid:95-96.

[24] Ibid.

[25] Thanks again mainly to Gorbachev's first signal of possible change which was made in 1985 (*PPRG, 1991:2*).

[26] Lech Walesa was the leader of the unofficial 'opposition party'- the Solidarity movement. Walesa was one of the leaders of the 1970 Gdansk strike committee. The Shipyard had dismissed him in April, 1976 for criticising the Gierek Regime's policies. In 1978, with other colleagues, he established the Free Trade Union of the Baltic Coast. In January, 1980 he was dismissed again from his job for leading a commemoration of those killed in 1970 (*Andrews, 1985:28*). Between 1976-80, Walesa was active in the free trade union movement. He participated in meetings and discussions on self-government, trade unionism, and local and national economic problems. As a result of his active participation in strikes, lectures, meetings and discussions, he was chosen to be their leader. For some background on Walesa, see: J *Kurski, 1993, 'Lech Walesa: Democrat or Dictator?', (Westview Press:Boulder).*

[27] PPRG, 1991:2.

[28] Ibid.

[29] The official reason for the liquidation was not political, but the inefficiency of the Shipyard. However, it was understood as a step against the Solidarity advocates (*PPRG, 1991:3).* The issue of the Gdansk Shipyard still exists until the time of writing this thesis.

[30] IMF, 1990; Myant, 1993; Blaszczyk & Dabrowski, 1993.

[31] Semi-free elections in the Polish context mean only a specific number (161) of members of Parliament are to be freely elected, while the rest of the members were to be appointed by the ruling party.

[32] General Jaruzelski was the General Secretary of the Polish Communist Party during the period 1981-89, and from 1985 until 19 July, 1989. At the same time, he was the President of Poland.

[33] PPRD, 1991:6-8.

[34] In fact, during the second half of the 1980s, intellectuals and workers began to realise that the only effective way to improve economic well-being was to abolish the

communist economic system, because any further minor reform attempts would be fruitless *(PPRG, 1991).*

[35] Myant, 1993:81; Blaszczyk & Dabrowski, 1993:25; Mujzel, 1993:35. It is of interest to mention that Mazowiecki was chosen by Walesa for the post of Prime Minister, after receiving approval from the SD and ZSL.

[36] PPRG, 1991.

[37] PPRG, 1991:5-6.

[38] The team responsible for preparing the transformation plan included Balcerowicz, some Polish and foreign advisors (especially Sachs), and the IMF team *(Balcerowicz, 1994:80; PPRG, 1991:6).*

[39] Swakow & Wilkin, 1991. Some people might argue that from the beginning, **Balcerowicz** knew what he wanted. He wanted a 'big bang', a smaller scope of government intervention, priority should be given to the stabilisation element, and the Polish economy should be open to international competition. However, these dilemmas encountered the team as a whole.

[40] Hungary started shortly before Poland discussing the issue of transforming its economy from a Centrally Planned into a market-type economy *(Blaszczyk & Dabrowski, 1993).*

[41] Swakow & Wilkin, 1991:2-4

[42] PPRG, 1991.

[43] Ash, 1990:43.

[44] Balcerowicz, 1990; Sachs, 1990; Wilkin, 1994; Rosati, 1991b:21; Michael, Choksi, and Papageorgion, 1989.

[45] Sachs & Lipton, 1990:221.

[46] Moskwa & Wilkin, 1991:9.

[47] Some people might then ask the following questions; "Are we not dealing with a form of colonialism/imperialism?" And secondly, "How genuinely important is the vote of confidence of Parliament, except to serve as rubber-stamping for external decisions?" These questions are significant because they raise the fundamental issue of the legitimacy of the government and its decisions in the eyes of the people. And if it is to be a democracy in the Western style, the people are the eventual source of legitimacy.

[48] Gomulka, 1992:108; Calvo & Coricelli, 1992:176.

[49] Lipton & Sachs, 1990:221; Rosati, 1991b:21.

[50] Ibid.

[51] Blaszczyk & Dabrowski, 1993:14; Rosati, 1991:28; Jones, 1992:103; Kolodko, 1992:132-35.

[52] Thumm, 1991:51-54.

[53] Kolodko, 1992:135. The Letter of Intent is a report from the Government to the IMF, explaining the economic development policy for a specific period of time. This report is usually used when there is an economic restructuring programme between the concerned government and the IMF.

[54] The World Bank, 1991:94-106. The Letter of Policy is almost the same as the Letter of Intent, but directed to the World Bank.

[55] Lipton & Sachs, 1990:12-3; Thumm, 1991:54.

[56] Coricelli & Rocha, 1991:132.

[57] Nuti, 1993; Wojtyna, 1994; Balcerowicz, 1994.

[58] Coricelli & Rocha, 1991:132-133.

[59] Ibid.

[60] Ibid.

[61] Ibid.

[62] Ibid.

[63] Christofides, 1994:59.

[64] Ibid:60.

[65] Ibid:59.

[66] Ibid.

[67] Ibid.

[68] This list included medicines, liquid fuels, and domestically produced herbicides and other plant protection chemicals (*Ibid:60*).

[69] This list included 61 enterprises, including steel works, coal, copper, ceramics, magnets, and chemical works (*Ibid*).

[70] Ibid:59-60.

[71] Rosati, 1991.

[72] Hunya, 1994:91-92.

[73] Only in the case of a very inelastic demand abroad could the terms of trade weaken so much with rising output that 'immiserising growth', that is a negative welfare effect, would occur (Bossak, 1994).

[74] Ibid.

[75] EIU, 1995:12.

[76] A flexible exchange rate is desirable when shocks are either external, or originate from the real side of the domestic economy, whereas a fixed rate is preferable if shocks have domestic and monetary origin (Ebrill *et al*, 1994:44).

[77] Otker, 1994:44.

[78] In his dictionary Pearce (1992:80) defines convertibility as an attribute of a currency which is freely exchangeable for another currency, or for gold. Internal convertibility means allowing domestic registered businesses unrestricted access to foreign exchange (*Welfens & Jasinski, 1994:37*).

[79] NBP, 1995:112.

[80] Bossak, 1995:89.

[81] NBP, 1995:7-8.

[82] See Schwartz, 1994:7-9, 17-22.

[83] See Blazyca and Rapacki, 1996:85-100, for details.

[84] In this study I shall refer to this strategy as Kolodko's Strategy.

[85] MoF, 1995, files.

[86] Ibid.

[87] Ibid.

[88] Ibid.

[89] Blazyca & Rapacki, 1996:90.

SECTION (4) THE NEW ECONOMIC SYSTEM IN POLAND (1990-1995)

The main concern of this section is to study the general features of the structure of the new economic system that has emerged in Poland during the first six years of the transition period (1990-95). The aim is to analyse the impact of the privatisation process on the performance of the Polish economy during the period 1990-95. It is expected that changes in the economic indicators are a result of the changes in the three elements of the *economic transformation programme* of 1989/90.

When Poland launched its programme, the aim was to transfer its economy from a Socialist, centrally planned economy to a capitalist, market orientated one. In other words, the Polish economy was supposed to move from price control to price liberty, from a subsidised economy to a relatively highly non-subsidised economy, from 'soft budget constraints' on enterprises to 'hard budget constraints', from passive money economy to an active money economy, from automatic bank credits to a selective (market-motivated) credit policy, from a traditional tax system to a modern tax one, from an economy without capital market to one with a modern capital market, and from a situation where the State had most of the property rights, to a situation where the people would be sharing those rights.[1]

It is of interest to mention right at the outset that the 'shock therapy' plan of 1989/90 was highly successful. The key macroeconomic outcomes are: (1) the remarked growth rates of GDP since March, 1992- Poland was the first country in the region to break the recessionary forces accompanying transition. (2) the reduction of the inflation rates which were bordering on hyperinflationary levels at the start of the transition in late 1989 and early 1990. (3) the huge expansion of the private sector in the economy. (4) the decline in both producer and consumer subsidies. (5) the introduction of a modern tax system. (6) the reduction of the amounts of external debt. (7) the creation of the capital market. (8) in addition to the fact that unemployment rates seem to be peaked, and started declining since the third quarter of 1994.

1. Output (GDP)

Output fell sharply by 11.6% [2] in **1990** against an expected decline of 3%, and by almost 7% in **1991.** Regarding 1990, the fall in inventories explain 5% of the decline in GDP. In fact, GDP of the public sector fell by 19.6%, while that of the private sector increased by 7.4%. All industrial sectors were hit by the recession. Industrial value added fell by about 23%, while production of socialised industry fell by almost 30%. Agriculture was not affected, showing an increase of 2.5%. Private sector sales are estimated to have grown by about 17%, part of which is due to a mere reclassification of previous socialised sector activities. The bulk of the increase in private sector activities seems to have occurred in trade, services, construction and transport. The factors most responsible for the decline in output in 1991 were the collapse in trade among COMECON partners, and the attendant worsening in the terms of trade.[3]

In 1992, GDP grew by 2.6%, thanks to the growth of industrial production by 3.9% (compared with a cumulative decline of 36.6% during 1989-91), on one hand, and the devaluation of the zloty by (10.7 %) in February, 1992 and gains in competitiveness, on the other. Moreover, the growth of the private sector played a prominent role in the recovery. Output of the private sector in industry increased by 32%, while in the State-owned sector, it declined by 5%. As a result, the share of industrial output in private hands increased from a fourth in 1991, to almost a third in 1992.[4]

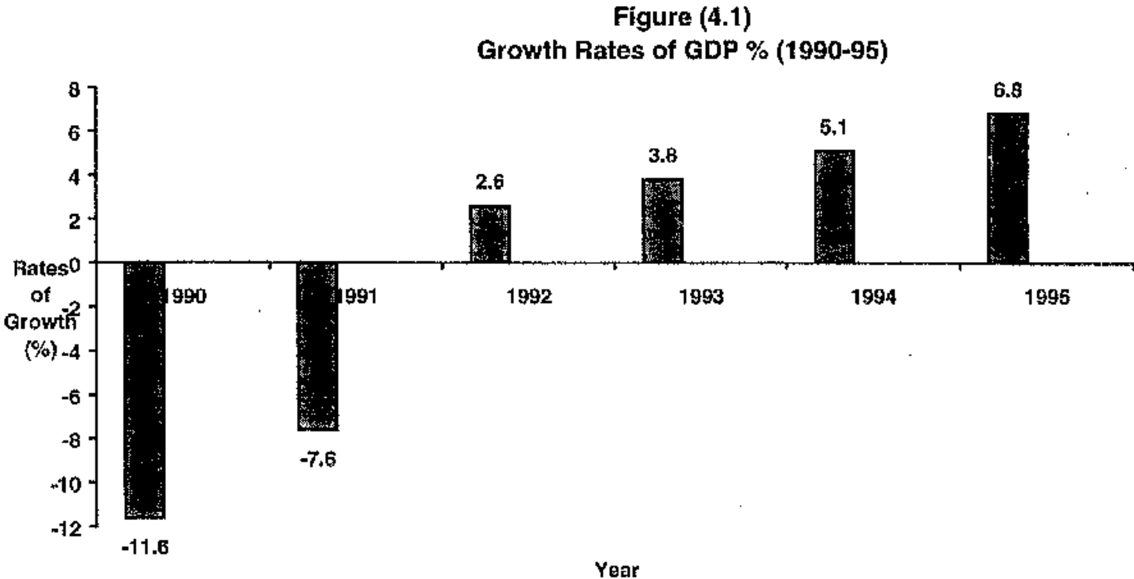
In 1993, GDP grew by 3.8%.[5] The main sources of economic growth were on the demand side, especially consumption demand. The high growth rate was the result of an upswing in economic activity in almost all the basic branches of the economy, the sole exception being transportation. The fastest rate of growth in 1993 was recorded by communications (11.8%).[6]

In **1994,** GDP grew by 5.1%, and by 6.8% in **1995.** The factors responsible for the growth of GDP in 1994 were the growth in exports and the growth in private sector investments. Exports grew by 25% (in terms of US dollars), while imports grew by

only 12%. Investments increased by 6%, the highest rate since 1989. Investment outlays grew faster, in the private sector (80% in nominal terms), than in the public sector (30% in nominal terms).[7] In terms of economic activities, the main driving forces behind the growth of GDP in 1994 were the growth in the industrial sector, which increased by 11.9%, followed by the telecommunications sector, which increased by 14.7%.

Based on the official exchange rate, in 1994, Poland's GDP totalled US$ 94 billion, i.e. US$ 2,430 per capita. And if based on Purchasing Power Parity (PPP) Poland's per capita GDP amounts to US$ 4,500-5,500.[8] That is to say, the exchange rate of the zloty is undervalued by almost 50%.

Figure (4.1) shows the growth rates of the GDP over the period 1990-95:



Bear in mind that more than half of the GDP in 1994 and 1995 came from the private sector. Export and investment expansion also provided the strongest stimuli to Poland's GDP growth in 1994 and 1995. One can conclude that the growth in exports and the development of the private sector were the main contributing factors leading to the recovery of the GDP since 1992, and allowed economic performance in 1993, 1994 and 1995 to be even more favourable.

The consequences of the above discussed developments is shown in Table (4.1). There was a shift in the structure of GDP over the six years (1989-94) towards higher shares of the services sector and lower shares in the other sectors. As can be seen from the Table, the share of industry in GDP fell from around 45% in 1990 to 33% in 1994. Agriculture and forestry shares fell from 8.5% of GDP in 1990 to around 6% in 1994. The share of the construction sector in GDP fell from 9.2% in 1990 to 5% in 1993. The most notable change was in the share of 'services and others' in GDP, which increased from 14% in 1989 to 36.8% in 1994.

As for the structure of employment, the most important detail in Table (4.1) is the fact that Poland still has a very substantial agricultural sector, which employs about one quarter of the labour force in 1993. This is a very clear indication of a relative backwardness of the Polish economy in its transitional period.

Table (4.1)

Sectoral Origin of GDP and Employment (Current Prices) (%)

Sector	1989	1990	1991	1992	1993	1994
Industry- Output	44.1	44.9	40.2	34.4	32.7	33.0
- Employment	28.6	28.0	27.2	25.9	25.3	n.a.
Agriculture & Forestry-						
- Output	12.9	8.5	6.9	6.9	6.7	6.0
- Employment	27.3	27.6	28.1	27.6	25.8	n.a.
Construction -Output	8.2	9.2	10.2	7.2	5.9	5.0
- Employment	7.7	7.5	7.2	7.1	6.2	n.a.
Transportation & Telecom						
- Output	4.5	4.8	5.6	5.3	5.3	5.2
- Employment	5.7	5.6	5.4	5.2	5.0	n.a.
Trade - Output	16.3	12.7	13.1	12.5	14.1	14.0
- Employment	8.5	8.4	10.0	10.7	13.9	n.a.
Services & Others -Output	14.0	19.9	24.0	33.7	35.3	36.8
-Employment	22.2	22.9	22.1	23.5	23.8	n.a.
Total	100.0	100.0	100.0	100.	100.0	100.0

Source: ***The Central Statistical Office, 1995, Rocznik Statystyczny.***

2. The growth of the Private Sector

It is expected that the three elements of the Polish *economic transformation programme* of 1989/90 (i.e. macroeconomic stabilisation, microeconomic liberalisation, and

privatisation) have influenced the growth of the private sector in Poland during the first six years of the transition period (1990-95). In practice, it is very difficult to divorce the effect of the privatisation process from that of the other factors on the growth of the private sector, as the impact of these factors would overlap.

a. Share of the private sector in the GDP and employment

Poland's private sector is, relatively, the biggest in the whole region. The most important factors responsible for the growth of the private sector during the period 1990-95 are: (1) changes in the economic legal regulations, such as easing the rule of initiations of economic activity.[9] (2) continuing deep decline in output and employment in the public sector. (3) reclassification of the co-operative sector from 'socialised' as of old, to private. (4) classification of 'limited privatisation' in the trade and services sector, which to a small extent embraced stores and workshops, in the private sector. (5) the establishment of new private enterprises. (6) and finally, privatisation of SOEs through different paths to privatisation, especially sale of equity and liquidation.[10]

As can be seen from Table (4.2), the role of the private sector in the Polish economy, as measured by its share in GDP and employment, has dramatically increased. Two big jumps in the growth rates of output occurred; the first in 1991, by 11.2%, and the second in 1992, by 5.1%. This was thanks mainly to the expansion of the output in the industrial sector. As for employment, there was only one jump in 1991 by 5.4%. This was thanks mainly to the increases in employment in the construction and transportation sectors.

In 1991, for the first time in the past half century in Eastern Europe in general, and in Poland in particular, the private sector employed more people than the public sector. In 1995, more than 50% of the GDP in Poland was produced by the private sector as compared to less than 30% in 1989. In addition, more than 60% of the total labour force in Poland was employed by the private sector, in comparison to 35% in 1989.

The development of the private sector in the past six years has also positively contributed to lessen the "*unemployment shock*" suffered by Polish economy after 1989 performing the role of a shock absorber. According to official data, the aggregate fall in public sector employment during 1990-94 amounted to about 2.4 million people, whereas the number of employees in the private business increased by nearly 1.2 million people. This net rise in private sector employment should be attributed to the 'bottom-up' privatisation- by the end of 1993 only about 130,000 jobs had been transferred from public to private sector through privatisation of SOEs. If one adds all forms of a 'top-down' privatisation, including the sales of units from SOEs and asset stripping, this total reaches no more than 300 thousands. It should be stressed, however, that the positive impact of a former SOEs sector on the labour market continued through 1994 and 1995. By end-March, 1995 employment in this category of firms (i.e. already privatised or in privatisation process) amounted to 1.4 million and increased, compared to end-1994, by 4.4%. At the same time, the number of employees in public firms not undergoing ownership changes, declined by 0.5%. The highest increase of manpower was recorded in companies privatised under the liquidation track (39.5%) and in Treasury companies (5.6%). Simultaneously, employment fell in companies privatised under the 'capital' path (2.7%), the exception being companies with foreign majority stake (a rise by 6.2%).[11]

Regarding economic sectors: table (4.2) shows that the highest weight of private business was recorded in domestic trade and construction, while the lowest was in industry and transportation. This was thanks mainly to the privatisation process in its broadest sences of the word, i.e. the 'grass-roots' or 'bottom-up' privatisation, and 'up-down' privatisation. The share of the private sector in turnover of foreign trade has increased dramatically. More than 50% of the total Polish exports was carried out by the private sector in 1994, compared to less than 5% in 1990, thanks mainly to the favourable changes in foreign trade regulations, and the privatisation process. See Table (7.4), Section Seven, for data detail.

Table (4.2)

Share of The Private Sector in Output And Employment in Poland (1989-95) (%)

Economic Sector	Year	1989	1990	1991	1992	1993	1994	1995
Total	**Output**	29.0*	30.9	42.1	47.2	50.0	53.0	59
Private Sector	**Employment**	44.1*	48.9	54.3	56.0	58.9	61.0	n.a
Industry	**Output**	16.2	18.3	24.6	31.0	35.1	38.3	n.a
	Employment	29.1	31.2	35.8	41.4	43.0	44.0	n.a
Construction	**Output**	33.0	41.8	62.2	77.7	84.3	86.2	n.a
	Employment	37.4	42.1	59.5	71.8	71.2	79.3	n.a
Transportation	**Output**	11.5	14.2	25.2	33.4	38.7	42.8	n.a
	Employment	14.3	15.2	23.0	25.1	27.5	23.0	n.a
Domestic Trade	**Output**	59.3	63.7	82.8	86.4	89.0	89.2	n.a
	Employment	72.7	82.2	88.3	90.5	92.4	93.4	n.a
Foreign Trade	**Exports**	n.a	4.9	21.9	38.3	44.0	51.1	n.a
	Imports	n.a	14.4	49.9	54.5	59.8	65.8	n.a
Agriculture	**Output**	n.a	n.a	40.3	44.4	92.9	95.1	n.a
	Employment	n.a	n.a	n.a	n.a	n.a	96.0	n.a

Source: ***Rapacki, 1995:4, based on data from: Statystyka Polski, 1992; CUP, 1993; Poland 1989-93..., 1993; Changes in Ownership Structure.., 1994; Information...,1995; GUS, 1995; Nowe Zycie Gospodarcze, No.4, 15 June, 1995.***

*** Output = 19%, Employment = 35.0, if co-operatives are excluded.**

b. Number of registered firms in the Private Sector

The sudden rise in the number of Privately-Owned Companies (POCs) reflects the very rapid recent growth of the private sector in Poland. The extraordinarily rapid growth of the private sector is concentrated in retail and wholesale trade, and services. There are several reasons for the recent fast increase in the number of POCs: (1) these companies include the large number of newly established foreign joint-ventures (FJVs), stimulated by the relatively privileged general conditions for company activity (e.g. tax exemptions), as well as by the favourable terms offered by the Polish partners (e.g. leasing capital assets- machinery and buildings- almost "for nothing"). Also, once the law permitted it, many POCs were established, others taking advantage of links with former members of the *'nomenclature'* and often missmanaging state financial resources and property. (2) an increasing number of individual establishments also results from the tax exemptions offered for new companies. (3) finally, the enormous

profit rates in trade act as a "magnet", attracting new, small sums of capital into business.[12]

Table (4.3)

Economic Units in The Polish Private Sector (1989-94)

	Industry	Construction	Agriculture	Trade	Total
Domestic Companies					
1989	*2,975*	*2,661*	*n.a*	*1,767*	
1993	*12,914*	*12,413*	*1,062*	*23,155*	
1994	*14,258*	*10,516*	*1,354*	*25,996*	*69,300*
Joint Ventures					
1989	*243*	*12*	*n.a*	*34*	
1993	*4,638*	*1,147*	*178*	*5,958*	
1994	*5,841*	*1,299*	*282*	*7,742*	*19,700*
Cooperatives					
1989	*17,500*	*732*	*n.a*	*15*	
1993	*19,746*	*1,018*	*4,180*	*3,784*	
1994	*19,816*	*1,050*	*3,900*	*3,795*	*1,900,000*

Source: (1) Central Statistical Office, Statistical Year Book, Different Issues.
(2) Central Statistical Office, Statistical Bulletin, Different Issues

As can be noticed from Table (4.3), setting up new private business (either with private domestic capital, or with private foreign capital), is the main reason behind the growth of the economic units in the private sector in Poland. The fastest growth, in terms of the number of economic units in the private sector, has occurred in trade, industry and construction. How much was the participation of the privatised companies responsible for the growth of the private sector?.

A look at Table (6.2) in Section Six, which illustrates the total number of privatised SOEs, shows that the number of SOEs diminished by 3,917 enterprises by the end of December, 1995. However, it is of importance to note that not all were transferred to the private sector. That is because 24% of this number, as of the end of September, 1995, went bankrupt, based on Article 19 of the law of SOEs of 1981. So, a large number of those enterprises cease to exist. Therefore, one can conclude that, by the end of 1995, a very small percentage (less than 1%) of the increase in the number of economic units in the private sector was a result of privatisation.

There was great regional differentiation in the rate of formation of private companies. Most of the domestic companies were established in the provinces of Warsaw, Katowice, Gdansk, Poznan, Krakow, Lodz, Bydgoszcz and Lublin. In the other provinces there were considerably fewer. Most of the Joint Ventures were created primarily in the provinces of Warsaw, Gdansk, Poznan, Katowice, Krakow and Lodz .[13]

c. Financial performance of corporate sector

As can be seen from Table (4.4), the financial position and performance of the private sector were below the public sector level. More specifically, this refers to gross income volume, gross income to costs of goods sold ratio and net profit margin. This was the case despite the fact that the private sector showed faster growth pace and higher allocative efficiency. On the other hand, the private sector has recorded higher net income (except for 1994), net profit margin and short-term liquidity, as measured by the super quickration, compared to public firms. This was mainly due to a lower tax burden in the public sector and its smaller debt liabilities.[14]

Table (4.4)

Financail Performance of Corporate Sector (1992-94)

Financial Indicator		1992	1993	1994
Gross income (zl bln)	**Total**	3.9	6.6	12.8
	Public	3.9	5.7	10.4
	Private	0.0	0.8	2.4
Net Income (zl bln)	**Total**	-2.8	-1.1	6.0
	Public	-2.2	-0.9	4.9
	Private	-0.6	-0.2	1.1
Gross income/costs of goods sold (%)				
	Total	2.2	2.9	5.1
	Public	3.0	3.9	6.5
	Private	0.0	1.1	2.5
Net profit margin	**Total**	-1.5	-0.5	2.3
	Public	-1.6	-0.6	2.9
	Private	-1.2	-0.3	1.1
Super quick ration (%)	**Total**	n.a.	16.8	20.7
	Public	n.a.	15.5	20.3
	Private	n.a.	20.5	21.3

Source: Rapacki, 1995:11, based on data from the Central Statistical Office, 1995, Informationon Socio-Economic Situation in Poland in 1994, Warsaw, Poland.

It is worth mentioning that other factors, such as "window dressing" or "creative accounting" practices aimed at reducing tax liabilities, and deflating wage bills so as to lower the liability for social security contribution, were responsible for the poorer financial performance of the private sector. Private firms tended to over-report costs and under-report profits.

3. External trade

Table (4.5) shows that during the last two years the growth rate of exports was 8 times more than the growth rates of the whole 1989-93 period. However, during the whole transition period, the dynamic of exports was lower than the dynamic of imports. In 1995, in relation to the level of 1989, exports (counted in US dollars) grew by 70.4%, and imports grew by 171%. The main reason behind the high increase in imports and modest increase in exports up until 1993 was the low profitability of exports as compared with domestic sales. The low profitability of exports is due to the following factors: **(a)** the very high price and limited quantity of working capital has put Polish exporters under strong pressure to secure immediate payment by foreign customers, because credit was not a limiting factor for Western firms. This is reinforced if one knows that Polish exports were virtually transacted under payment schedules of a maximum of 3 months, which means that Polish exporters sold their products at much lower prices than suppliers in Western countries. **(b)** Polish companies were weak in the area of creating export dealings. Most producers still sell their products through intermediaries. This process detracted some ratios from their export profitability. **(c)** the competitiveness of Polish exports in foreign markets is still suffering from a lack of funds for upgrading technology and production processes. **(d)** and finally, the lack of promotion schemes to exporters.[15]

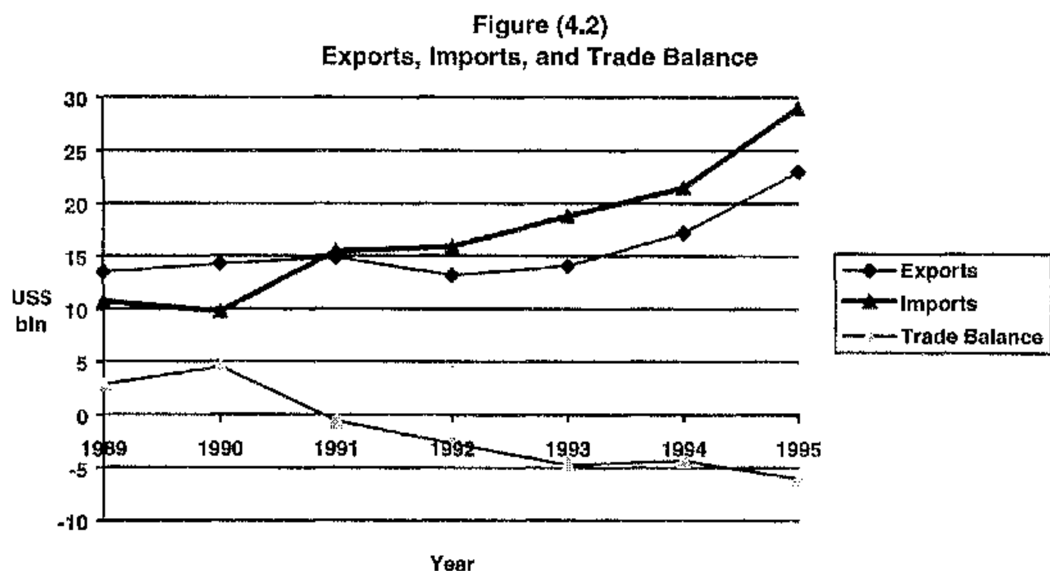
Table (4.5)

Trade Balance in Poland (1989-95) (US$ Bln)

	1989*	1990	1991	1992	1993	1994	1995
Exports	13.5	14.3	14.9	13.2	14.1	17.2	23.0
Imports	10.7	9.8	15.5	15.9	18.8	21.5	29.0
Trade Balance	2.8	4.5	-0.6	-2.7	-4.7	-4.3	-6.0

Source: ***Central Statistical Office (1995) Poland: Quarterly Statistics, Vol.III, No.1, PP32. * Note: data on 1989 covers only the socialised sector.***

Figure (4.2) shows trends of exports, imports , and trade deficit over the period 1989-1995.



As can be seen from Tables (4.6), (4.7), and (4.8), the deterioration in the Trade Balance was accompanied by two other major changes: (1) a reorientation of trade from Eastern to Western Europe, mainly to the EEC countries. There was an increase in imports from the developed countries, mainly from EU and EFTA, and a decline in imports from East and Central European countries and the former Soviet Union. Table (4.6) shows that in 1990, exports to EU increased from 47.2% of the total Polish exports, to 70.5% in 1995. Whereas, total exports to East and Central Europe decreased from 21.4% of the total Polish exports in 1990, to 12.0% in 1995. Regarding imports, Table (4.6) shows that imports from EU increased from 45.6% in 1990 to 64.5% in 1995, while imports from East and Central Europe declined from 22.3% in 1990 to only 10% in 1995.

The main reasons behind these changes are the collapse of the COMECON agreement, and the establishment of an 'Association Agreement' between Poland and some other

Eastern European countries and the European Union, which became effective in March, 1992.

(2) A significant change in the commodity structure. Concerning the composition of exports, Table (4.7) shows that there was a decline in the share of mineral fuels, lubricants and related materials, machines and transport equipment, and a higher share of chemicals, manufactured goods and food and live animals, beverage and tobacco. As for imports, Table (4.8) shows that there was a decline in the shares of crude materials, oil and fats, lubricants and related materials, and an increase in the shares of chemicals, manufactured goods, and machinery and transport equipment.

Table (4.6)

Geographical Distribution of Exports and Imports in Poland (1989-95) (%)

Year	Total Exports to DC	of which EU	EFTA	LDC	E-CE	Total Imp-orts to DC	of which EU	EFTA	LDC	E-CE
1990	65.3	47.2	13.8	13.3	21.4	67.1	45.6	**16.8**	10.6	22.3
1991	73.8	55.7	14.1	9.4	16.8	68.4	40.7	**14.8**	12.3	19.3
1992	72.0	57.6	10.6	12.9	15.1	72.3	52.8	**13.2**	11.4	16.4
1993	74.3	62.9	7.5	12.9	12.8	75.3	56.7	**12.0**	14.4	10.3
1994	76.4	62.6	4.8	10.1	14.5	79.5	57.5	**17.7**	10.5	10.0
1995	75.5	70.5	5.0	7.5	12.0	79.5	64.5	**9.5**	10.5	10.0

Source: ***GUS, 1995 (August) Poland Quarterly Statistics, Vol III, No.1.***

Table (4.7)

Compositions of Exports 1985-1995 (%)

Category	1985	1989	1990	1991	1992	1993	1994
1- Food and live animals, beverages & tobacco	8.2	11.3	11.5	13.5	13.4	10.9	11.5
2- Crude materials, Oil & Fats	7.4	6.0	7.0	9.3	8.7	5.7	4.8
3- Mineral fuels lubricants & related materials	15.6	9.7	10.7	10.7	10.7	9.7	9.0
4-Chemicals, manufactured goods	28.6	39.0	44.6	48.0	48.1	52.7	54.9
5-Machinery and transport equipment	40.2	34.0	26.2	18.5	19.1	21.0	19.8

Source: ***GUS (August, 1995), Poland Quarterly Statistics, Vol.III, No.1.***

Table (4.8)

Compositions of Imports 1985-1994 (%)

Category	1985	1989	1990	1991	1992	1993	1994
1-Food and live animals, beverages & tobacco	9.8	12.4	7.6	12.6	10.6	10.5	9.6
2-Crude Materials, Oil & Fats	11.1	9.0	7.5	5.7	6.1	5.2	5.9
3-Mineral Fuels lubricants & related Materials	21.6	12.4	21.5	18.7	16.8	12.5	10.4
4-Chemicals, Manufactured goods	27.7	33.5	26.3	29.5	36.7	42.2	54.2
5-Machinery and Transport Equipment	9.82	32.7	37.1	33.5	29.8	29.6	28.9

Source: ***GUS (August, 1995), Poland Quarterly Statistics, Vol.III, No.1.***

During the whole period 1990-95, Poland's imports originated mostly in those countries which were the major purchasers of Polish goods.

It is of interest to mention that external trade in Poland is now conducted by about 70 large foreign trade enterprises. These enterprises are descended from the old central agencies, and close on 100 thousand other economic agents. The latter include both State-owned and private enterprises involved in production, which have in the 1990s embarked on export and import dealings on their own account, and a host of new private firms, which mainly act as intermediaries in foreign trade.[16] Moreover, private companies accounted for almost 75% of Polish exports and 57% of Polish imports in 1994. Private companies predominate in trade with the European Union (63% of imports and 68% of exports), while trade with the Central and East European countries is still conducted for the most part by State-owned companies (90% of exports and 68.5% of imports).[17]

4. The State Budget

As can be seen from Table (4.9), the state budget deficit peaked in 1991 at 7.0% of GDP, and started declining to reach 3.0% of GDP in 1994.

a. Revenues

As can be observed from Table (4.9), the structure of the revenues shows a systemic change in the taxes: away from taxing enterprises' profits and toward taxing personal incomes and consumption. Enterprise Income Tax (EIT) revenues declined from an average of 11.5% of GDP during the period 1988-90, to an average of only 4.8% of GDP during the period 1991-93. EIT reached a peak of 14% of GDP in 1990. The introduction of a modern Personal Income Tax in 1992, contributed to the increase in revenues from this source, from 3% of GDP during 1988-91, to over 8% of GDP during 1992-93.[18] The main factors responsible for the change are reflected largely in the transitory impact of historical cost accounting in a highly inflationary environment, and the increase in the importance of consumption and income taxes.[19]

Turnover tax revenues (including Excise Tax revenues) bottomed out at 6.3% of GDP in 1990, but because of expansions in the tax base, adjustments in tax rates, and improvements in tax administration, they increased to 10.6% of GDP in 1993. Value Added Tax [20], which replaced turnover taxes in July, 1993, yielded higher revenues than turnover taxes almost from the very beginning.

Table (4.9)

Fiscal Budget: Revenues and Expenditures as % GDP

	1988	1989	1990	1991	1992	1993	1994	1995
Fiscal Balance	-1.4	-5.0	0.6	-7.0	-6.0	-2.7	-3.0	na
A) Revenue	35.6	25.1	33.3	25.7	27.4	29.1	29.4	na
a)Tax Revenues	33.9	21.6	28.2	21.9	24.3	26.2	na	na
-Enterprise Incentive	12.7	9.7	14.0	6.1	4.4	4.0	na	na
-Personal Income tax	-	-	-	-	6.3	7.6	n.a.	n.a.
B) Expenditure	37.0	30.1	32.7	32.7	33.4	31.8	32.4	n.a.
a)Producers subsidies	6.0	4.5	3.4	1.7	0.8	0.8	n.a.	n.a.
b)Consumer Subsidies	10.0	8.4	3.9	3.4	2.5	2.5	n.a.	n.a.
c)Social Security Benefits	9.4	11.2	10.6	17.3	19.9	20.4	n.a.	n.a.
- Pensions	7.1	8.2	8.1	12.2	14.8	15.0	n.a.	n.a.
- Unemployment	-	-	0.2	1.2	1.7	1.2	na	na

Source: ***World Bank, 1994:115.***

b. Expenditures

Overall Government expenditures averaged 48.5% of GDP during 1988-89, and 49.5% during 1992-3. There were significant changes in the composition of expenditures. The most notable changes were in producer and consumer subsidies.

1. Producer subsidies

Producer subsidies underwent a dramatic reduction during the transformation. Starting from a level of 6% of GDP in 1988, they decreased to less than 1% of the GDP in 1993. This was due to the need to impose 'hard budget constraints'[21] on SOEs and to ensure a more efficient allocation of resources. Also, the reductions were a logical consequence of introducing a modern system of enterprise taxation in 1989, which decreased both the scope and the need for cross-subsidies and profit remittances to the budget.[22]

Reducing producer subsidies was relatively easy, in comparison with many of the other areas of reform, for three reasons: "first, the system of cross-subsidies (punitive taxation and discretionary subsidies) was at best a zero-sum game; second, revoking these subsidies was not perceived as revoking entitlements; and third, at least over the short run, some enterprises were composed for the reduction in producer subsidies by increasing tax arrears and/or interenterprises arrears." [23]

The cuts in producer subsidies probably reinforced other factors that adversely affected enterprise profitability, including increases in wages and salaries, the cost of raw materials and energy, and interest payments. Also, cuts in producer subsidies may have reinforced other factors that adversely affected aggregate demand, such as reductions in the Government's capital expenditures and its expenditures on purchases of goods and services, and external factors, such as the collapse of the COMECON arrangements.[24]

The main positive impact of reducing subsidies is the reduction of government deficits.[25] Reducing subsidies has some other consequences. To elaborate, enterprises faced a multitude of constraints during the transition, including restricted access to

credit, the problem of exporting to traditional markets, and sometimes controlled producer prices at artificially low levels (an example was utilities). At the same time, the main help was the reduction in taxes imposed on enterprises' profits. Hence, the withdrawal of producer subsidies was only one amongst many constraints faced by SOEs. The importance of the withdrawal of producer subsidies would be the fact that it brought into the open the extent to which each SOE was able to stand on its own feet; in this sense, it also contributed to output reductions in 1990 and 1991, layoffs (as will be discussed below), curtailments of investment, and the emergence of tax arrears and interenterprise arrears.[26]

2. *Consumers' subsidies and Social Security Benefits*

There was a pronounced shift from consumer subsidies to Social Security expenditures (including pensions). With the liberalisation of prices in 1990, extensive subsidisation of consumer goods became impossible. As can be seen from Table (4.9), subsidisation of consumer goods was reduced from 10% of GDP in 1988 to less than 3% in 1993. At the end of 1993, only a few direct consumer subsidies remained in effect. Still, in addition to direct subsidies, there were a number of consumer subsidies provided in the form of prices that were administered below market-clearing levels, such as municipal transport prices. The cost of this kind of subsidies is not directly reflected in the Budget, but they are not without cost: it is no coincidence that transport companies, as they operate with administered output prices, also had significant tax arrears.[27]

It is of importance to mention that at the same time that consumer subsidies were reduced, more people obtained access to Social Security payments, particularly pensions. For example, pension expenditures increased from 7.1% of GDP in 1988 to 15% of GDP in 1993, largely fuelled by a boom in early retirement. The number of pensioners increased by 27% (1.9 million) between December, 1989 and late 1993. However, the increase in Social Security benefits and the simultaneous reduction in consumer subsidies would also suggest that many of the transition-induced social costs were shouldered by Social Security arrangements rather than by more temporary social assistance schemes.[28]

5. The capital market, the banking system, and the money markets

The other aim of the whole transformation process in Poland is the creation of capital and money markets, and the modernisation of the banking system.

Since the beginning, there has been some debate about the relative merits of bank finance and equity capital in supporting the transformation process. One school of thought emphasised that transition economies should focus on the development of commercial banks, which when placed on a sound footing, would be the main channel for providing finance to firms. Others emphasised that firms would be better able to raise capital from equity markets, since they would be largely free of the adverse selection effect. Furthermore, stock markets were seen to have a significant role in the privatisation process by setting the market value of privatised companies on an ongoing basis, thereby facilitating the valuation of newly privatised ones. The existence of a capital market was seen also as providing support for the development of a supplementary pension system as well as forcing the banking system to become more competitive.[29] What happened in practice?.

The Polish authorities gave attention to both sides of the equation from the start of the transition process. They believed that the privatisation process will create a capital market, therefore from the very beginning they created the legal framework for the capital market, and at the same time started restructuring the banking system. How did the capital market emerge in Poland, and what is the contribution of privatisation?.

a. Capital market and the development of the Stock Exchange

The capital market is one of the few areas of the Polish economy which had a complete and comprehensive legal framework from the start and has not been suffering from legal 'loopholes'.[30] The Warsaw Stock Exchange (WSE) was reopened on April 16, 1991, 52 years after its closure.[31] Officially, it opened at the beginning of July, 1991. The delay was caused by parliamentary debate over the Bill regulating the capital market in Poland. It ended with the passing of the Public Trading in Securities and

Mutual Funds Act. The WSE is one of the very few new capital markets whose reputation has not been tarnished. This is mainly due to the introduction of comprehensive legislation right from the start. Initially, only the first five privatised enterprises had shares listed on the WSE.[32] These are Exbud, a Kielce based construction company with a substantial export and overseas construction business; Silesian Cable in Czechowice; Krosno Glass, another major exporter based in south east Poland; Prochnik, a clothing manufacturer at Lodz; and Tonsil, an electronics firm.[33] By the end of 1991, their number went up to nine, and by the end of November, 1995, there were 50 companies quoted in the basic market of the WSE, and 12 companies were quoted in the parallel market.[34]

At the start all the shares listed belonged to enterprises which were privatised by public stock subscription. The reason the companies listed are growing slowly is because the process of privatising State-owned assets through public offer of shares has proved to be more difficult than was expected. Most companies are not interested in being listed since it is costly and requires the full disclosure of financial data on a regular basis.[35]

The WSE was established from scratch, and at first every session was perceived as a great success. However, specialists are criticising the fact that the WSE is so strictly regulated. The system of setting prices for shares is far from what might be called a market-driven system. Many economists indicate the need to deregulate the WSE. But bear in mind that the capital market does not function in an economic and political vacuum. The recent political controversies in Poland, as well as difficulties in the transition from a Centrally planned towards a market orientated system, have without doubt had a negative impact on the speed of development of the WSE.[36]

The main instruments of the capital market are: Securities issued or guaranteed by the State (such as, Treasury Convertible Bonds, Dollar Bonds, Corporate bonds), and Shares of the companies [37]

For the time being, the WSE does not significantly influence the Polish economy, nor can it be referred to as its barometer. However, the Polish capital market will change

significantly when the 512 companies in the Mass Privatisation Programme are listed in the WSE. This programme will create two types of financial instruments: shares certificates and shares in the funds for which the certificates are exchangeable under certain circumstances, as explained in Section Six below.

b. The banking system

The banking sector in Poland is presently in the process of thorough-going transformation. In addition to the ownership reform and financial strengthening of the banks, many regulatory changes are also taking place.

In 1989, a genuine reform of the Polish banking began, designed to establish a two-tier system (the Central Bank and Commercial Banks). On January 31, 1989, the *Sejm* adopted a new Banking Act and the National Bank of Poland (NBP) Act. According to the new NBP Act, the NBP became the Central Bank in Poland, the bank of issue and the bank of banks, with a main objective of strengthening the Polish currency.[38] Other duties of the NBP include the passing of opinion on the plan for the Balance of Payments BOP, the elaboration of reports on the condition of the Zloty, and drafts of the guidelines of monetary policy[39]. At the same time, NBP is obligated to submit to the Sejm a report on its objectives, a report on the implementation of monetary policy, and recently its financial plan. Beside this, NBP is required to see to the proper operation and development of the banking system, by exercising supervision over the banks, licensing banking activities, issuing regulations to laws and imposing their implementation. The Bank's tasks in this regard also include supervision of the Bank's credit policies, collecting and distributing information about the banking system, its financial position and liquidity, and counteracting irregularities in the banking system that might threaten confidence in its solvency and honesty. It must be remembered that banks, being public trust institutions, must rely entirely on the depositors' faith in their honesty and good management of the money entrusted to them.

In addition, NBP collects (from banks and other institutions) data needed for the preparation of reports on the BOPs, guidelines of the monetary policy and reports on its implementation, and for periodic appraisals of the monetary situation. The NBP is

empowered to issue foreign exchange permits to banks as well as corporate bodies and natural persons and to exercise foreign exchange offices which sell and buy co-operates with international banking institutions and foreign banks with a view to pursuing the interest of the State. Finally, NBP acts as 'the lender of the last resort' by supplying refinancing credit to the banks, including credit in the form of rediscount credit and lumbered credit, with securities being used as collateral.[40]

The Banking Act of January 31, 1989 laid down a new legal framework for the operation of the banking system, while also vesting substantial supervisory powers in the President of the NBP and facilitating the application of prudential banking standards. The General Inspectorate of Banking Supervision assumed the role of the primary supervisory agency within the banking sector. Its responsibilities in this respect include collecting statistical data reported by the banks, analysing this data, and supervising the observance of statutory regulations and prudential practice.

In February, 1992, major amendments to the Banking Act were adopted. Those amendments reinforced the supervisory functions of the NBP (in particular, enhancing the powers of the president of the NBP). The institutional independence of the NBP from the Government was also increased, and provisions were made for instruments designed to support bank privatisation.

There are three main categories to the banking sector in Poland: Specialised banks, commercial banks (State-owned , privatised and privately-owned), and co-operatives.

1. Specialised banks

There are six specialised banks in Poland: Bank Handlowy S A, the major source of trade financing; Powszechna Kasa Oszczednosci - Bank Panstwowy (PKO BP), which maintains its predominance in consumer savings and construction loans; Polska Kasa Opieki SA (PKO SA), which concentrates on consumer foreign-currency savings and transactions; BGZ; the Polish Development Bank; and the Export Development Bank,

which was established in 1988 and privatised in 1992, mainly engaged in providing finance.[41]

2. *The Commercial Banks*

The Banking Law of 1989 laid out a liberal approach to the entry of new private banks. As a result of the changes in legislation and administrative procedures a relatively large number of new private banks opened. By the end of 1990, the number of private banks had grown to about 75 and by the end of 1992 nearly 90 private banks were in operation. Due to the problems in the private sector, the number of private banks fell to about 85 in 1993. Among the commercialised banks in Poland there were nine State banks. Four of them were privatised by the end of 1995.

3. *Co-operative Banks*

There are over 1,600 co-operative banks in Poland, accounting for 6% of total banking sector assets. The co-operative banks, which were operating initially under the umbrella of the Bank for Food Economy (BGZ), are small, with average total assets of zl 2 billion per location in 1993, and service the agriculture sector. Since September, 1992, the NBP has become the *de facto* supervisor for co-operative banks. The co-operative banks are no longer fully autonomous; credit decisions are taken by a credit committee that includes representation from the associate bank. Co-operative banks have also been prohibited from issuing guarantees, since off-balance sheet activities are a major part of the problem facing these banks.[42]

c. *The money markets*

The main result of the emergence of a relatively modern banking system is the creation of money markets. The most popular financial instruments traded on the money market are: bank deposits; Certificate Deposits (CDs) denominated in various currencies; Treasury bills; Treasury bonds; bank bills; and commercial papers. The majority of transactions concluded on the money market, however, involve bank deposits and

Treasury bills. The size of the money market, measured by daily trading volume, was between 12-20 billion (old) zloty. The number of transactions was not more than a few hundred daily.[43]

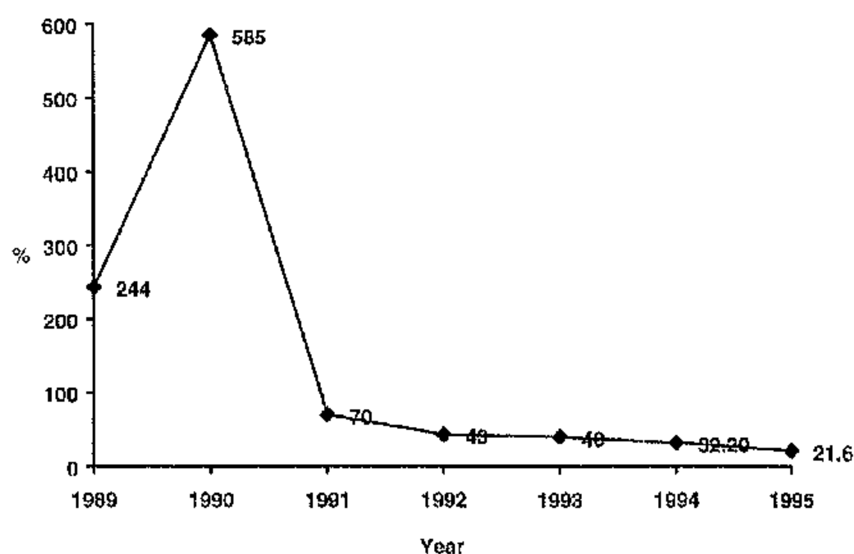
At this stage, I would like to investigate the performance of inflation and credits of banks to nongovernment agents over the transition period.

1. Inflation

Poland was able to reduce the average inflation rates from a hyperinflationary levels (585.8% in 1990) to 21.6% in 1995. However, these rates are still high in comparison to those in other countries in the region.[44] Inflation is of both a demand-pull and cost-push characters. Among the excess demand factors contributing to inflationary processes are the following: a budget deficit financed by the banking system; the excessive growth of the money supply in nominal terms in relation to GDP; the increase in mutual debts in inter-firm settlements; the increase in the level of wages and salaries (despite a fall in real terms). Whereas the main sources of cost-push were: the increases in the prices of energy, rents and housing maintenance costs, and tax liabilities; the crawling-peg devaluation of the Zloty, which drives up inflation; the introduction of excise tax and VAT.[45]

Figure (4.3) shows the trend of inflation rates in Poland over the 1989-95 period.

Figure (4.3)
Inflation rates in Poland (1989-95) (%)



2. Credit

As can be seen from table (4.10), credit to non-government was sluggish during the period 1991-93. In real terms (using the CPI as the deflator), credit to nongovernment declined by nearly 13% in 1992 and by 4% in 1993. Credit granted to State enterprises has been especially tight, declining in real terms by 22% in 1992 and by 12% in 1993. Credit to the private sector grew very rapidly from a low base in 1991, but declined in real terms in 1992; this credit grew by 2% in real terms in 1993. The most rapidly growing component of credit was loans to households.

Table (4.10)

Credit to Nongovernment (percentage change in real terms)

	1991	1992	1993
Total	1.2	-12.9	-4.0
Houshold	n.a.	15.5	36.9
State Sector	-8.9	-22.1	-12.0
Private Sector	54.9	-3.4	2.0

Source: ***IMF, 1994:43.***

The Banks' caution in lending to enterprises contributed to the hardening of budget constraints faced by firms. Apparently, a major source of finance for firms has been retained earnings rather than external finance.[46]

6. External debt

Poland's external debt in convertible currencies amounted at end-August 1995 to US$ 43.8 billion, compared with 48.0 US$ billion in 1990. This represents a decline of US$ 4.7 billion (Table 4.12). This was mainly due to an agreement concluded with Commercial Banks affiliated to the London Club (LC) and implementation of stage two of an earlier debt deal with the Paris Club (PC) of official creditors.

Under the terms of the LC agreement the debt owed to this group of creditors was reduced and rescheduled in October, 1994. The operations involved in this deal comprise debt buy back for a price of US$ 1.324 billion and a reduction of US$ 5.142 billion in the amount of the debt. The obligations outstanding after the buy-back and reduction have been converted into long-term (mostly 20 and 30 year) Government Bonds. The liability incurred by the issue of the bonds into which the principal and interest payment due to the London Club creditors have been converted after the buy back and reduction operations amounts to about US$ 8.0 billion.

April, 1994 saw completion of stage one and the commencement of stage two of the debt-reduction agreement concluded with the PC. The first stage provided for a reduction of 30% of the debt owed to this group of creditors. The reduction took the form, depending on the option chosen by creditors, of an 80% remission of past interest due, or writing off the principal. In 1991-94 a total of 2.9 million US$ worth of principal maturates and about US$ 6.1 billion worth of interest payments was written off. With the commencement of stage two of the debt-reduction deal in April, 1994 there came a cancellation of principle payments due amounting to US$ 3.3 billion. This write-off automatically reduced the sum on the basis of which interest is assessed. Thus, on 31 December, 1994 Poland's debt to the 17 creditors belonging to the PC stood at US $ 26.818 billion.[47]

Table (4.11)

External Debt And Debt Service Burden 1989-95

Specification	1989	1990	1991	1992	1993	1994	1995
Debt US $ billion	40.8	48.5	48.4	47.0	47.3	42.2	43.8
Debt/Exports (%)	538.6	446.5	379.3	336.1	3478	247.1	298.0
Debt Services due ratio (%)							
Interest	45.8	36.0	26.7	33.3	28.9	14.8	...
Principal	40.9	42.6	42.5	13.2	10.3	3.6	...
Debt Services due /Exports (%)	86.7	78.6	69.2	46.2	39.1	18.4	....
Debt Services Due/Exports (%)	20.6	6.8	10.5	11.0	13.2	8.8	....

Source: ***The National Bank of Poland, Information Bulletin, Different Issues.***

As can be seen from Table (4.11), the reduction of external debt obligations to its biggest creditors not only reduced the amount of the external debt, but also significantly affected indicators reflecting the size of the debt and servicing costs as well as the ratios of both debt and debt service due to exports.

In addition, this would diminish the risk level of foreign investment in Poland. Hence this, together with the relatively high rate of GDP growth, and the reduction of units labour costs makes Poland a more attractive area for investment. In particular, the bull market on the Warsaw Stock Exchange (WSE), the implementation of the National Investment Funds Programme NIFP and the possibility of conducting debt-Equity swaps could have a significant impact on the stimulation of interest among foreign investors.[48]

7. Foreign direct investment

The history of foreign direct investment in Poland dates back to the 1970s. However, real progress in this field was only recorded in the last three years 1993-95,[49] thanks mainly to a booming national economy, cheap labour, a large domestic market, and the significant intensification of merger and acquisition activities.[50] There was also the adoption of the Act on Companies with Foreign Capital of June, 1991. This law has extremely liberalised foreign investment procedures. The law was constructed on the basis of equal treatment of foreign and domestic firms, with some minor exceptions.

As can be seen from Table (4.12), total FDI has increased from US$ 8 million in 1989 to US$ 5.9 billion in 1995. Foreign direct investment in Poland amounted to US$ 2.1 billion in 1995, compared to US$ 4.3 billion over the whole 1988-94 period.

Table (4.12)*

Foreign Direct Investment (FDI) in Poland (1989-95) US$ Million

	1989	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**
FDI	8.0	105	323	1,408	3,000	4,321	5,933

Source: ***The Polish Agency for Foreign Investment (PAIZ), 1995:34.*** *** Note: This table includes data on FDI exceeding $US 1.0 million.**

As for countries of origin of the biggest foreign investors, Table (4.13) shows that the USA is at the top of the list, accounting for 30.6% of the total value of foreign investment in Poland in 1995. Multinationals came second (15.4%), and Germany third (10.4%).

Table (4.13)

Foreign Direct Investment in Poland, as of December 1995

Country	**Investment made (US$ mln)**	**% of total Investment made**	**Investment committed (US$ mln)**	**Number of companies**
USA	1,815	30.6	1,618	58
Multinational	912	15.4	194	13
Germany	614	10.4	417	71
Italy	390	6.6	1,748	10
Netherlands	360	6.1	218	12
UK	350	5.8	165	19
France	335	5.6	191	25
Austria	248	4.3	16	23
Switzerland	196	3.3	69	15
Sweden	178	3.1	100	15
Other	535	8.8	403	68
Total	5,933	100.0	5,139	329

Source: ***The Polish Agency for Foreign Investment (PAIZ), 1996.***

Regarding the sectoral structure of the biggest foreign investments in Poland, the electro-mechanical sector predominates and outpaces the finance sector, food processing, energy, and communication.[51]

8. The labour market

a. Employment

During the period 1989-94 employment across the economy as a whole fell by some 2.5 million people (Table 4.14). In the public sector the decrease amounted to 3.5 million; in the private sector, however, the number of jobs went up by 1.1 million. In other words, there was a significant structural shift between public and private enterprises: the private share of employment in the national economy grew from 46.6% in 1989 to 61.6% in 1994, and it now employs 3.5 million people more than the public sector.[52]

Table (4.14)

GDP, Employment and Disguised Unemployment

	1989	1990	1991	1992	1993	1994
GDP (1989=100)	100	88.4	81.7	83.8	87.0	91.3
-Total No. Of Employed (1000)	17002	16280	15326	14677	14584	14754
-Index 1989=100	100	95.7	90.1	86.3	85.8	86.6
-Disguised unemployment (relative to 1989)						
-In Million	n.a	-1.3	-1.4	-0.4	-0.2	-0.8
-As % of Employment	n.a	-7.6	-9.3	-2.9	-1.4	-5.2
-Productivity	100	92.4	90.7	97.1	101.4	105.2

Source: *Bossak, 1995:75, based on Rocznik Statystyczny, 1993 and 1994; and GUS, 1995, Informacja o Sytuacji Spoleczno-gospodarczej Kraju w, 1994r.* Note: Disguised Unemployment = (1989 Employment * GDP index (minus) actual Level of Unemployment in each year).

As can be seen from Table (4.14), in the employment curve two phases can be distinguished and linked to fluctuations in GDP. The first phase spanned the years 1990-91. A decline of 18% in GDP was accompanied by a decline of 10% in employment. A similar pattern was noticed in industry: output down by 33.2%, jobs by 13.2%. The time-lag factor (the ratio of the fall in production to the fall in employment) amounted in the first case to 1.8 and in the second to 2.5.

The highest level for disguised unemployment was in 1991, 1.4 million persons in the national economy. As from 1992, the gap between the increases in output and employment began to grow smaller. In 1993, it was eliminated almost entirely.

Productivity returned to near the 1989 level. In 1994, a new phase began, consisting of a reduction in the disguised unemployment that had been present in the economy before the launch of the transformation process.[53]

One of the causes of unemployment has been the gradual trimming of the excessive employment levels in SOEs. This very clear from Table (4.15).

Table (4.15)

Unemployment in Poland (1990-95)

End-Quarter		Total (ooo)	Unemployed as a result of mass-layoffs	Unemployment Rates (%)
1990	**I**	277	15.1	1.5
	II	568	58.1	3.1
	III	926	126.4	5.0
	IV	1126	183.1	6.1
1991	**I**	1322	250.5	7.1
	II	1574	315.3	8.4
	III	1741	422.1	10.4
	IV	2156	498.0	11.4
1992	**I**	2216	539.5	12.1
	II	2297	565.6	12.6
	III	2498	606.7	13.6
	IV	2509	603.6	13.6
1993	**I**	2649	608.2	14.2
	II	2702	585.9	14.8
	III	2830	569.7	15.4
	IV	2890	562.4	15.7
1994	**I**	2950	550.3	16.7
	II	2933	484.2	16.6
	III	2916	n.a.	16.5
	IV	2838	n.a.	16.0
1995	**I**	n.a.	n.a.	15.8
	II	n.a.	n.a.	15.1
	III	n.a.	n.a.	15.0
	IV	n.a.	n.a.	14.9

Source: ***Bossak, 1995:73, based on data from: Bezrobocie Rejestrowane, 1991-93; GUS, Biuletyn Staty Styczny, No.12. GUS, (1995) Poland Quarterly Statistics, No.1, Vol.III, Warsaw, Poland.***

Table (4.15) shows that unemployment grew rapidly in the first two years, then at a much reduced pace. For the first time since the start of the transformation process, the rates of unemployment decreased in the third quarter of 1994, as the economy began to generate more jobs than it shed. Therefore, one could argue that one of the symptomatic features of the evolution of the labour market has been an extremely rapid increase in the rate of unemployment, which rose from 1.5% (first quarter 1990) to peak

at 16.6% in the first quarter of 1994, then started to decline in the second quarter of 1994, to reach 14.9% by the end of December, 1995.

One would expect that the rate of unemployment would increase to reflect one of the negative consequences of the Mass Privatisation Programme, due to expected high layoffs. However, in the light of the huge expansion of the private sector, one could be optimistic and assume that many of the layoffs would be absorbed by the private sector.

What has been done to counteract the problem of high rates of unemployment?

1. The enactment of 16 December, 1994

A law establishing a new national collective bargaining wage increases was the main event of 1994 in the field of industrial relations. This law abolished the wage controls introduced in 1990 in the form of a progressive tax on increases in excess of a specified rate (the so-called "*popiwek*"), with an upper bracket of 500%, subsequently reduced (earlier in 1994) to 300%. The new system, effective since January, 1995, applies to the whole corporate sector, private as well as State. It represents a turning point in relations between government employees and unions. Its key elements are the following.[54]

2. The establishment of the Employment Fund in 1992

The chief means of counteracting unemployment in Poland have hitherto been labour market programmes financed by the Employment Fund. These programmes reform two different kinds of functions: passive- provision of a safety net to ease the consequences of unemployment (relief payments, pre-retirement benefits, early retirement); and an active- stimulation of re-employment procedures opportunities (training schemes, public works, self-employment grants, etc.). What actually happened? The unemployment rate was increasing steeply, which indicates that the programmes, the so-called "active labour market policy" have not been particularly effective.[55]

Table (4.16)

Employment Fund Expenditures (in Billion Old Zloties)

	1992	1993	1994	1995
Total Expenditures	22,827	31,474	44,600	61,900
Active Programme	1073	3545	5700	7,500
Passive Programme	21,754	27,929	38,900	54,400
% Spent on				
Active Prog.	4.7	11	13	12
Passive Prog.	95.3	89	87	88
Beneficiaries				
Total(x1000)	216.9	214.2	380	415
of Unemployed	9.2	11.5	13.6	15.0

Source: ***Bossak, 1995:81.***

The Employment Fund is financed from revenues from "tax on payrolls" (3% of gross wages) paid by employers. This source of revenue accounted for 36.5% of the Funds' revenues in 1993 and 37.2% in 1994; and secondly, from Central Government grants. As can be seen from Table (4.16) above, expenditures on these programmes amounted to zl 5.7 trillion (i.e. 13% of the total Expenditure Fund).

2. Wages

As can be seen from Table (4.17), nominal wages increased by more than 900% during the period 1990-93, while real wages fell by 33% during the same period, and for the first time since the start of the transition process, increased by 3.2% in 1994. In the industrial sector, real wages decreased by 36% during the period 1990-93, and increased by 7.4% in 1994.

Table (4.17)

Growth Rates of Nominal And Real Wages in Poland (1989-94)

	1989	1990	1991	1992	1993	1994
Nominal Wages	291.8	398.0	70.0	38.9	31.3	36.5
Real Wages	11.6	-27.4	.02	-2.9	-3.0	3.2
Real Wages (Industry)	9.1	-32.1	-1.9	-2.5	0.0	7.4

Source: ***Central Statistical Office.***

Among other factors, it was the high decline in real wages and high rates of unemployment that returned the ex-Communists to power.

9. Conclusion

The combination of policies has succeeded in dramatically reducing and containing macroeconomic imbalances. Poland was the first country in the region to break the recessionary forces accompanying the Eastern European transition. Since March, 1992 Poland has been one of Europe's fastest growing economies. The restoration of growth occurred simultaneously with sustained declines in inflation rates, which in 1989 had reached hyperinflationary levels. Poland has made progress in attaining external balance and increasing external creditworthiness. Poland's foreign trade has been definitively reoriented away from the former members of the COMECON toward the developed capitalist countries of the OECD. Poland has established the region's largest private sector, and the Warsaw Stock Exchange enjoyed an impressive improvement in 1993, 1994, and 1995. Productivity has increased substantially in the private sector and in many SOEs. Unemployment appears to have peaked, and started declining in the third quarter of 1994.

However, Poland's economic successes have been neither complete nor widely applicable to other countries. State Budget deficits in the order of 2.9-6.7% of GDP have persisted since 1990, and foreign investment, although increasing, has been less than expected or needed.

Bearing in mind that the main aim of the thesis is to study the privatisation process in Poland. In the next section a theoretical framework on privatisation is created. This is followed by an examination of the concrete experience of privatisation in Poland.

Endnotes:

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[1] This section is a comparison between the features of the new economic system, and those of the legacy of the Socialist system in Poland in the late 1980s. It will be a comparison between Socialist Poland and Capitalist/Transtionalist Poland.

[2] These figures have been criticised by many economists. For example, Berg & Sachs (1992) estimated the decline in GDP by only 8%. They attributed this decline to a sharp reduction in inventories, since the fall in domestic consumption was more than compensated by the increase in net exports.

[3] Ebrill, 1994:3.

[4] Ibid.

[5] According to estimates of the Central Statistical Office (GUS). GDP grew by 4% according to IMF estimates; and by 4.6% according to the Institute of Market Economy Research estimates.

[6] Bossak, 1994:52.

[7] Bossak, 1995:38.

[8] Tiusanen, 1995:13; Bossak, 1995:38

[9] The major change in the legislation after the collapse of the Socialist system was the amendment of the Polish Constitution. This resulted in the elimination of the protection given to some forms of ownership. Article (1) states: "Undertaking and carrying on an economic activity shall be free and allowed to every person on equal terms". Article 6 declares that the "Republic of Poland shall guarantee freedom of economic activity irrespective of ownership", and Article (7) that "It shall protect ownership and the rights of inheritance and shall guarantee full protection to personal property."

[10] I was told by the Central Statistical Office (CSO) that not only the newly established enterprises are 'greenfield' (new) businesses, because they include those enterprises which are established from the assets of the liquidated SOEs. Also, that small businesses which employ below 5 people are not included in private sector statistics *(The Central Statistical Office, 1995, Personal Communications)*.

[11] Rapacki, 1995:9-10, based on data derived mainly from the Central Statistical Office.

[12] Szomburg, 1993:86

[13] Blaszczyk & Dabrowski, 1993:61.

[14] Rapacki, 1995:10; Bossak, 1995:66.

[15] Bossak, 1994:136

[16] Bossak, 1993:117

[17] Bossak, 1995:23-4.

[18] Schwartz, 1994:12-13.

[19] Ebrill *et al*, 1994:13.

[20] The reason for introducing VAT was to approximate the Polish tax system to that of the European Union and the need to develop arrangements better suited to the requirements of a market economy and in keeping with the premises of a neo-liberal policy committed to the principle of fiscal neutrality (*Bossak, 1994:103*).

[21] Kornai (1980:302-4) fixes five sufficient conditions that fulfil and guarantee a perfect hardness of the budget: first, prices have to be exogenous, i.e. prices of inputs and outputs should be given to the firm. That is to say firms have to be price-takers not price-makers, regardless of who determines the price. Second, the tax system should be hard, which means the formulation of the tax rules (laws and regulations) cannot be influenced by our firm, they are given exogenously for it; the tax system links taxes to various objectively observable and measurable criteria; the firm cannot receive any individual exceptional exemption; the tax imposed should be collected unconditionally on the prescribed terms. Third, there should not be free State grants, i.e. the State does not give any grants to cover current expenses, nor make any free contributions to investment. Fourth, there should be no credit, i.e. all inputs purchased must be paid for exclusively in cash. Fifth, there should be no external financial investment.

[22] Schwartz, 1994:14.

[23] Ibid:11.

[24] Ibid.

[25] Welfens & Jasinski, 1994:28.

[26] Schwartz, 1994:14.

[27] Ibid:14-15.

[28] Ibid:15.

[29] Chopra, 1994:40

[30] Golebiowski, 1994:149

[31] PAIZ, 1993:45

[32] Golebiowski, 1994:149

[33] Jones, 1992:116-117.

[34] National Bank of Poland, 1996:22

[35] Golebiowski, 1994:149

[36] Ibid.

[37] Ibid.

[38] Article (5.1).

[39] In spite of that, the NBP is considered according to the new Act as an independent body. Its autonomy is partly reflected in the mode of appointment of its President by their Lower House (Sejm), at the request of the President of Poland, for a six-year term.

[40] Article, 5.2

[41] Bury *et al*, 1994:18.

[42] Ebrill *et al*, 1994:39

[43] Bury *et al*, 1994:61.

[44] For example, in 1994, inflation rates were 9%, 14%, and 19% in the Czech Republic, Slovakia, and Hungary, respectively.

[45] Bossak, 1994:87.

[46] IMF, 1994:44.

[47] Bossak, 1995:135

[48] Bossak & Kalicki, 1994:206

[49] The main factors which blocked the inflow of FDI during the first three years of the transition period (1990-92) were the following: (1) political instability and uncertainty in Poland as well as more anti-foreign sentiments, especially among the peasant and nationalist parties; (2) a high level of legal instability and uncertainty; (3) unclear division of responsibility in the area of privatisation decisions; (4) the very late liberalisation of foreign investment law (June, 1991); (5) restrictive land legislation; (6) the high amounts of external debt to international private banks (*Blaszczyk & Dabrowski, 1993:58-59).* In fact, most of these factors have now changed.

[50] Lubinski, 1996:126, 128.

[51] Polish Agency for Foreign Investment, 1995:35.

[52] Bossak, 1995:74.

[53] Bossak, 1995:75.

[54] Ibid:71.

[55] Ibid:76.

PART THREE: THEORETICAL BACKGROUND ON PRIVATISATION, THE DEVELOPMENT OF POLAND'S PHILOSOPHY ON PRIVATISATION, STATISTICAL AND ECONOMIC RESULTS OF PRIVATISATION IN POLAND (1990-95), AND THE IMPACT OF PRIVATISATION ON ENTERPRISES

SECTION (5) THEORETICAL BACKGROUND ON PRIVATISATION

The main purpose of this section is to create a theoretical framework on privatisation to serve as a general background for our empirical work on the Polish privatisation process in the following sections. In the first part I discuss the concept of privatisation, focusing on the meaning of privatisation in Eastern Europe. Secondly, I discuss the main issues of privatisation in Eastern Europe, specifically: the overall role of privatisation, compartmentalisation of privatisation policies, corporate governance and property rights, and finally the problem of privatising large enterprises. Then the main methods and techniques of privatisation used in Eastern Europe, with their advantages and disadvantages are discussed. Finally, the main challenges to privatisation in Eastern Europe are analysed.[1]

1. The meaning of privatisation

The word privatisation carries different meanings depending upon the type of economy we are in, and the purpose it is used for. In general, privatisation has two main concepts; the broad concept, which means "*an increase in the private sector activity, including the creation of brand-new (start up) private enterprises, without any reduction in the activity of State enterprises*"; and the narrower, but probably most common, definition of privatisation, which involves "*the transfer of ownership of State assets to private hands.*" Generally speaking, the word privatisation means "relying more on the private sector and less on government to satisfy society's needs". [2]

In Eastern Europe, privatisation can be seen as a process that takes the State (political bodies as well as government administration and the *nomenclature)* out of the decision making over the allocation of the returns from SOEs; and the need to create a new ownership structure that would effectively oversee the management of the newly privatised enterprises.[3]

2. *The main issues of privatisation*

A review of the literature shows that the theoretical debate on privatisation revolved around the four "old" questions; "Why to privatise?"; "To whom to privatise?"; "What to privatise?"; and "How to privatise?". These questions deal with four main issues which affect the quality of privatisation in Eastern Europe. These are the overall role of privatisation in the transitional process, the compartmentalisation of privatisation policies, property rights and corporate governance, and the problem of privatising large enterprises.[4]

a. The role of privatisation

This issue deals with two main points; (1) the speed of privatisation; and (2) the main goals of privatisation in Eastern Europe. Many researchers (such as Hare & Brosfeld, 1991; Lipton & Sachs, 1990; Schwartz, 1995) argue that the virtual absence of well-established and functioning financial markets, and the lack of an established and well-understood legal and regulatory framework, require great care to be taken in determining the place of privatisation in the sequence of transition.

Initially, the discussion of the role of privatisation in the process of transition focused on the *speed of privatisation,* and it was far from clear whether privatisation should lead, accompany, or follow the process of transition. Volumes of literature are available which discuss the issue of sequencing of the main four elements of any reform programme: restructuring, privatisation, stabilisation, and liberalisation. As the last two elements have been discussed in above section, our discussion will focus on the first two elements: privatisation and restructuring.

The restructuring controversy concerns State enterprise financial, organisational, and physical restructuring. There are several kinds of financial restructuring: (1) restructuring the balance sheet of the company. Assets recorded on balance sheets at book values well above estimated market values should be written down to market values. (2) Debt may be rescheduled by an extension of maturities. Debt may be

converted into equity. The government may absorb some of the enterprise's debt, in order to give the enterprise adequate positive net worth. (3) An enterprise may be recapitalised by the injection of new capital. For example, a State enterprise can be transformed into a new corporation whose equity consists of the government's contribution in kind of assets of the former State enterprise, and funds provided by private investors. (4) Bankruptcy acknowledges that liabilities exceed assets, that the enterprise cannot be put on a sound footing, and that it should be terminated with some creditors' claims unsatisfied. Because creditors will commonly be other State enterprises or State banks, the government ultimately bears the losses of unsatisfied creditors.[5]

Organisational restructuring usually involves the division of a larger entity into smaller parts: (1) the enterprise can be broken up into several legal entities. (2) the enterprise can be transformed into a holding company with shares in subsidiary enterprises that acquire the assets and liabilities of the original enterprise. The aim is to privatise some, if not all, of the subsidiaries. (3) some productive facilities may be sold. (4) some non-business activities-like housing, health care and recreation for employees- can be taken by local government agencies.[6]

Bear in mind that the economies of Eastern European countries are biased towards large enterprises. Therefore, demonopolisation is an important aim of organisational restructuring. And in order to make them more competitive, large enterprises should be restructured before privatisation.[7]

Physical restructuring involves the upgrading or replacement of obsolete plant and equipment, the introduction of new technological processes, and investment to improve energy efficiency and environmental protection. The government should avoid such rehabilitation of assets before divestiture. Particularly in a period of fiscal stringency under macroeconomic adjustment, the government should not incur additional costs for an enterprise that may not be recoverable at its sale. In any case, potential investors are likely to have different views from government about how to rehabilitate the facility. Thus, physical restructuring should be left to the new private owners.[8]

Advocates of 'commercial' privatisation (for example, *Fisher & Gelb, 1991; Walkowiak, 1990; Kierunki, 1990; Rzadowy, 1990; Zamierzenia, 1991*) based their ideas on Western (mainly UK) experience. They usually proposed restructuring prior to privatisation, in order to make the latter more profitable for the State budget. Whereas the opponents of this approach (for *example Blaszczyk, 1991; Dabrowski, 1990*) argued that the State has very limited capacity to deal with enterprise restructuring, especially in post-communist economies where the State apparatus is extremely weak and the size of the State sector is enormous. Moreover, restructuring is a time, and money-consuming process, very sensitive to political pressure and lobbying. The representatives of this way of thinking were in favour of quick privatisation using a simplified procedure of selection, valuation and decision.

Practical experience justified the second approach rather than the first. However, some preparatory measures should be taken by the government administration prior to commercialisation and privatisation. Moreover, the intention to distribute the former State-owned assets among the whole of society was seen for a long time as contradictory to the necessity of enterprise restructuring. While the former implies widely diffused ownership, the latter needs the presence of a strategic share holder with a controlling package of shares. Practical experience shows that a reasonable compromise was possible. Under the capital privatisation scheme a controlling package is sold to a selected 'strategic' investor and the rest is offered partly to employees (up to 20%, usually less) and partly to the general public through open subscription. Under the Mass Privatisation Programmes, the investment funds would take the role of strategic investors dealing with the restructuring process.[9]

Proponents of slow privatisation put forward three basic arguments: (1) macroeconomic stabilisation, domestic price liberalisation, and current account convertibility have to precede privatisation because efficient decisions can only be made on the basis of correct relative prices; (2) the introduction of competition to prevent monopoly profits; and (3) the introduction of modern tax systems and accounting procedures, and financial market and capital market reforms, have to precede privatisation to allow for

proper enterprise valuation.[10] Proponents of fast privatisation basically pointed towards the broader macroeconomic consequences of continuing to burden the economy with a large and inefficient State enterprise sector for decades to come.

It has become widely accepted that the transition from plan to market, and the urgently needed improvements in enterprise efficiency, are unlikely to occur without extensive and rapid privatisation .[11] This view is reflected in the mass privatisation programmes that are discussed and set up in countries like the Czech and Slovak Republics, Romania and Poland. With all Eastern European countries swiftly implementing macroeconomic stabilisation policies, domestic price liberalisation and current account liberalisation, arguments for delaying privatisation were significantly weakened. The rapid progress that was achieved on devising mass privatisation schemes that would allow for fast nominal divesting of State assets, while delaying the question of asset valuation, further strengthened arguments in favour of fast and comprehensive privatisation.[12]

After agreeing on a form of sequencing, some fixed goals should be determined for privatisation. Privatisation may comprise a fairly large number of general policy objectives. Box (5.1) lists the main declared goals of Eastern European privatisation programmes.

Box (5.1)

The Main Declared Privatisation Goals

(1) to change the social structure, and create a middle class. (2) to increase the ability of the economy to adapt to external conditions. (3) restructure the viable enterprises in order to make them competitive under market conditions. (4) to promote demonopolisation in order to provide an efficient market structure. (5) ***to contribute towards the creation of a well-functioning market economy***. (6) to reduce the share of State owned enterprises in the economy. (7) to generate funds from the sale of enterprises. (8) to ensure a wide range of diffusion of ownership of privatised assets. (9) to provide an effective system of corporate governance. (10) to create conditions conducive to raising productive and allocative efficiency, etc..

Source: ***Schwartz, 1995:31; Estrin, 1994; Hare, 1994; Blanchard et al, 1991; Bolton & Roland, 1992; Frydman et al, 1993.***

Generally speaking four objectives of privatisation can be distinguished: economic (microeconomic and macroeconomic), social, political, and systematic goals.[13] The remainder of this part discusses these goals in some detail.

1. Economic Goals

Privatisation is expected to improve the economic efficiency of individual enterprises, branches composed of them, and thus the economy as a whole. In this aspect, Bornstein (1992) distinguishes between two types of efficiency: ***productive and allocative***. He says that "***productive efficiency*** *can be improved if the same (or greater) output can be produced at lower cost. In State enterprises the incentives to managers and workers for productive efficiency are weak, for several reasons. Plan assignments stress output rather than cost reduction. Job security is a societal obligation of the enterprise. Losses are covered by budget grants or automatic bank credit at subsidised or even zero interest rates. In contracts, under private ownership, without government support, enterprise managers are subject to contractual discipline by shareholders seeking profit maximisation, to take-over discipline, by potential private bidders and to bankruptcy discipline by creditors. Thus privatisation of a State enterprise can, for example, reduce overstaffing and cut excessive use of material and energy.*" [14]

On the other hand, "***allocative efficiency*** advocates *the assignment of resources to their most productive uses by profit-seeking entrepreneurs when prices reflect relative scarcities, production and trade controls and barriers to entry and exit are absent, and competition is perfect. Under public ownership, allocative efficiency may suffer because State enterprises, controlled by government directives and protected from competition by law and trade policies, have weak incentives to respond to prospective buyers' demands concerning quantity, quality and assortment of goods and services. Privatisation can improve allocative, as well as productive, efficiency if competitive pressure is exerted by three forces: (1) the rivalry of many domestic sellers and buyers of the same or substitute goods and services; (2) the lack of barriers to entry and exit; and (3) the absence of protection against imports.*[15]

Gleb and Gray (1991:31-32) argue that "*it is possible that a relatively small number of State enterprises could operate reasonably efficiently in an economic system in which most economic activity is private. But a small private sector can only operate successfully if private ownership and the pressure of competition stimulate efficiency.*"[16]

One can argue that significant gains in efficiency are more likely if certain major public monopolies are privatised, but only if they are exposed to competition and their monopoly power reduced. Moreover, when accompanied by microeconomic liberalisation to foster competition and by regulation to prevent monopolistic practices, privatisation can increase not only productive efficiency but allocative efficiency as well, in that it should lead to a structure of output that is more highly valued by consumers, given social costs of production".[17]

Other economic goals of privatisation include budget revenue from asset sales, or the fiscal impact of privatisation, absorption of some of the 'monetary overhang' of households' liquid assets, or the monetary impact of privatisation, and an inflow of convertible currency from foreign direct investment (FDI). I shall only discuss the fiscal impact and the impact on FDI, as it is believed that the impact of privatisation on cutting 'monetary overhang' is minimal.[18]

a. Fiscal impact

It is believed that raising revenues for the State budget would only work if assets of privatised enterprises could be sold in the market at more than give-away prices, and if the resulting revenue is not entirely absorbed by the administrative and transaction costs associated with carrying out the privatisation.[19] It is expected that revenues to the State budget from levies on SOEs profits would fall after privatisation. However, part of these revenues would be offset by taxes on profits of privatised firms. Therefore, to avoid an expected increase in the budget deficit, as a direct loss of profit tax revenue, it might be of importance to reduce government expenditures and /or amend the tax system to adapt to the newly created economic system.

Regarding expenditure, it is expected that it might increase in the short term, especially if the amount of expenditure for the administration of privatisation is larger than the drop in government subsidies.[20]

2. Impact on FDI

It is expected that the sale of State assets or company shares to foreign investors can improve a country's balance of payments. In the short run, the inflow of foreign currency strengthens the capital account. In the longer run, on the current account, foreign investment may generate additional exports (or reduce imports) by an amount greater than that devoted to the repatriation of profits. Moreover, FDI- which is expected to be mainly private- can provide know-how in technology, production, finance and marketing; and connections with export markets and international financial markets. However, Eastern European privatisation programmes are to a certain extent free to impose some restrictions on foreign investors. For instance, local governments can totally exclude some branches (such as transport, energy, oil refining) from the privatisation process. Foreign investment may be excluded from some branches (mainly small-scale privatisation such as retail trade and services) which are scheduled for privatisation, but for which the government believes domestic sources have adequate capital, technology and management ability. How then, can FDI be motivated?. One can talk about five different ways to promote FDI. These are the following: (1) foreign ownership may be authorised for most or all of a firm's equity. (2) repatriation of profits and capital in convertible currencies may be promised. (3) foreign investors can be given tax incentives like reduction in profits taxes for five or ten years. (4) specific enterprises may be advertised abroad for privatisation through foreign investment.[21] (5) and foreign investors could be treated as local investors with few exceptions.

2. Social and Political Goals

One of the social goals of privatisation is the redress of past injustice when private property was expropriated by the State without proper compensation. In this case, the restitution of the property (or, if that is not possible, financial compensation) is proposed. Another goal is to reduce inequality in the distribution of wealth and income by the repatriation of some State property equally among all (resident adult) citizens, for instance by free transfer of shares in operating companies or holding companies that have some shares in operating companies. Dividends from these shares would decrease inequality in the distribution of income. Also, it is hoped that such 'popular capitalism' will create public (electoral) support for further privatisation, for economic freedom and for political pluralism and democratic institutions.[22]

Finally, privatisation can weaken the old power structure of the communist elite in State enterprises, and the Ministries and Government agencies supervising Ministries and enterprises. However, specific individuals from this '*nomenclature*' may remain as managers, and perhaps become owners, of privatised enterprises.[23]

3. Systematic Goals

One can argue that without privatisation, no meaningful market conditions could begin to exist. To elaborate: the transfer of State ownership is essential to achieve four major goals: first, to create competition among enterprises in the market place; second, to promote entrepreneurship and risk-taking in economic initiative; third, to spur innovative production and management; and finally, to favour the development of a new managerial class that is fully committed to achieving cost efficiency in combining different factors of production.

In practice, a typical set of privatisation policy objectives may include; choosing the "right" buyer; getting a "fair" price; privatising a certain number of enterprises within a given period of time; safeguarding employment; and obtaining investment guarantees. As it is very difficult to simultaneously control all five variables- ownership, price,

time, employment, and new investment- trade-offs are inevitable. For example, by selecting a strict time frame for privatising the economy, the other four variables would normally have to be left more or less free of restrictions.[24] Given multiple and not necessarily compatible goals it comes as no surprise that privatisation programmes also operate with multiple privatisation tools, and the trade-offs that exist at the level of privatisation objectives are closely associated with similar trade-offs that exist at the level of privatisation tools. For instance, "mass" privatisation programmes, designed to transfer ownership rights of a large number of SOEs to the citizens at large, are closely associated with meeting time goals. With time being dominant, there can be little selectivity about price, ownership and employment. Similar conclusions hold for other privatisation tools: for instance, one-by-one asset auctions would be the most appropriate procedure for policy-makers wishing to maximise proceeds from sales, whereas special employee or management buy-out or leasing programmes target specific groups of potential buyers. In general, the number of privatisation goals should equal the number of privatisation tools that policy-makers wish to pursue.[25]

b. Compartmentalising privatisation policies

Once agreement is reached that privatisation is a cornerstone in the whole transition process, the next important issue is how the privatisation policies should be compartmentalised. In fact, the existence of trade-offs implies that policy-makers have to decide what part of the privatisation process should be controlled. However, given rather broadly defined objective functions, policy makers in most countries have opted for a similarly broad range of privatisation tools to be adopted. As no single tool is best to meet all policy objectives, and given that the demand for the various parts of the existing portfolio of State assets is also highly differentiated, privatisation policies in many Eastern European countries have become compartmentalised in the sense that separate policy objectives should be pursued for specific subsets of SOEs: that is, new owners are carefully selected for some SOEs, prices are maximised for others, a strict time frame is pursued for a third group, employment guarantees are safeguarded in a fourth group, and so on. The many privatisation policy objectives, and the highly

differentiated demand for the existing portfolio of State assets, have brought about a whole range of privatisation tools being adopted. See Part Three of this section.

It is of importance to mention that while some cases may be extreme in their degree of compartmentalisation of privatisation schemes, there are a number of important commonalties. For instance, one of the common elements is special rules for the privatisation of small enterprises, such as retail stores, hotels, restaurants, gasoline stations, small service enterprises and cinemas. Private savings were generally sufficient to purchase these enterprises and accordingly, they have had strong domestic demand in all Eastern European countries. For example, by the end of 1991, Hungary had managed to privatise 90% of all its small enterprises. East Germany managed to privatise 80% of small commercial entities by the end of February, 1992.[26]

One other common element in Eastern European countries is that in almost their privatisation programmes, there is an element of restitution (reprivatisation) available. In general, Eastern European countries have decided in favour of physical restitution rather than financial compensation, but some countries did severely limit the property subject to restitution. For example, in the Czech and Slovak Republics, a strict deadline for filing claims and the decision to restrict restitution claims to property that was nationalised under Communist rule (i.e. between 1948 and 1989) effectively limit the amount of property subject to restitution. In Hungary, physical restitution only exists for agricultural land; non-agricultural property is only compensated for by giving securities to the former owners.[27]

The other element common to Eastern European privatisation programmes is the largely demand-determined early privatisation of companies in good financial condition. However, only Romania has an explicit programme for enterprises in good financial health.

There are also marked differences among Eastern European countries, particularly with respect to the acceptance of mass privatisation and the acceptance of foreign investment. In general, domestic credit in Eastern Europe is severely constrained,

particularly in relation to that available to potential Western buyers. Hence in the absence of mass privatisation schemes, domestic credit constraints would make sales to foreign investors almost unavoidable. For example, in Hungary, the rejection of mass privatisation has necessarily meant a strong openness to foreign investment. Other countries, particularly those in which mass privatisation is expected to play an important role, have sometimes placed more restrictions on foreign investment. Stricter controls on foreign investments have usually been reasoned out by the need to ensure congruence of interests between enterprises and nations regarding long-term corporate strategies.[28]

c. Corporate governance and property rights

The term corporate governance, as used by economists, refers to "*the corporate-governance arrangements by which shareowners hire and fire managers and monitor and reward them in order that they serve optimally the shareowners' interests. Every system of corporate governance is a structure of control rights, and the owners of enterprises want the system that is best for the price of their shares and thus best for them. In analysis of these arrangements, the shareowners are said to be the "principal" and the problem is to choose and to motivate a manager, called the "agent", to pursue their interests to a cost-effective extent. Corporate control is not the standard agency problem, though, since there are many "principals" in a large enterprise and the "principals" want to be able (if the terms are favourable) to transfer their control rights to new principals*".[29]

Property rights refer to "*these rights pertaining to the permissible use of resources, goods and services. Ownership of an asset consists of the following rights: to use that asset, to change its form and substance and to transfer all rights through sale. Ownership of an assets is not unfettered because some restrictions are generally imposed by private contract or law*".[30]

The issues of corporate governance and property rights are of importance in Eastern Europe in general because of two reasons: first, the lack of confidence in the

managerial class, where many managers owe their positions to their Communist party allegiances rather than to their technical competence. Secondly, Eastern European countries lack many of the individual and institutional actors that are normally involved in corporate governance in the Western countries.[31]

Bear in mind that the whole idea of privatisation is the transfer of ownership of State assets to private hands. Privately owned enterprises lie at the heart of market economies.[32] The issue of detecting whether private ownership really does govern privatised enterprises and control their management can be approached through three main concepts: corporate control, property rights and power within organisations backed by three theories, respectively the theory of corporate control, the theory of property rights and the theory of organisations.[33]

Although the theory of property rights has had a strong impact on the analysis of privatisation, it is a "follower" of the theory of corporate control at least in one respect: it has been elaborated as a reaction against the idea of a managerial capitalism, and sometimes derived from the study of corporate control.[34]

As a rule, two models of ***corporate control*** are distinguished: outsider control model, which is found in the UK and the USA; and the insider control model found in most of Western Europe and Japan.[35]

"*Outsider control*" is basically that of owners, whether they are "hard core" shareholders, family members of a former tycoon, banks, institutional investors (investment funds, insurance companies, etc.) or, that of any coalition of these owners. The State and its agencies can obviously have some shares in the capital of a joint stock company, or even dominate the coalition of external stakeholders supervising the company. An extensive definition would include business partners, suppliers, customers, trade unions, trade associations and even some competitors among the participants to a possible outsider control over a corporation.[36]

On the other hand, "*insider control*" pertains to situations in which the chief officer, senior executives, managers or personnel have the last say on strategic decisions. A coalition of insiders can also capture corporate control. A specific case of "*insider control*" is of course the managerial corporation where managers are empowered to take decisions and are not appointed but practice self-appointment; they usually decide their own salaries, bonuses and stock options. Another specific case is the "social corporation": it is a joint stock or limited liability company ruled by its employees, who appoint the managers, and employee share ownership is at least one part of a mixed ownership of the social capital fund. "*Insider control*" is assumed when it is not possible to identify any significant shareholder, that is to say when no individual or no obvious coalition of shareholders concentrate more than 5% or 10% (or lower) of total corporate capital.[37]

The main features of the *outsider model* are: (1) dispersed ownership, and separation of ownership and control; (2) little incentive for outside investors to participate in corporate control, and consequently weak commitments of outside investors to the long-term strategies of firms; and (3) friendly and hostile take-overs, and frequent market entrance and exit. On the other hand, the main features of the insider model are: (1) concentrated ownership, and association of ownership and control; (2) corporate control being exercised by shareholding parties (banks, other firms, employees), with outside interventions being limited to periods of clear financial failure; and (3) absence of take-overs, and frequent market entrance and exit.[38]

Hence, one can argue that an increasing degree of real (capitalist) privatisation is dependent on the possibility of alleviating or getting rid of corporate governance by the State or by enterprise insiders.[39]

The ***theory of property rights*** attempts to identify who makes decisions on corporate assets and who is empowered to discipline managers and workers.[40] Economic efficiency is assumed to depend basically on the exercise of corporate governance by owners (shareholders) over managers and the whole enterprise. In the case of small enterprises in which the boss is the sole owner, there is no question. But in the case of

large enterprises, numerous shareholders must delegate decision making on the use of assets, on the use of assets income and, sometimes, on the disposal of property. The capacity of monitoring managers appears then to be a crucial issue for shareholders, otherwise their property rights will be alleviated by managerial behaviour of rent-seeking and of maximising take-home gains (higher wages, bonuses, personal cars, etc.). In fact, the more scattered the distribution of corporate capital, the higher is the shareholders information costs for monitoring management.[41]

The roots of linking dispersed ownership to ineffective corporate governance dates back to Berle and Means (1932). They showed that even at the top executive levels of the modern corporation there is a great gap between ownership and control, and a corresponding great opportunity for discrepancy between the goal of owners (profit) and the goals of managers (career status, wealth, a quite life, and so on). Then, many theories were put forward about the best avenues to alleviate the governance problem. For example, Demsetz (1988) suggests that the governance problem is largely overcome in practice through a mixture of managerial compensation based on stock prices, and an adequate size of share ownership by minority shareholders. Moreover, Morck, Shleifer and Vishny (1988) show that an enterprise's market valuation tends to be lower when management holds a very small share of the enterprise capital than when it holds a moderate amount of enterprise capital.[42]

Bear in mind that there are two strategies to create proper corporate control. The first is to create the owner forthwith and to hope that suitable mechanisms of enterprise control will evolve with time. The second is to introduce rudiments of an efficient enterprise control mechanism from the beginning in the process of widespread privatisation.[43] The question that should be answered at this stage of analysis is; "What method or technique of privatisation would be suitable to create an appropriate owner in the Eastern European privatisation process, which in the end would establish an effective structure of corporate control?."

To answer this question, I would like to discuss the consequences of two paths to privatisation, namely, **"take-over"** and **"mass privatisation"**.

1. Take-overs

It is argued that "*the market for corporate control through* **take-overs** *is highly* imperfect, *with significant externalities and asymmetries of information. Therefore, the market cannot be relied upon to do a good job in matching potential owners and firms: many efficient take-overs may never be achieved, and many inefficient take-overs may be consummated. The main problem is the fact that take-over bidders may be forced to raise the price of the take-over, and therefore, often do not undertake the effort even when efficiency considerations would recommend it."* [44] *On the other hand, some take-overs may go forward even when they are not justified by efficiency, if the take-over process results in a gain in wealth for the bidder not as the result of a rise in efficiency, but by a transfer of wealth from some stackholders in the target firm.*[45] Moreover, it is shown that "*take-over bidders may be forced to raise the price of the take-over bid to a point that exhausts most or all of the potential financial benefits to them of the take-over. This is because the incumbent shareholders in the target firm have an incentive to free-ride on a take-over bid, by holding on to their shares if they believe that the enterprise will become more valuable if the take-over bid is successful. Thus, in order for the take-over bidder actually to acquire a firm, the bidder must make an offer that is generous enough to tempt the incumbent shareholders to part with their shares."* [46] In their study on hostile take-overs, Bhagat, Shleifer, and Vishny (1990) showed that "*the bidder gain little in the take-over bid, while all of the gains are appropriated by the shareholders of the target firm.*" [47]

2. Mass or voucher privatisation

In the case of "**mass**" or "**voucher**" privatisation, it is expected that the capital of a privatised enterprise would be scattered. In this case, the *theory of property rights* must conclude that shareowners obtain only *alleviated* property rights on assets insofar as the cost for monitoring managers would be too high for each small shareholder. Voucher or mass privatisation creates a host of shareholders. This in turn means that none of them can really influence the management of their enterprise. Each one of the

shareholdershas two options: ***either*** to sell his or her shares to "the core (large stack) investor" or remit them to investment funds, ***or*** complain that he or she keeps shares with alleviated property rights. In the first case, the result would be a concentration of capital which is, according to the theory of property rights, a precondition for some owners to monitor the firm management.[48] The 'core investor' involves some type of mutual funds that act as core investors and which in turn are owned by the general public. Lipton & Sachs (1990) envision core investors created by the government, which would also endow them with certain initial equity holdings and appoint their initial directors. Frydman & Rapaczynski (1991) propose free entry into the mutual fund market, and competition among the mutual funds to obtain shares from the public. Sachs (1991) argues against allowing mutual funds to gain a majority stake in individual enterprises, whereas, Frydman & Rapaczynski (1991) propose auctioning of enterprises to the different mutual funds in such a way as to ensure a few large initial shareholders. Schwartz (1995) argue that "*countries that are actively considering mass privatisation with mutual funds have, implicitly or explicitly, given a large role to the insider model of corporate governance. On the other hand, those that largely rely on individual sale, notably Hungary, have not yet made a clear decision on the system of corporate governance. In any case, in all countries where privatisation has been slow, there has been a continuation of a system where corporate governance is largely exercised by the State.*" [49]

Once the capital distribution has been concentrated, the question to be answered is; "Who can discipline managers and workers, and who can dispose of assets in privatised enterprises?." If the answer was: the State or its bodies, such as State banks, State holdings, and State insurance companies, can dispose of assets because they still hold a majority or a substantial minority of total shares, then we must ask, "Who can discipline managers, except themselves?". Owners' property rights would be alleviated, and the privatised enterprise would not actually be a private enterprise. Such an outcome is partly confirmed by the fact that Czech investment funds, which hold together a majority share in 860 enterprises, did not embark either on restructuring productive assets or on paying very high promised dividends to smallholders who remitted them vouchers formally. In other words, investment funds and other financial

intermediaries do not yet behave either as if they were private investors, or as if they will discipline managers; all this contradicts the full exercise of the property rights of owners (smallholders in the last resort).[50] Then comes the issue of proper manager incentives.

A privatised enterprise is not genuine, in this theoretical framework, as long as managers and/or employees remain capable to make decisions as regards use, income or disposal of assets, in particular since their behaviour as wage earners (resistance to lay-offs, wage claims, in-house benefits in the work place, etc.) prevails against their possible strategy as shareholders. Efficient management and enterprise restructuring thus require either appropriate managerial incentives, or a coalition backing restructuring and efficiency which is less likely the more capital distribution is scattered. Such a situation is well known in the theory of property rights as a ***principal-agent*** problem in which the ***principal*** is in possession of less information than the *agent* (moral hazard) and must design a suitable procedure for inciting managers (agents) to act according to the principal interest (maximising profit and the value of assets).[51] In spite of reservations about the principal-agent model, some authors (such as, Mayhew and Seabright, 1992) suggest implementing a contractual incentive system within the State enterprise before privatisation, insofar as this latter will supposedly scatter corporate capital in the hands of numerous shareholders.

Transforming privatised into private enterprises in Eastern Europe requires the emergence of shareholders with property rights non lessened by managerial behaviour. Concentration of a significant "bundle" of shares is needed for a group of shareholders to satisfy the conditions of majority control. A concentration process of this kind has rapidly raised the issue, in the Czech and Slovak Republics, of publicising the names of main shareholders in privatised enterprises. Publicity has been provided on the secondary market for shares, but it has triggered a side effect in attracting the demand for shares toward companies involving foreign investors. In addition, the emerging capital markets in Warsaw, Budapest, Prague, Moscow and so on, are still too tiny to provide an anonymous process of capital concentration. Moreover, most of the privatised enterprises are not quoted. Capital concentration in the hands of stable "hard

cores" of monitoring shareholders will be therefore a rather slow process in Eastern European countries. It is expected that owners' capacity to discipline managerial behaviour through the threat of a possible external take-over will remain weak in quoted enterprises, and non-existent in non-quoted privatised enterprises, in the foreseeable future.[52]

One of the basic underlying assumptions of the theory of property rights is that private shareholders aim primarily at economic *efficiency* and *profit maximising*. Can this assumption fit firms as specific as formally privatised enterprises are?.

The ***theory of organisations*** can help in answering this question. This theory argues that the implementation of a business plan requires to be backed by a stable coalition of stakeholders within the corporation; it could be either a coalition of insider or outsider stakes.[53] Although it can be argued that conflicts among stakeholders, even among insiders, such as between managers eager to restructure the enterprises and employees then threatened with unemloyment, can hinder the emergence of an insider coalition.[54] This introduces the question of real economic power within an enterprise considered as an organisation, and drives the analysis to issues such as the strategic behaviour of different economic agents and groups, alliances, authority and ideology- the "enterprise or organisation workshop".[55] In this approach, the enterprise is a room for co-ordination- and not only for discipline- between economic behaviours and activities, namely that of employees, managers, senior executives, chief officers and shareowners. Among these participants in the enterprise, some subsets or groups can coalesce around a mutual target of satisfying results under the hypothesis of a restricted rationality of economic agents. At any moment, some coalition dominates the enterprise, but can be removed by another in the making. The ruling coalition should adopt a management providing the highest return on assets if we want a formally privatised enterprise to be transformed into a private firm maximising its profit. The type of coalition in power, and contingencies of economic environment, determine according to the theory of organisations, the kind of *target* which must reach a satisfying level in the firm: efficiency, or survival, or profit, or autonomy, or growth, or asset value.[56] The emergence of a new dominating coalition within the enterprise can obviously change

the prevailing target.[57] Survival usually characterises insiders' coalitions, in particular when the enterprise encounters some kind of deep crisis endangering its existence. Enterprises from the State sector in Eastern European countries are cases in point. Once privatised, the survival target becomes the highest enterprises priority in an environment of increased competition and harsher economic circumstances (inflation, recession, etc.) to which the insider coalition was not prepared until now.[58]

In a fully-fledged market economy, efficiency and profit are preconditions for enterprise survival in the medium term. It would be expected that the newly privatised enterprise, to be transformed into a private enterprise, has to cope with the following problem: How can its targets change from *growth* and *autonomy* to *efficiency* and *profit*?. As noted above, the two former targets are usually favoured by insiders' coalitions, because insider power and jobs very much depend on growth and autonomy, while the two latter targets are supported by outsider coalitions of shareholders. Also as noted above, a basic prerequisite for privatisation success lies in weakening the power of insiders' coalition within the enterprise, and strengthening the power of outsiders' coalition. The problem is that power distribution among coalitions is rather stable in organisations and targets of a coalition can be considered as "homeostatic".[59] In other words, a ruling coalition and its targets cannot be changed overnight by the legal procedure of privatisation. According to Mintzburg (1986), major factors of target stability are the organisation's (enterprise's) ideology, resource slack, and the co-ordinating role of the chief executive officer (company director). In the Eastern European privatised enterprises, though one could argue that the second factor is decreasing compared with Soviet times, the rule of the director and enterprise ideology are likely to be crucial factors of evolution towards a genuine private firm or a managerial corporation, or an employee-monitored (some self-managed) enterprise, or a quasi-public company. The fact that many directors and managers, who have been in place for a long period of time, remain at the head of newly privatised enterprises in Eastern Europe, and maintain a stable network of relationships among themselves, would probably preserve insiders' coalition in power.[60]

d. The problem of privatising large enterprises

One of the main features of the economies in Eastern Europe is that they are biased toward large-scale enterprises, such as mines, steel mills, shipyards, petrochemical complexes and textile mills.[61] The main issue here is the fact that privatisation of these enterprises has been proceeding with much slower speed. This has been due to two main reasons: (1) large enterprises usually have an obsolete capital stock and employ obsolete production technologies, and may therefore be unlikely to attract interested buyers at positive prices.[62] (2) large enterprises account for a big share of employment and production in the economy, and privatisation or shut-down may be politically difficult for various reasons, ranging from nationalism to the potentially strong adverse impact on output and employment.[63]

To solve these problems, Schwartz (1995) suggest five choices: (1) shut-down and liquidation in parts; (2) massive investments to modernise the capital stock of these enterprises. Given the fact that local individuals have the financial resources to carry out the necessary investment, governments in Eastern European countries have three other choices: (3) find ways to attract foreigners on a large scale; (4) establish diluted share ownership by local individuals via mass privatisation; and /or (5) break up the existing large-scale enterprises into smaller units that are privatised separately.

Given the scale of the problem, Eastern European Governments have been hesitant or unable to tackle the question of large enterprises in a comprehensive fashion. Instead, they have begun to construct privatisation policies around the possibility that these enterprises remain State-owned for a while. Usually, this involves the construction of "half-way houses". Halfway houses come in various forms, but usually involve putting the enterprise under the control of an independent board of executive directors, and transforming it into a joint stock or limited liability company. For example, in Hungary, property rights were redefined to make the State Property Agency (SPA) the sole owner of all SOEs; the enterprises were then given a board of directors who required them to produce properly audited balance sheets, and the SOEs were supervised continuously with the help of independent contractors. The Czech Republic has adopted a more radical position, where the speedy transfer of ownership rights to

the private sector was thought to alleviate the need for halfway houses. Some researchers (for example, Bruno, 192; Sachs, 1991) have argued that halfway houses to privatisation are generally inevitable, unless one is willing to take the line that what cannot be privatised instantaneously had better be junked immediately. While "corporatisation" entails a number of problems, the perceived advantage is that SOEs start being covered by normal commercial law, and obtain corporate governance through a professional board of directors.[64]

In general, "halfway houses" do not solve the problems of privatising large enterprises. In particular, they fail to fully expose SOEs to a uniformly hard budget constraint that implies the risk of bankruptcy, may induce decapitalisation by the firm's managers, and can easily put the Government in a position where it either has to provide a bail-out for the firm or let it go bankrupt. While "halfway houses" may allow Governments some more breathing space, eventually decisions will have to be made.[65]

3. Various Privatisation Models: Advantages and Disadvantages

Many privatisation methods and procedures have been initiated in the developed, developing, and the former Centrally Planned Economies. Box (5.2) summarises these methods and techniques.

Box (5.2)

Main Tools of Privatisation World Wide

(1) Sale by public offering of shares , or by private treaty (closed or limited), or by public auction
(2) Selling a proportion of the whole operation
(3) Selling parts to private buyers
(4) Leasing assets or firms
(5) Management and/or workers buyout
(6) Free (or almost free) distribution of shares/vouchers to the citizens, or to the workforce/management, or to social institutions
(7) Restitution of property to former owners
(8) Privatisation via liquidation or bankruptcy,
(9) Privatisation via bankruptcy
(10) Diluting the public sector
(11) Buying out existing interest groups
(12) Deregulation via private associations
(13) Encouraging alternative institutions
(14) Making small-scale trials
(15) Repealing monopolies to let competition grow
(16) Encouraging exit from State provision
(17) Admitting demand pressures
(18) Curbing State powers
(19) Withdrawal from the activity
(20) The right to private subsitiution
(21) privatisation by installment

Source: ***Pirie, 1988; Vuysteke, 1988; The World Bank, 1991; Bornstein, 1992; Blommenstein & Hare, 1993; Hare, 1994; Frydman & Rapaczynski, 1994.***

In fact, the above ***21 techniques*** of privatisation can be grouped into ***three*** main methods.[66] The rest of this section will be devoted to analysing, **in some detail**, the advantages and disadvantages of the three methods.

Box (5.3)

Methods of Privatisation

How		**To Whom?**			
To	**Sale**	Employees Managers EMBOs	General people Stock Market	Foreign or domestic investors	previous owners
Privatise?	**Free Distribution**	spontaneous Privatisation, emlpoyee management, take-over of assets		Vouchers privatisation	restitution

Source: Estrin, 1994:21.

a. Sale of SOEs

The sale can be completed by the auction of selected assets, management/workers buy outs, and public or private sale of shares by various techniques; selling parts to private buyers, selling by instalments, or selling a proportion of the whole operation. The most important problem facing any Government adopting this method of privatisation is the valuation of the enterprise assets.

1. Sale to Enterprise Employees

Bornstein (1992) argues that employees have the chance to buy their enterprise, either with all or part shares. In the case of buying the whole enterprise, a leveraged buyout can occur, all the shares can be acquired and thus control of the enterprise. Regarding the case of buying part of the shares, it is more relevant for larger enterprises. He suggests that employees can be given the right to buy 10-20% of the shares at concessional price.

This type of sale has advantages and disadvantages. Among the **advantages,** employees are the obvious potential buyers because they are acquainted with the enterprise, even though, like the population at large, they have no experience in the purchase and holding of shares. Employee share ownership may strengthen incentives for at least productive, if not allocative efficiency. Sales of shares at a concessional price compensate employees for loss of property rights if a workers' council exercises some degree of control over production and investment decisions under State ownership of the enterprise.

As for the **disadvantages,** budget revenue will be lost if shares are sold at discount. In regard to equity, conventional share prices for employees favour workers in some enterprises over the rest of the population. With respect to efficiency, it is questionable how much employee share ownership improves efficiency in larger firms where harder work by an individual cannot make much difference to total profits. Moreover, if workers have control of the firm, there is a risk of excessive wages, avoidance of

layoffs of surplus workers, and underinvestment in plant and equipment. In addition, there is the question of social justice. They argue that free or subsidised distribution to workers involves fundamental inequalities,since some workers, would have the chance to receive an undeserved "*manna from heaven*", while other citizens would be left with nothing because they are employed in the State administration, or the private sector.[67]

2. Sale to Other Domestic Investors

Assets of small enterprises can be sold at auction to the highest bidder, but large enterprises should be transformed into joint-stock companies first, and then offered for sale at fixed price or by auction to the highest bidder. This kind of sale has advantages and disadvantages as well. The advantages are: they bring in more budget revenue than discounted sales to employees, or free transfer shares. With a given wealth distribution, sale by auction can achieve an optimal allocation of shares in the sense that they are purchased by the buyers willing to pay the most for them. Compared with people acquiring shares by free transfers, buyers of shares are more likely to want, and may be more able, to exercise control over the enterprise. The main impediments to public sale of shares are: (1) potential buyers' skimpy knowledge about equities; (2) lack of capital to purchase many shares; and (3) the likelihood of considerable inequality in purchase and ownership of shares.[68]

3. Sale to Foreign Investors

This kind of sale can **provide**: (a) additional capital for the country; (b) foreign currency for the BOP; (c) know-how in technology, production, finance, and marketing; and (d) connections with export markets and international financial markets. The **disadvantages** of selling to foreign investors: (1) there may be reluctance to sell part of the national heritage, created by decades of collective saving and investment, to outsiders; (2) some specific branches or large enterprises may be deemed too "*basic*" or "*strategic*" to permit foreign control; and (3) the consequences of underpricing may be considered more serious when foreigners gain at the expense of nationals.[69]

In Eastern Europe, households (as well as institutions and banks) lack experience in buying shares in IPOs or in a secondary market provided at a Stock Exchange. Prudent investment in shares requires understanding of the Stock Market as a whole, enough securities available at sufficiently low prices to diversify risk in a person's portfolio, a regulatory framework for disclosure of relevant information about particular companies through prospectuses and financial reports, and independent advisory services furnishing evaluations of stocks and buy, hold and sell recommendations. Even when there is interest in equity investments, domestic liquid assets of individuals are too small to purchase a significant portion of the thousands of State enterprises to be privatised.

Also, the distribution of share ownership would be unequal, reflecting the existing distribution of wealth and the probability that the wealthier would be more inclined to invest in shares-partly because the wealthier include managers, bureaucrats and others with better information about specific companies' status and prospects. Furthermore, among the wealthier will be former Government or Party officials, or black marketers who became rich under the pre-reform Regime.

Sometimes privatisation through the sale of shares to institutional investors such as banks, insurance companies and pension funds is recommended, on the grounds that they will be superior to individuals as buyers of shares because such institutions will have funds to buy large stock, and will have greater interest and technical capacity to monitor and evaluate the performance of the enterprises' management. However, in Eastern Europe there is no set of well-capitalised institutional investors able to buy large amounts of State property. Commercial banks are only now being developed, and it would be inflationary for them to create money to buy shares, although they might acquire some shares through debt-to-equity swaps for part of their outstanding (especially the bad) loans to enterprises. Only in the relatively distant future could shares be sold to institutions yet to be created and capitalised, like insurance companies and pension funds.

b. Free transfer: personal entitlements and endowments to institutions

This type of transfer can involve *personal entitlements, endowments to institutions, or combinations of the two.* Personal entitlements can be to former owners (the restitutions or reprivatisation), employees and/or managers, and the citizens as a whole, while endowments to institutions can be to banks and/or pension funds. All these approaches have some advantages and disadvantages. In this part of the study, I examine two variants which involve personal entitlements (free distribution to employees and free distribution to citizens at large), and one variant which involves endowments to institutions (holding companies).

1. Personal entitlements

a. Free transfers to employees

The success or failure of this approach depends upon the purpose of adopting this kind of transfer. To elaborate, free distribution of shares to employees can be adopted by the Eastern European Governments to compensate employees for the value of assets resulting from employees' earlier decisions to forego wages and benefits, or for a loss of property rights exercised by workers' councils. Also, free distribution of shares to employees (say, 10% or 15% of shares in an enterprise), could help the concerned Government to make more shares available for a 'strategic' (domestic or foreign) investor to control the enterprise.

b. Free transfer to citizens

This type of divestiture of State property can be conducted through three variants of transfer: (1) voucher coupons to bid for shares in operating companies; (2) actual shares in operating companies; (3) shares in investment trusts like mutual funds, or holding companies that in turn possess shares in operating companies. Each variant has certain advantages and disadvantages.[70]

1. Voucher coupons for share auctions

In this case, each adult citizen is offered the right to buy, for a nominal sum intended to cover some of the administrative costs, a voucher book with a set of coupons that can be used to bid in auctions of some of the shares in some joint-stock companies. The coupons are denominated in points, not the national currency unit. The price of a share is established only when shares are later resold.[71]

The main **advantages** of this variant are the following: (1) it is a fair approach for transferring assets, as each adult citizen gets the same number of voucher points at the start of the transfer process, the price is objectively determined in an auction, and the worth of a share in money is determined by the performance of the company. (2) no initial valuation of shares in money is required. (3) the person has the freedom to decide his/her own portfolio, with shares going to those willing to pay the most (points) for them.

The main **disadvantages** are: (1) as the people have no experience in such auctions, it is doubtful whether they would have adequate knowledge to bid sensibly for company shares.[72] (2) as there would be millions of people bidding for shares in hundreds of companies, the auction process would be complex and confusing. An alternative process would be needed until a price (in points) for each enterprise's shares is found such that all of the shares to be sold in all of the enterprises involved are placed among bidders, and all coupons offered are accepted. If the auction process leaves some unsold shares or some unabsorbed coupons, presumably the point valuations of the shares are not correct.[73] (3) whenever resale for money of shares purchased with coupon is permitted, there would be great dissatisfaction on the part of 'losers' whose shares command lower money prices, and whose 'investment' of voucher points proved disappointing in comparison with the outcomes of the bids of others.[74]

2. Shares in operating companies:

In this approach, citizens receive a free portfolio of shares in a set of operating companies. Because the number of adult citizens is larger than the number of operating companies, it would be expected that each portfolio could have approximately the same book value with a different number of portfolios to each adult citizen. The main advantage of this variant is that citizens would get a diversified portfolio. Whereas, the main disadvantage is that citizens have no choice about the shares of their portfolios.[75]

3. Shares in investment trusts

This variant gives citizens free shares in an Investment Trust (IT) that in turn has been endowed with free shares in some operating companies. Each citizen receives the same portfolio of IT, although the ITs need not have the same portfolio of company shares. The IT shares would be non-tradable until the value of ITs and their shares was established through trading in the shares of operating companies.

The main advantages of this variant, compared to the first two, are: (1) it is fairer, because every citizen gets the same portfolio of IT shares and thus of underlying operating company shares held by ITs. (2) a person's portfolio will be more diversified, because each of the five or ten IT shares held corresponds to part of the IT's portfolio of shares in many companies. (3) also, when company and IT shares become tradable, the prices of IT shares should be less volatile than the prices of shares of individual companies. Finally, it is of importance to mention that the success of this approach would depend on the nature and operation of the ITs that receive institutional endowments of company shares.[76]

2. ***Institutional endowments***

a. Holding companies

This variant is a version of variant three (shares in investment trusts). The IT is a Holding Company (HC) endowed with a portfolio of operating company shares spread across branches, both to provide diversification and to avoid monopoly control in a particular branch. 10-20 HCs might be established, depending on the size of the country and the number of enterprises to be privatised in different branches. A "*lead*" HC will have a dominant position in each operating company, say at least 30- 40% of the shares. A portion of each operating company's shares would be held by other HCs, each of which has a small "*passive investor*" position. The lead HC exercises control of the operating company, even if the Government (represented by the State Treasury or MoP) retains a percentage of the shares greater than that given to the lead HC. The lead HCs control of an operating company involves; restructuring it as necessary; appointing, motivating and evaluating the operating company's management; and eventually disposing of shares in the operating company as a further stage of privatisation. Shares might be sold on the Stock Market to citizens and other investors, or spun off to people with share in the HC.[77]

c. Combinations of techniques

This involves the employment of more than one method, but not necessarily all of them, because each method has advantages and disadvantages.

4. The main challenges to Privatisation in Eastern Europe

The challenges to the Eastern European privatisation processes are unique, in their system-wide scope, in their political and historical context, and in the desired speed of reform. These constraints can be classified into the following categories: stock-flow, fiscal, information, administrative and political, the acceleration dilemma, 'Top Down' versus 'Bottom Up' privatisation, motivation in the State sector before privatisation,

organisation of the State sector, enterprise restructuring, lack of a capital market; the shortage of household savings; identification of enterprises chosen for privatisation; valuation; restructuring; demand for shares of privatised companies; and internal organisation of privatisation administrations.[78] In this part, I discuss only those which are not covered in the other parts of the section.

a. Political Constraints

Politics is probably the most important braking factor on the whole privatisation process, especially privatisation of medium and large-scale enterprises. In fact, when the political constraints to the privatisation process are discussed, it is not always clear what the concept of political constraints mean. This concept includes the people, trade unions, workers' councils, the Parliament, the Government and the President. So who constrains the privatisation process in this case?. Some times the constraints come from the Government, when there is a lack of a government will, but at other times the government tries to accelerate the process and the constraint comes from Parliament, or the President. On other occasions constraints come from the trade unions, the workers councils, and the people. However, it has been proved that politics is the main constraint to privatisation in Eastern Europe.

b. Identification of enterprises chosen for privatisation

The problem at the start of the privatisation process was how to specify the best enterprises to be privatised in order. This task was very critical since it creates certain precedents and can form (or destroy) the confidence of the people in this new form of savings investment. The previous financial records of the firm can hardly be used as a basis for selection, because these were related to a time of different financial, fiscal and monetary regimes. Therefore, the criterion of 'potential growth' has an important meaning, such as: brand name, competitiveness on international markets, managerial staff performance and technical equipment.[79]

c. Valuation

There were two categories of opinions concerning the evaluation of privatised enterprises in Poland: a group of people who believe that enterprises should be evaluated by the market; and another which believes in case-by-case valuation to enterprises, even if it causes some delay in the implementation of the privatisation process. The delay could be the result of lack of the necessary skills in Eastern Europe. It is very important to mention that the first Polish Government rejected the idea of 'market valuation', because, according to the Government point of view, lack of information, speculative and/or random trading, distorted prices, and lack of investors' confidence, could lead to fraud.[80]

d. Low levels of demand for shares of the privatised companies

Limits of demand for shares create one of the most serious and controversial problems of mass privatisation. By very rough estimation, the book value of the State-owned enterprises, when compared with the savings of the population, leads to the conclusion that the privatisation of the existing assets would last over a hundred years! Hence it is unavoidable to augment the demand by issuing free vouchers as quasi-money. However, the free-voucher system in its logistic dimension creates immense problems.[81] The key advantage of this scheme over the others suggested is that it does not affect the companies themselves prior to privatisation. It handles some of the demand-side problems without prejudging the supply side of the market; it treats all citizens alike but does not treat all companies alike.

The idea is much more complicated when considered as a logistical problem. First of all, and paradoxically, the introduction of a free vouchers scheme, by its very (massive) scale, creates an additional demand which is difficult to satisfy on the supply side. For example, if one assumes the voucher value equals US $ 50 per head (which is equal to two weeks' average salary) and that the vouchers can 'buy' one-third of the offered

stock, then we arrive at a total value of US $ 6 billion of privatisation offers being needed to absorb the vouchers issued.[82]

e. Lack of capital markets

This factor is related to the problem of valuation. At the start of the privatisation process in Eastern Europe there was no capital market to give the right value of the assets of the SOEs proposed for privatisation. Later, some Stock Exchange Markets were esablished. However, these markets are still tiny, so it is not possible to rely on them to give the right price for the SOEs' assets.

f. Low levels of credit to the private sector

For instance, Polish data suggests that credit to the private sector as a fraction of domestic bank assets is rising quite slowly. It was 16.6% in December, 1990, and rose to 17.3% in mid-1991. As the private sector accounts for more than half of the GDP and total employment, the State sector should reduce, or at least stabilise borrowing, while the investing private sector should receive a rapidly increasing fraction of credit. In the case of Poland, this is exactly what has happened. See Section Four. Moreover, the private sector has to finance not only its working capital, but its acquisition of assets, as small-scale privatisation gathers speed.[83]

g. Protection of new owners

The Privatisation Law of 1990 must provide for the protection of the new owners' right. For example, as is already stated in the legislation governing foreign investments in most of Eastern Europe, an enterprise cannot be nationalised or expropriated without prompt and effective compensation should be included.

Against the above theoretical background, what is the meaning of privatisation in Poland?; What are the main governmental goals of privatisation in Poland?. How did Polish privatisation philosophy develop?. How did the various economic, political and

social groups affect the final shape of that philosophy, during the period 1990-95?. What kind of privatisation models did Poland use to privatise its SOEs during the period of the study?, and Why?. How did the whole privatisation path progress in Poland?. These questions are answered in the next Section.

Endnotes:

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[1] In this section, I avoided to a high extent giving any hint on Poland, leaving that to the next sections.

1 Bornstein, 1992:284; Savas, 1985:4.

[3] Fryman & Rapaczynski, 1994:141-142; Phelps *et al,* 1993:3; Lipton & Sachs, 1990:313; Schwartz, 1995:41.

[4] Schwartz, 1995; Lipton & Sachs, 1990; Frydman & Rapaczynski, 1994.

[5] Vuylsteke/World Bank, 1988:101-105.

[6] Ibid:23-24.

[7] Bornstein, 1992:310-311.

[8] Vuylsteke,/World Bank, 1988:107.

[9] Ibid.

[10] Keating & Hoffman, 1991

[11] Hemming, 1992

[12] Schwartz, 1995:37.

[13] Jedrzejczak, 1993:89-90; Bornstein & Kumar, 1991:303; Bornstein, 1992; Blaszczyk & Dabrowski, 1993; Howell, 1994; Frydman & Rapaczynski, 1994; Vickers & Yarrow, 1988; Zecchini, 1991.

[14] Vickers & Yarrow, 1988:9-27.

[15] See Vickers & Yarrow, 1988, Ch.3 for details.

[16] See Gelb & Gray, 1991:31-2 for more detail.

[17] Hemming & Mansoor, 1988: 22.

[18] Bornstein, 1992:285

[19] Hare, 1994:33; IMF, 1994; World Bank, 1991.

[20] Hemming & Mansoor, 1988; Bornstein, 1992:303.

[21] Ibid:305-313.

[22] Zecchini, 1993; *Bornstein, 1992:285.*

[23] Ibid.

[24] Ibid:33.

[25] Ibid:33-34.

[26] Ibid: 38.

[27] Ibid.

[28] Ibid:39.

[29] Phelps *et al,* 1993:15.

[30] Pearce, 1985:35.

[31] Lipton & Sachs, 1990:314.

[32] Schwartz, 1995:31.

[33] Andreff, 1995:2.

[34] Berle & Means, 1932; Galbraith, 1967; Marris, 1964.

[35] Frydman & Rapaczynski, 1994:59; Schwartz, 1995:39-40; Andreff, 1995:4; Phelps *et al*, 1993:16, 18.

[36] Ibid.

[37] Ibid.

[38] Cobett & Mayer, 1991:57-75.

[39] Andreff, 1995:2; Frydman & Rapaczynski, 1994:12-13.

[40] Andreff, 1995:7; Frydman, 1994:169-173.

[41] Lipton & Sachs, 1990:316; Frydman & Rapaczynski, 1994:169-172.

[42] Lipton & Sachs, 1990:316-317.

[43] Phelps *et al,* 1993:3.

[44] Lipton & Sachs, 1990:316-317. For more details on take-overs, see: Grossman S J & Hart O D, 1980, "Take-overs Bids, The Freerider Problem, and the Theory of the Corporation." *Bell Journal of Economics*, 11:42-64.

[45] Lipton & Sachs, 1990:317. See Shleifer A and Summers L, 1988. "Breach of Trust in Hostile Take-overs." In *Corporate Take-over: Causes and Consequences,* edited by A J Auerbach. (Chicago: University of Chicago Press).

[46] Ibid.

[47] Ibid.

[48] Andreff, 1995:8; Frydman & Rapaczynski, 1994:169-209; Schwartz, 1995:40.

[49] Schwartz, 1995:40-41.

[50] Andreff, 1995:8-10.

[51] For excellent details on the principle-agent relationship see: Sapping, D E M, 1991, "Incentives in Principle-Agent Relationships", Journal of Economic Perspectives, vol.5 (2):45-66.

[52] Andreff, 1995:9-10.

[53] Williamson, 1975; Aghion, Blanchard, and Burgess, 1993; Carlin, Van Reenen, Wolfe, 1994.

[54] Aghion, Blanchard, and Burgess, 1993; Carlin, Van Reenen, Wolfe, 1994.

[55] The study of power can, of course, go far beyond the area of economics. Therefore, I shall concentrate on the theory of organisations, to restrict the analysis to power in Eastern European enterprises.

[56] Mintzberg, 1986.

[57] Cornelli & Li, 1994.

[58] Andreff, 1995:11.

[59] "Homeostatic targets" mean that any factor which disturbs organisation targets is countervailed by inner forces which restore as soon as possible the initial system of targets (*Andreff, 1995:12*).

[60] Ibid:11-12.

[61] Lipton & Sachs, 1990:301.

[62] Wellisz, 1991: 247-70; Schwartz, 1995:43.

[63] Schwartz, 1995:43.

[64] Ibid:43.

[65] Kopitas, 1991; Bruno, 1992; Schwartz, 1995:43-44.

[66] This classification is based on Estrin, 1994; Hare, 1994; and Bornstein, 1992.

[67] Frydman & Rapaczynski, 1994; Bornstein, 1992

[68] Ibid.

[69] Bornstein, 1992:292.

[70] Bornstein, 1992:294.

[71] World Bank, 1991:89-90.

[72] Bornstein, 1992:294-295.

[73] Boensztein & Kumar, 1991:308-309.

[74] Bornstein, 1992:295.

[75] Ibid:296.

[76] Ibid:296.

[77] Ibid:297. Poland offers an excellent example of such a version. See Section Six. Therefore I would like to stop the discussion at this stage, to avoid repetition.

[78] Bolton & Roland, 1992; Blaszczyk & Dabrowski, 1993; Jedrzejczak, 1991:115-6; and 1993:95-9; Szomurg, 1995

[79] Jedrzejczak, 1993:95

[80] Ibid:96.

[81] See the Subsection on the role of privatisation above.

[82] Ibid.

[83] Ibid:62

SECTION (6) The Development of Poland's Philosophy on Privatisation

The main purpose of this section is to analyse the development of *Polish privatisation philosophy* from the late Eighties to the end of December, 1995. The main proposals that were initiated in Poland during that period are discussed, and related to the Polish economic, political, and social set up. The aim is to try to discern whether there is a change in the attitude of the Polish governments to the privatisation policy, or not, and to ascertain the main reasons behind that change. The main questions that are tackled in this section are: first, did *Polish privatisation philosophy* change in the last part of the period of the study (September, 1993- December, 1995), in comparison to the start of the period of the study- when the non-communists were in power (September, 1989-September, 1993)? Second, why certain privatisation methods were chosen, above others? Third, how much the political, social, and economic pressure groups were able to shape (or reshape) *Polish privatisation philosophy* during the period under analysis?

The analysis of the development of privatisation philosophy in Central and Eastern Europe has a special flavour. That is because it is a landmark in the whole transition process, not only in the post-war history of Eastern Europe, but in the history of the communist world. This is understandable. But, in the case of Poland, two facts enrich our discussion: first, those who started the transition (the Solidarity leaders) were no longer in power after September, 1993, as the ex-Communists emerged as the dominant party. Second, as noted in Section Four, there are many conflicting forces that shape Polish economic policy in general, and privatisation policy in particular.

For analytical purposes, I would like, in this section, to divide the period of the study into three sub-periods: the first period summarises the debate on privatisation before the collapse of the Communist regime in 1989; the second covers the era when the first three Solidarity-led governments were in office (i.e. September, 1989-September,

1993); and the third covers the period when the ex-Communists were in power (i.e. September, 1993-December, 1995[1]).

1. Polish privatisation policy before 1989: (Communist era)

My discussion of the features of the Polish economic socialist system, in the second section, showed that during the 1945-89 period there was a continuous resistance to privatisation especially in the industrial sector, and the attempts to reform the Polish economy were concentrated on the issues of decentralisation and decollectivisation rather than privatisation. That was because of the fact that in the previous communist system, private ownership was only marginal to economic life, and to economic and political thinking as well.[2]

Bear in mind that privatisation is a comparatively new concept, and that the private sector in general was ideologically incongruous, politically suppressed, and economically to a certain extent tolerated during the communist era, especially when it came to the industrial sectors. The first sign of relaxing some of the restrictions on private sector activity (apart from that in 1956) was after the economic crisis of 1980-82. During that time, the Communist government realised that a plurality of ownership was needed. However, this was not a call for a full transfer of ownership from public into private, rather it was a call for the citizens to set up their own new firms. When **Messner** (who seemed to be from the 'revisionist wing' of the Communist Party) took office as Premier (during the period 1985-88), some steps were taken to encourage the private sector. For example, some regulations for setting new firms were relaxed, accounting requirements were lessened, and permission was given for private businesses to contract freely with the dominant state sector. Moreover, in 1986 new regulations were formulated, permitting the establishment of small-scale joint venture firms. Messner's aim was to create market competition, in the environment of 'soft budget constraints', but without ownership changes.[3]

a. 'Nomenclature' privatisation phenomenon

When **Rakowski** replaced Messner in 1988, several steps were taken to open property rights, promote competition and reduce centralisation. The most important action that was taken to open up property rights was the adoption of the Act on Economic Activity of December 23, 1988. That legislation abolished the requirements of possessing a permit to carry on economic activity (with a very limited number of exceptions, namely mining and quarrying, processing and trading in precious metal, explosives and pharmaceuticals, the distillation of alcohol and manufacture of tobacco products, and air and sea transport services). All a businessman was obliged to do was to register the said activity with the relevant local government office. The previous ceilings on employment in private firms and on the size of private farms were revoked. At the same time, Parliament also passed the Act on Foreign Involvement in Economic Activity, in 1988, which liberalised the regulations on foreign investment in Poland. The Act was taken like a call for the transfer of the SOEs into joint stock public corporations, where state ownership is combined with an independent board of directors.[4]

The predictable conclusion is that managers of SOEs, as an 'interest group', which used to be closely related to the Polish Communist party, and which had been, in fact, subjected to various political controls[5], saw this call, which was initiated by **Rakowski's** government, as a rare opportunity to improve their power position in their enterprises. Therefore, they began to '*privatise*' the economy by establishing joint stock companies (JSCs). Two types of JSCs were established; the first group of enterprises formed by the large-scale enterprises, was basically owned by the state; i.e. by other state enterprises (through 'cross-ownership'). The second type of companies was put in the hands of the managers (members of '*nomenclature*').[6] Usually, the property of the privatised state enterprise was undervalued, thus private shareholders (directors of state enterprises or members of their families and other prominence) could purchase a portion of the state property very cheaply to include in their newly-formed company. Private shareholders, using their managerial posts in state enterprises, gave the new companies many concessions which brought about further losses to state

companies. This process termed 'nomenclature' privatisation was politically and publicly unacceptable.[7]

As for workers, they are a '*heterogeneous*' interest group. Two main general workers' groups can be distinguished, when it comes to how they perceived privatisation. The first group saw privatisation, which was initiated by the government of **Rakowski**, as a way to secure their jobs. The other group, that is the more organised independent workers' unions, saw privatisation as an assault on the workers' councils, similar to the measures that followed the enforcement of Martial law in 1981. That was because they continued to insist on the formula of genuine self-management with public ownership.[8]

The general result was that this kind of privatisation (*nomenclature)* was rejected by Polish society. Therefore, one can easily understand why the Solidarity delegation, during the *'Round Table'* negotiations, opposed the idea of privatisation[9], and was unwilling to believe the idea of a real market and capitalist economy, preferring the idea of social ownership and democratic planning.[10]

In public circles, the issues of private enterepreneurship and ownership changes in the public sector evolved in a theoretical and academic way. This was represented by the Conference; "Proposals For The Transformation of The Polish Economy", which was initiated by a group of scholars from Warsaw. The main question that was to be answered; "What would you propose to do with the Polish economy if it were up to you and if the *freedom of choice* was not impeded by the current political restrictions?". The main proposed answers revolved around the following four ideas: (1) the reorganisation of the public sector (M Swiecick); (2) or group ownership (M Dabrowski); (3) or privatisation methods based on the 'British model" (S Kawalec); (4) and, as always the case in Poland, a great idea came from the north, from Gdansk, the idea of 'non-equivalent' 'mass' privatisation with the use of vouchers (Szomburg and Lewandowski).[11]

What happened after the great political victory following the 'Round Table' talks?. A new political, economic, and social era began. Therefore, it is of importance, at this

stage of this work, to give some political and social background on Poland during the new era.

b. Political and social background on Poland

Poland is a parliamentary Republic. Legislative authority is vested by the Constitution in a bicameral Parliament with a 460-member, more powerful Lower House (The Parliament, or "*Sejm*") and a 100-member Upper House (The Senate). The President is Head of State and possesses some executive authority. The Government (The Council of Ministers), which has responsibility for domestic and foreign policy, is chaired by the Prime Minister (PM). The President and Parliament are elected by universal suffrage. The PM is chosen by Parliament following a nomination by the President. The Government is appointed by Parliament following a recommendation by the PM, who presents the proposed composition of his Cabinet. This Government is then responsible to Parliament.[12]

During the period of our study, three parliamentary and two presidential elections have been held. The first presidential election took place in December, 1990, and was won by **Walesa**- who was the leader of the 'unofficial' opposition party, the Solidarity movement. President **Walesa** remained in office until December, 1995. The second presidential election was held in November, 1995, and was won by Alexander **Kwasniewski**, who was the leader of the SLD party[13].

The first parliamentary election was held in June, 1989 and the Solidarity movement won all the seats that were freely elected. Box (6.1), in the footnotes[14], shows the Party Affiliation of Parliament Deputies, elected in June, 1989, compared to the composition of the Parliament in 1985. The second was in October, 1991. Box (6.2), in the footnotes[15], shows the composition of the October, 1991 Parliamentary results. The third parliamentary election was held in September, 1993. The voters turned out parties originating from the Solidarity movement, and chose the parties which sprang from the former communist parties: the Democratic Left Alliance (SLD) and the Polish Peasant Party (PSL). Box 3.2, in the footnote[16], shows the composition of the September, 1993,

Parliament in Poland, and reveals that the majority in the Polish Parliament was held by the ex-Communists.

During the period under analysis (September, 1989-December, 1995), Poland witnessed Four Solidarity-led governments and Two ex-communist governments. The Four Solidarity-led governments are: first, the **Mazowiecki** government which was in office from September 12, 1989 to December 10, 1990; second, the **Bielecki** government which assumed office in January, 1991 until December, 1991 -after the election of **Walesa** as the President of Poland- third, the **Olszewski** government which took office from December, 1991 to June, 1992; then **Pawlak** was appointed as PM in June, 1992, but failed to form the Government. After that, **Suchocka** came and formed the fourth government for the period August, 1992 to September, 1993, though the Parliament brought her government to an end by a vote of no confidence in June, 1993.[17] The Two ex-communist governments are: **Pawlak**'s Government (September, 1993- March, 1995), and **Oleksy**'s Government.

At this stage of my analysis, an idea should be given about the various conflict groups in Poland, i.e. those who have an influence on the decision making process. In fact, six main different conflict groups can be distinguished in Poland. Each group has some role in shaping the Polish privatisation philosophy. These groups are: (1) the managers of the state enterprises; (2) the workers' councils (3) the trade unions, (4) the government, (5) the Parliament, (6) and the President.

The Government is the first side of the equation, and obviously not a neutral actor that imposes only policies that are economically sound and neutral. Rather, it is one of the strongest groups in society. Also, the one that, on the basis of its ability to define the formal institutions, has the greatest role in determining the future course of the economy. Therefore, it is of utmost importance to grasp the inner motivations of the various governments. Three different types of governments emerged in the post-war history of Poland: (1) a communist government; (2) a non-communist, Solidarity-led government; (3) and, an ex-communist government.

The other groups, i.e. the workers' councils, the trade unions, the Parliament, and the President, are the other side of the equation which decides to what extent it is possible for a government to realise its ideas and wishes. A 'strong' government would emerge when the government's own interests coincide either with that of the opposition or with a number of small and well-organised groups (or both). In the case of Poland, the first non-communist government was able to formulate its privatisation policy after a long debate with these different groups.

The main features of the political situation in Poland after the collapse of the Communist system are; the participation of the Solidarity party in the Polish parliament for the first time since its establishment in 1980; the absence of a majority party in the parliament, until September, 1993, which in effect weakens the power of parliament; and the return of the ex-communists to power in September, 1993.

The main question that will be tackled is; "How did the different governments perceive a privatisation policy?".

2. Polish privatisation policy after the collapse of Communism (September, 1989-December, 1995)

A. Privatisation policy during the ex-communists era (September, 1989-September, 1993)

After the collapse of the Communist system, the central debate on privatisation all over Central and Eastern Europe was concentrated on the feasible pace of an effective privatisation strategy. In other words, the discussion quickly moved from the issue of whether it is right to restore the market and private ownership to the problem of how fast and in what way this should be done.[18]

Poland was the second country after Hungary to discuss the ownership issue and the necessity of ending the monopoly of state ownership. The Polish government was the

second, after the Hungarian, which adopted *privatisation as an 'official' economic policy* in 1990.[19]

I. Mazowiecki's Government Era (September, 1989-December, 1990)

This government declared a strong commitment to reintroduce a capitalist market based on private ownership within two to three years. That was clear, as noted in Section Three, from its transformation programme which was formulated in the last quarter of 1989, and implemented on January 1, 1990.

During this government's era, most of the techniques and methods of privatisation that are used in Poland were determined, the Law on Privatisation was formed, and the institutions that control and regulate the privatisation process were fixed. The questions that should be answered are; "What were the main techniques and methods of privatisation that were initiated during this period?"; "What are the institutions and regulations that control and regulate the Polish privatisation process?"; "How and why these techniques and methods, not others, have been chosen?"; and finally, "Was the privatisation law formed for the benefit of the government, other 'interest groups', or the Polish citizens at large?".

The **Mazowiecki's** government faced considerable difficulties and delays in the preparation and enactment of the necessary legislation concerning ownership changes. That was because of different social, political and economic factors, namely: (1) suppressed 'interest groups' resurfaced. (2) it was difficult for this government in the 'new democratic era' to impose its will, as communist governments had done during the past 45 years, especially in the absence of a parliamentary majority. See Boxes (6.1) and (6.2) in the Footnotes. (3) the fact that the government gave priority, as noted in Section Three, to the issue of stabilising the economy, rather than to restructuring and ownership matters. However, small-scale privatisation started directly after the declaration of this government, late in 1989, that its policy is to reintroduce a capitalist market based on private ownership.

a. Control over the privatisation process, and the decay of 'nomenclature" privatisation

The economic leaders of this government believed that poor economic performance was inextricably linked to poor corporate governance, and the related questions of the power of '*nomenclature*' and workers' councils. Therefore, concerning the privatisation area, the responsibilities of this government were to find proper and permanent answers to the following questions: "How could '*nomenclature'* privatisation be stopped?"; "Who should replace the State as a new owner?"; "How could the power of the 'insiders' (i.e. managers and workers of the state enterprises, and trade unions) be reduced?"; "To what extent can privatisation be spontaneous, and to what extent can it or should it be controlled by the government?"; "How could the appearance of 'strategic' or 'core' investors who would take responsibility for the privatised SOEs via the Mass Privatisation Programme (which would disperse ownership) be assured?". Finally, and most importantly, "How to integrate privatisation into the other elements of the economic transformation programme?".[20]

When it took office, the first step this government took, was the establishment of a governmental office, the Plenipotentiary for Ownership Changes, to stop the unauthorised '*nomenclature*' privatisation of state property, and this attempted to reassert state control over the privatisation process. By early 1990, therefore, the government had managed to block '*nomenclature'* privatisation.[21]

b. 'British model', 'employee' vs. 'citizen' ownership and 'insiders' pressure

From the very beginning privatisation efforts of the first Solidarity-led government focused on selling larger industrial enterprises through the "British-model" approach, which is based on the idea of *offering shares to the public*. This model reflected in part the view of the liberal economic leaders of Mazowieski's government.[22] Advocates of privatisation through public offering argued that it could give the most objective assessment of auctioned assets, and eliminate the problem of possible preferential treatment resulting from more limited methods of distribution. More importantly, it was believed that privatisation via public share offering (of course, alongside the other

elements of the economic transformation programme) would be an efficient method to reduce the "monetary overhang" from the economy. Whereas, opponents argued that it is a very expensive and time-consuming method, the existence of some technical difficulties of determining enterprise value in the absence of a well-functioning stock market, and a very limited demand for shares in the context of the relatively small purchasing power of Polish households. Also, not every enterprise would qualify for a public offering. If this was the exclusive method of privatisation, it would be a very slow process, focused on large enterprises in good economic conditions.[23]

On the other hand, trade unions and workers' councils initiated an approach based on allocation of shares either free or at nominal price, only to employees of the privatised enterprises.[24] The advocates of 'employee ownership' (i.e. managers and workers of SOEs) argued that this kind of ownership would motivate the workforce, increase the enterprises' effectiveness, minimise demands made by workers, and reduce the employer-employee conflict. Moreover, they saw employee ownership as a natural continuation of employees' self-management of the 1980s, when Poland had a relatively good experience and positive results. Whereas, the opponents of employee ownership (i.e. the liberal economic leaders of this government and some of the Polish intellectuals) argued that this kind of ownership would lead to a lack of social justice, danger of wage pressures, and a continuation of the communist system.[25] They also believed that the workers or managers firms that would be established might have difficulty in raising funds on the capital market.[26] In fact, the opponents expected that this system of ownership would not work in Poland, as it had failed in Yugoslavia.[27] Therefore, a conflict appeared between the government and the enterprises' 'insiders'. The first wanted to reduce the power of the 'insiders', while the second wanted to decentralise control over ownership at the enterprise level.

In the second half of 1990, disappointment at the slowness of the privatisation process refreshed the idea of free distribution of vouchers to all Poles, presented by *Lewandowski* and *Szomburg* in 1988. Therefore, the privatisation debate focused on the idea of achieving economic and social justice in the new ownership structure, and at the same time, on the idea of fighting pressure from the enterprises' insiders.[28]

One can conclude that during the last quarter of 1989 and the first half of 1990, the privatisation debate concentrated on two approaches; ***'employee ownership'*** vs. ***'citizen ownership'***. Meanwhile, the Polish Parliament was working on the privatisation law.

How could the power of 'insiders' be reduced?. In fact, it was believed that the process of liberalising prices and foreign trade that had gone on since January, 1990, would create a market environment for the products manufactured by state enterprises, so that only the economically and financially strong enterprises would survive. In practice, price liberalisation did not lead to bankruptcy. This was because state enterprises continued to have access to the available resources of state or inter-firm credits, and followed a new strategy of cutting back on investment. Therefore, the economic leaders of the government (together with their Western advisors) believed only pressure from shareholders would discipline the managers' behaviour.[29] As a result, a new form of property regime had to be introduced, a form that would lead to a reduction of the powers of 'insiders' and, at the same time, solve the question; "Who owns what?."

c. New form of ownership: ('corporatisation' or 'commercialisation')

The idea came from **Krzysztof Lis** - the first Plenipotentiary for Ownership Changes in Mazowiecki's government. He introduced the concept of ***'commercial privatisation'***, or ***'corporatisation'*** which was earlier developed by **Kawalec** in 1989.[30]

The idea of *'corporatisation'* was understood in different ways by different people. Some took it generally to mean de-statisation of SOEs, making them interested in greater profits, and development thus ensuring a strong competitive position on the market. Such firms would be ready to undertake risks and to expand and innovate at the micro level, thus removing the main sources of imbalance and inflationary pressures. In effect, this meant that 'commercialisation' would make state firms behave like private ones.[31]

Others saw '*commercialisation*' as a way of creating a fully competitive market environment around the state sector as well as eliminating unequal treatment of state enterprises in comparison with private ones. However, the most frequent interpretation of the 'commercialisation' idea concentrated on changing the legal status of the SOEs, i.e. on converting it into a joint-stock company solely owned by the Treasury. Such a step was advised strongly, both by many Western experts (see for example, *Fisher & Gelb, 1991*) and by Polish ones (see for example *Walkowlak, 1991*). What does '*commercialisation*' or '*corporatisation*', according to the Polish privatisation law of 1990, mean?. And, what other paths to privatisation does that law offer?.

d. Legally controlled process and privatisation methods

After a long discussion, the **Mazowiecki** government managed to clarify most of the problems, which had been a subject of dispute. Ten months after the government came to power, on July 13, 1990, the Law on Privatisation of SOEs won the approval of the Sejm [32], and two months later, in September, 1990, the Ministry of Ownership Changes[33] was established, to replace the Plenipotentiary for Ownership Transformation Office within the Ministry of Finance (MoF). The first Minister of Ownership Transformation was Waldemar **Kuczynski,** who took the office for a very short period of time (from mid 1990 until the beginning of January, 1991, when **Mazowiecki**' government left office).[34]

Besides the law on privatisation of SOEs of July, 1990, which came into force on August 1, 1990, the Polish privatisation process is regulated by the following laws:[35]
(1) the Law on SOEs of September 25, 1981; **(2)** the Law on Management of Agriculture Properties of the State Treasury and the Establishment of the Agency for Agriculture Property; **(3)** the Law on National Investment Funds and their Privatisation of April, 1993; **(4)** the Law on the Financial Restructuring of State Enterprises and Banks of 3 February, 1993; **(5)** the Banking Act of 1990; **(6)** the Bankruptcy law of 24 August, 1934; **(7)** the Annual Budget laws; **(8)** the Commercial Code of 1934, as amended in 1990; **(9)** the Act on Public Trading of Securities and Mutual Funds, which was enacted on 22 March, 1991, and amended in 1995; **(10)** the Law on Companies

with Foreign Participation of 14 June, 1991; **(11)** the Act on Economic Activity of December, 1988; **(12)** and the Act Regulating the rental of trade premises, as amended in June, 1990.

These laws and acts regulate the scope, rules, and procedures of privatising small, medium and large-scale SOEs, and designate the parties authorised to carry out the process of privatisation in Poland. Moreover, they provide a flexible legal framework for privatisation allowing different methods and forms of ownership, including the free distribution of vouchers, sale on preferential terms to employees, communal or individual ownership, as well as sales through public offers, auctions, or direct negotiations.

This long list of laws that regulates the process of privatising SOEs can block, and, at the same time, can push forward the whole privatisation process. It can be a barrier, if we consider the time period required to go through different bureaucratic procedures in order to initiate privatisation. For example, as will be seen below, the main factor responsible for the low percentage share of the number of privatised SOEs via the 'liquidation' path (under Article 19 of the law on SOEs of September, 1981) in the total number of privatised SOEs, was the difficult legal and commercial procedures which must be undergone in order that the firm could be liquidated.[36]

However, this can be a 'push factor', because it gives policy makers a solid legal ground to privatise any firm, based on its size, financial standing, and economic sector. In other words, the variety of laws provides a large number of possibilities for ownership transformation, and reduces the likelihood of centralising the privatisation process. In fact, the wide range of legal measures plays a major role in decentralising the whole privatisation process. In practice, several government agencies are involved in the whole privatisation process. For example, the MoP is responsible for converting large and medium-scale enterprises into commercial companies, and exercising the state's ownership rights in the converted companies, the selling of state companies and assets, and training professionals in the field of corporate governance and the securities market. Local authorities were responsible for privatising small-scale enterprises. The

Ministry of Finance is responsible for privatising the banking system, based on Articles (861) and (865) of the Banking Act of 1990 and the relevant provisions of the Commercial Code of 1934. The Agriculture Property Agency of the State Treasury is responsible for privatising or liquidating 1,659 state-owned agriculture enterprises. One can conclude that the process of privatisation in Poland is rather highly decentralised.[37]

Did the Law on Privatisation of SOEs of July, 1990 fix specific *targets* and *tools* for privatisation?. Did the Law define the parties that would replace the government?. Did the formulation of the law on privatisation and the establishment of the MoP help in reducing the pressure of 'insiders' on the government?. How does the Law deal with the 'insiders' issue?.

Our study of the Articles of the Law on Privatisation of July, 1990 shows that this Law did not fix *targets* to privatisation to be achieved, but very clearly, with other laws and regulations (which are listed above), did specify the main *tools* of privatisation. As a result, the government of **Mazowiecki** was criticised. Later, the government announced eight general goals for privatisation.

The law on Privatisation accepts the idea of a "***multi-track***" approach to privatisation. Based on Article (1) of the Law on Privatisation of SOEs of July, 1990, privatisation of an SOE is based on (1) offering to third parties shares or stocks of a company evolving from the transfer of an SOE and owned exclusively by the State Treasury, or (2) offering to third parties the assets of an SOE or the sale of the enterprise.

The problems of mass privatisation aroused less concern, although there was huge pressure on the government from some 'Solidarity' experts (e.g. T Stankiewicz), some Members of the Polish Parliament (to be expected) from Gdansk (e.g. J Merel, J K Bielecki), and the authors of the concept (Lewandowski and Szomburg).[38] However, Article 25 of the Law makes it possible to implement mass privatisation based on vouchers. It states: " (1) *Parliament shall, at the request of the CoMs, adopt resolutions concerning the issue and value of privatisation notes serving as payments*

for: a) *Acquisition of rights to shares issued as a result of the transformation of SOEs*; b) *Acquisition of titles of participation in financial institutions (societies of joint investment) which will have shares issued as a result of the transformation of SOEs at their disposal*; c) *Acquisition of enterprises or organised parts of the assets of SOEs specified under Article (37).* (2) *Privatisation notes issued on the ground of Section (1) above shall be allocated free of charge to all nationals of the Republic of Poland, domiciled therein, and in equal amounts.* (3) *The CoMs shall, in a regulation, set out the time limits of validity of the notes of particular issues, the form, and the principles of distribution and realisation thereof, as well as the principles of limiting or possibly prohibiting the transfer thereof.*" However, article 25 has not given rise to mass privatisation.

According to Article (2) of the Law on Privatisation of 1990, the Polish Parliament, based on a motion of the CoMs, should determine annually the general directions of privatisation and specify the use of sources obtained from privatisation activity. Parliamentary decisions are made jointly with the enactment of the annual budget. And, based on the same Article, the CoMs should, by decree, specify those SOEs which are particularly significant to the national economy, and whose privatisation requires the approval of the CoMs.

The main methods of privatisation provided by the Law on Privatisation of 1990 are 'capital' privatisation and 'privatisation via liquidation'.

1. 'Capital' privatisation

This method was defended by the government with the support of several of the 'Solidarity' experts and the silent support of the Members of Parliament from the ex-communist left.[39] This form of privatisation means in Poland the sale of shares of large and medium sized SOEs transferred into companies solely owned by the State Treasury- the so-called State Treasury Companies (STCs). Therefore, 'capital' privatisation is composed of two steps: (1) transformation of SOE into a joint stock or

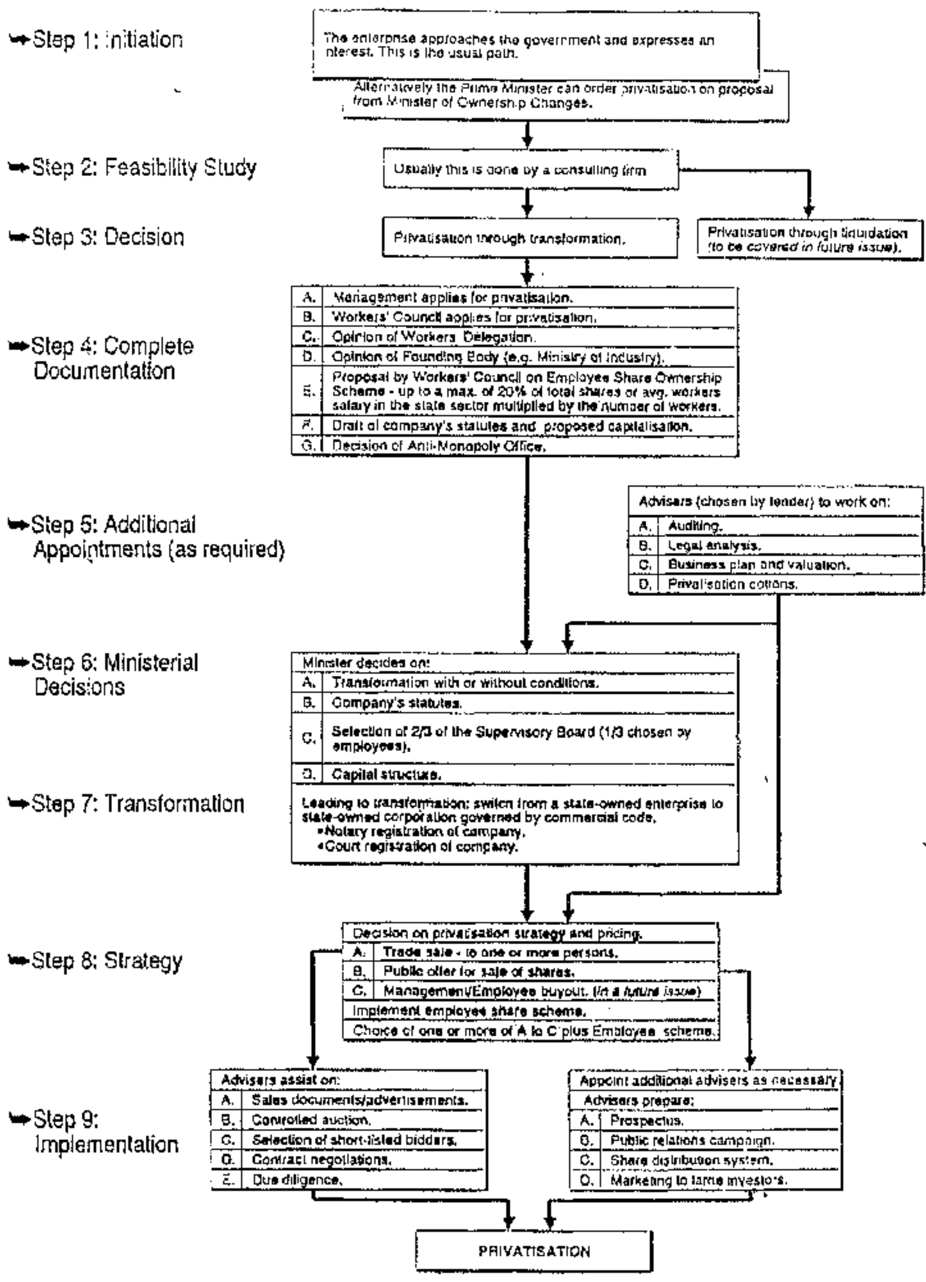
limited liability company based on Articles 5 and 6, the so called '*commercialisation*', or '*corporatisation*'. **(2)** Disposing of shares of State Treasury company to Third Parties, based on Articles 18-30, and governed by the regulations of the Commercial Code of 1934. The second step can be termed 'real' privatisation, because through this step ownership rights move from the State Treasury to third (private) parties.

Step One: *Transformation of SOE into a Company: (corporatisation)*

The Law on Privatisation of SOEs of July 1990 gives the right of transferring SOE into a company either to the Minister of Privatisation (based on Article 5), or to the Prime Minister upon a request of the Minister of Privatisation (based on Article 6). The Minister of Privatisation could transfer any SOE into a STC provided that the request of the founding body[40] is submitted with the consent of the executive director and the employee council, after obtaining the opinion of the general assembly of employees (delegates). The main contents of the request include an economic and financial evaluation of the transformed enterprise, a draft of the company's founding act- provided for by the Commercial Code- as well as the planned scope of the enterprise employee's preferences at purchasing shares in the company from the State Treasury. The Law stipulates the Minister of Privatisation has the right to refuse transformation of an SOE into a company taking into account the enterprise's economic and financial situations, or an important national interest. The Minister of Privatisation has to specify a statement of reasons and a list of conditions upon which the transformation will be permitted. In fact, the Minister's decision is also subject to appeal (Article 5). The new company which emerges from the process of transformation remains exclusively owned by the State Treasury, and assumes all the rights and duties of the transformed SOE and the Commercial Code of 1934 applies (Articles 7 & 8).

One should note that the legislature gave the 'insiders' a major role in the process of privatising their enterprises due primarily to the pressure they had put on the government since the beginning of the transformation process. In fact, the management and the employees of the privatised enterprises have an effective veto over Article 5.

Figure (6.1) illustrates the overall structure of the capital privatisation process:



Source: MoP, 1995.

Szomburg (1995) argues that this was not new, but dates back to 1981 when the government at the time, was forced by a 10 million - strong Solidarity movement, to pass legislation which gave state owned enterprises' managers and employee councils wide ranging decision making powers with respect to their productive and investment activities. But what matters more is how many shares the 'insiders' are given when the enterprise is privatised, as this affects the issue of corporate governance in the future. That is because the most important issue following the withdrawal of the state from its ownership position is who replaces it and controls and monitors the management of the privatised enterprise. Frydman & Rapaczynski (1994:143-44) argue that if the state withdraws from its ownership position and leaves the power to 'insiders' to control the privatised enterprise, while their incentives are not radically changed, there is a high likelihood that 'insiders' would continue to pursue policies and strategies to force the state into a new system of political enterprise governance, with all the negative consequences of government intervention. The questions that should be answered; "Would the process of '*corporatisation*' or '*commercialisation*' reduce the power of 'insiders'?"; and, "Would it be an opportunity to restructure the commercialised companies?".

It seems that the legislature was fully aware of this matter, as the process of transferring SOEs into companies solely owned by the State Treasury would reduce the power of insiders (managers, employees' councils; and trade unions) which was granted to them under the Law on State Enterprises of 1981, and would allow it to restructure the companies. A transition period between '*corporatisation*' and the sale of stock was created to allow the "*restructuring of the company, including discharge of its debts, replacement of management, sale of unnecessary or burdensome property, in order to enhance the efficiency of firms before they were fully privatised. Increased efficiency is to be achieved through radical changes in the commercialised firms organisational structure*" (Articles 19-22). The most significant change in how commercialised firms are run is the elimination of employee councils. This change shifts a company's internal power structure from the self-management model to that of professional management. By doing so, the importance of trade unions in the firms declines rapidly.

Without the workers council, the unions would not be able to dismiss members of the managing board, as a consequence losing their most powerful weapon against management. '*Commercialisation*' was designed to institutionalise this new structure of managerial power in the firm, by limiting employee influence over management and strengthening the managing board's power. Supervisory boards were created to inject economic rationality into commercialised firms. As opposed to the employee's council, whose interests were mainly directed at a level of wages satisfactory to the workers. The supervisory board was established to represent the financial interest of the owner in the profits of the firm. There was a strong belief that the 'outsiders' or 'external' control would be more efficient and rational than the control exercised by the workers (or the so-called 'insiders control'). Government supervision was to be limited to controlling the privatisation process. The newly formed companies were granted considerable independence from government interference in management decisions.[41]

The main question that should be answered; "Did commercialised enterprises adjust to market conditions?, or, "Did '*commercialisation*' improve the performance of enterprises?". This is discussed in some detail in Section Eight, below.

Step Two: ***Disposing of Shares of STC to Third Parties***

Article 18 states that the process of disposing of shares to third parties should take place in compliance with provisions of the Commercial Code, which requires the consent of the Councils of Ministers. This process should be carried out within two years (Article 19). The law states that shares of STC can be transferred to third parties by auction, open offer, or by negotiations entered into through public invitation. It is necessary to obtain the consent of the CoMs for another form of sale.[42] The third parties could be the managers of SOEs, workers of SOEs, other domestic investors, foreign investors, or the State Treasury.

Regarding the extent of insiders' shares in the ownership of the new company, Article (24) limits that to only 20% of the total number of the STC's shares. Employees have the right to purchase their shares on preferential terms (i.e. 50% of the price fixed for

public). This limitation is the main reason why Management/Employee Buy-Outs (MEBO) were not popular in the case of the capital privatisation path in Poland. The Finance Minister, at the time, explained that limitation by saying that Polish privatisation must not lead to an economy which is radically different from the West .[43]

State legal persons (for example, government institutions or SOEs) are not allowed to acquire these shares-exceptions need a special consent of the CoMs. What is also interesting in the Law is that it takes into consideration the shortages of the private sector's savings. This is very clear in Article (27:3) which allows Polish nationals to purchase shares by instalment plan.

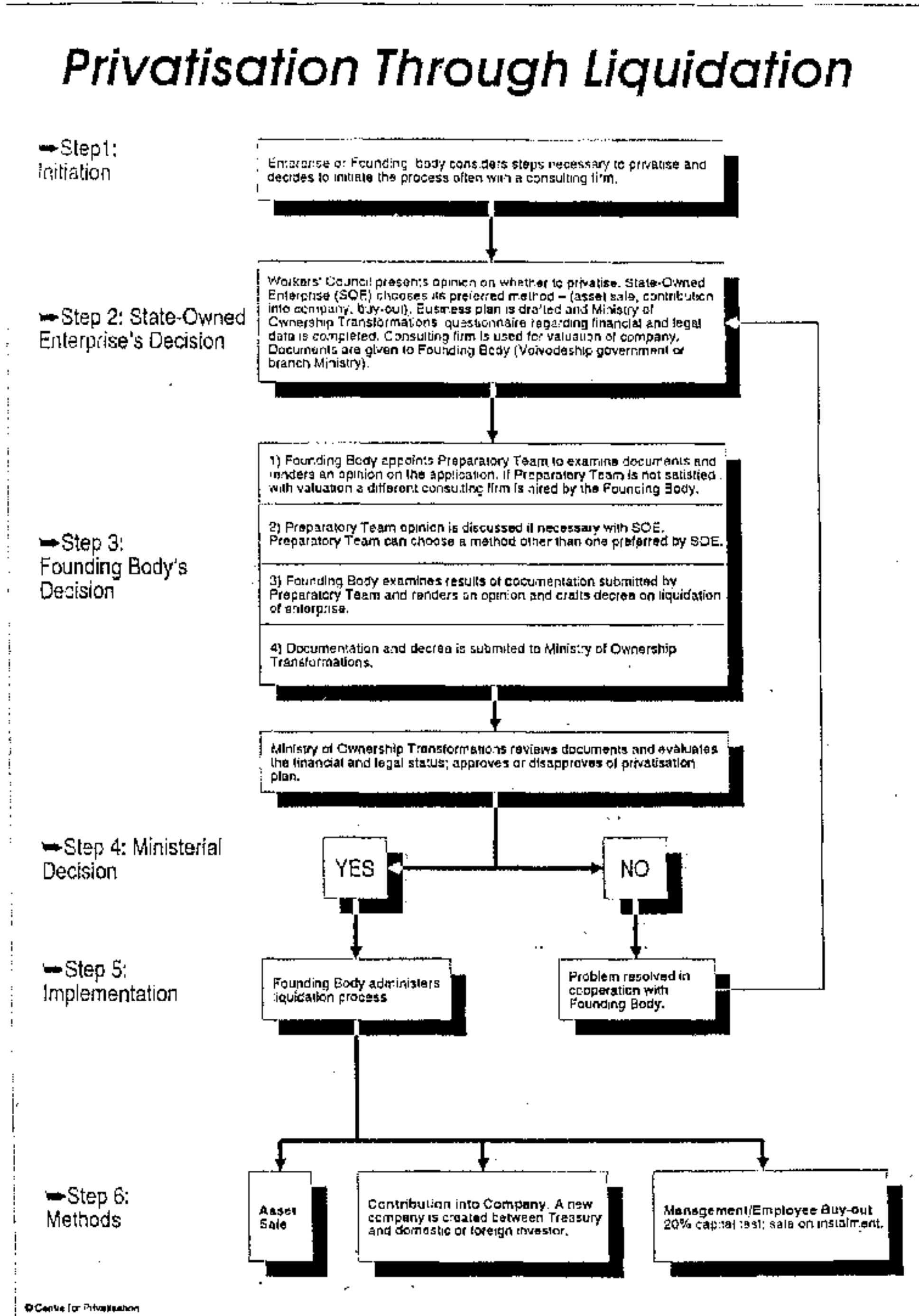
Why does the Law on Privatisation of 1990 distinguish between citizens, 'insiders' and the State?. Who then are the 'insiders' and who is the 'government'?. These questions are clearly answered when one realises that the very logical aim of the whole Polish privatisation process is *"to promote a wider share of ownership among the public at large , including employees of enterprises".* See goals of privatisation below. This means that the legislation aimed at a measure of economic justice when this law was enacted. Section Seven investigates and assesses the economic and statistical results of privatisation achieved in the first six years of the transition.

2. *Privatisation Through Liquidation*[44]

This privatisation path is designed for enterprises characterised by medium and small scale employment, which are in good financial and economic standing. The law gives the founding body the power, acting upon the consent of the Minister of Privatisation, to wind up a state enterprise in order to: "(1) sell the enterprise or any organised parts of its estate; (2) contribute the enterprise or any organised parts of its estate to a company; (3) turn over the enterprise or any organised parts of its estate to non-gratuitous use for a specified time".[45]

The law states that the founding body has the right to take a decision to wind up a SOE, on its own initiative or upon the request of the Workers' Councils of the enterprise.

Figure (6.2) illustrates the procedures of privatisation through liquidation.



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Source: MoP, 1995.

Article (37) of this law gives the employees' council and the executive director of the enterprise the power to object against the decision to wind-up their enterprise[46]. While, as noted above, in the case of '*commercialisation*', the MoP has the right, according to Article 5(3), to refuse transformation of SOEs into a company.[47]

The main procedures that can be used to liquidate any SOE, as specified by the law of privatisation of SOEs of July, 1990, are: (1) the sale of the assets of the SOE; (2) leasing, (3) contribution in kind into new companies, (4) or, mixed procedures of the above.

In this type of liquidation, the successor of the liquidated enterprise takes over both the assets and the liabilities of the liquidated enterprise, and the Law did not fix a limit on the participation of employees of liquidated enterprise. Special rules giving preferential rights to the employees apply to this type of privatisation followed by leasing. In such cases, the employees' council in consultation with the general meeting of enterprise employees may initiate the privatisation. In making any decision about leasing state property, preference should be given to a company composed of private individuals only and joined by the majority of the employees from the liquidated enterprise. This company can lease the assets of its former enterprise (or of part of it) on a negotiated basis (without public auction). Article (8:5), however, specifies that the above mentioned company should accumulate a capital of 20% of the book value of the liquidated enterprise.

One might argue that this type of privatisation looks like '*nomenclature*' privatisation. But the fact is that there are three main differences between this type of privatisation and the '*nomenclature*' privatisation of **Rakowski's** government: **first,** this type of privatisation is now controlled by the MoP. **Second,** this type offers an advantage to the 'insiders' of the liquidated enterprise to handle the process for their own interests. And, **third,** these groups of enterprises show better economic results than expected and 'insiders' try to use the assets of these enterprises more efficiently[48].

At this stage of my analysis, it is of importance to mention that in Poland, there is another type of liquidation- the so-called 'bankruptcy liquidation'.[49]

3. Bankruptcy Liquidation

This type of liquidation is based on Article (19) of the Law on SOEs of September, 1981. The main differences between this type of liquidation and the one based on Article (37) of the Law on Privatisation of SOE of July, 1990, are: **(1)** the one which is based on Article (37) concerns enterprises in a relatively good economic and financial situation, while the other concerns enterprises in a very poor financial situation. **(2)** in the first case as noted above, the successor of the liquidated SOEs takes the assets and liabilities of the liquidated enterprise, whereas, in the second case, only assets of the bankrupt enterprises are sold at auction, in most cases to the 'insiders' of the enterprises. In fact, enterprises which did not go bankrupt, survive in a new form and their assets can be used in an efficient way so that their employees find new employment[50]. **(3)** liquidation via the Law on SOEs of September, 1981, *"are not, strictly speaking, bankruptcies, since the only "unpaid creditor" is most often the State, which also happens to own the enterprises in question. Such liquidation is often only a covert form of ownership transformation, with the assets of the "bankrupt" sold at auction, most often to enterprise 'insiders' who support the process. Nevertheless, this form of winding up is the most common consequence of insolvency, and its effect, despite the differences with respect to traditional bankruptcy, is the closest Poland now has to a disciplining force hardening somewhat the notoriously "soft budget constraint" of the state enterprises."*[51] Whereas, liquidations under Article (37) of the Law on Privatisation of 1990 are not insolvency-related, and are in fact asset-sale forms of privatisation.[52] **(4)** it is expected from a logical point of view that the new enterprises, which are established from the assets of their old bankrupt enterprises, should be better off financially, and perform better economically than in the case of the liquidated enterprises based on Article (37). That is because these enterprises would not be forced to survive in their old form[53]. **(5)** Unlike liquidation via Article (37) of the Law on Privatisation of July, 1990, those based on Article (19) of the Law on SOEs

of 1981 do not have to be approved by the workers' councils (although the councils must be consulted).

One can conclude that such liquidation (i.e. those based on the Law on SOEs) is the only mechanism for winding up firms that the State (in which it is the firms' owner) recognises should no longer exist or that can be relatively easily transformed into viable private businesses. Fortunately, this liquidation involves small and medium-sized SOEs, where the resulting social problems are limited.[54]

e. Involvement of foreign investors in the privatisation process

It is of interest to mention that during the period of the first Solidarity-led government, there was disagreement on the involvement of foreign investors in the privatisation process. The liberals were in favour of not only allowing, but even actively encouraging foreign investors to purchase shares in as many enterprises as possible, except in some restricted fields. In this case, the government was criticised not only for selling the country to foreigners, but also selling it at cheap prices. Others (the nationalists) were against the involvement of foreigners in the privatisation process[55]. This issue will be tackled in the following section below. However, it is of importance to mention that the Law on Companies with Foreign Participation of July, 1991, allows foreigners to purchase up to 10% of the assets of the privatised enterprise freely, and up to 100% of the assets, after obtaining approval from the MoP, which is expected to be almost automatic except in some special cases.

One could argue at this early stage of analysis that, due to the absence of large-scale participation of foreign capital on the one hand (as will be seen below), and the shortages of domestic savings on the other, the ambitious timetable of privatisation was not fulfilled.

f. Reprivatisation

The other main issue which was intensively discussed during the first non-communist government era was **reprivatisation.** However, until the end of 1995, Poland still does not have a reprivatisation or restitution law. At the beginning of 1995, the ninth amended draft law on reprivatisation: *Act on the Compensation for losses of Real Estates Taken in Violation of Regulations Issued in the Years 1944-1962* was the subject of a vivid debate. It was positively revised by a specially established Consultative Committee on Reprivatisation and initially accepted by the Council of Ministers. It was expected that in the second half of 1995, this draft law would be the subject of Parliamentary Debate, so that the Act would be passed through Parliament.[56] One of the consequences of the delay in restitution legislation in Poland is that in many cases the claims of former owners of property lead to the withdrawal of potential foreign investors, who are afraid of the legal difficulties that could arise from unclear ownership titles.[57]

g. The declared goals of privatisation

Mazowiecki's Government officially announced its main goals of privatisation, after criticism that its Law on Privatisation of July, 1990, does not include any hints on the main goals of Polish privatisation policy. The goals published in January, 1991, although general, were very clear, and specify a time scale for the Polish privatisation process. It states that the government aims at *"privatising of half of the present state owned sector within three years; and achieving the same ownership structure as Western Europe within five years".*[58]

In very plan, the Government pointed out that the main objectives of the privatisation process are the following:

"(1) shifting the economy from a centrally planned system to an open market system to foster efficiency and competition; (2) improving the performance of enterprises through increased efficiency by installing private initiative, and motivated management and labour; (3) reducing the size of the public sector and burden on the public budget and

administration; (4) promoting wider share ownership among the public at large, including employees of enterprises; (5) develop entrepreneurs and managers with initiative, drive and a keen sense of opportunity; (6) generate funds from the sale of enterprises, which can be used for enterprise restructuring".[59]

The most important goal for privatisation to achieve is to "*prevent the collapse of the stabilisation process which started in late 1989".*[60] This was because liberalising prices and trade, and creating a market environment for products produced under state ownership, were not sufficient to discipline the managers' behaviour.[61]

Some implicit and explicit factors played a major role in shaping these goals. Among the *explicit* factors, the most notable are; **(1)** to increase the efficiency of the enterprises; **(2)** to reduce or even stop the annual amount of subsidies deducted from the State budget; **(3)** the will of the government to move away from the communist system, to promote wider share ownership among the public at large, and to generate funds from the sale of enterprises. Whereas, the most important *implicit* factor is the will of the Polish Government to join the European Union, as can be understood from the second general goal of the privatisation plan[62].

Some of these goals are broadly defined. The Polish policy makers wished to achieve a broad number of policy targets, which may or may not be compatible with enhancing efficiency. The Government aimed at privatising the Polish economy in the shortest possible time ("*half of the present state owned sector within three years*"). It is very clear that not all of these objectives can be achieved at once, and trade-offs and compromises are inevitable. For instance, when a policy decision is made to privatise a given number of SOEs (say half of the 8,441 SOEs) as quickly as possible (say in 3 years time) to obtain rapid improvements in efficiency- any constraint imposed on the other objectives will tend to slow down the process of privatisation, and limit the actual extent of efficiency gains. In other words, successive Polish Governments aimed at privatising the economy as quickly as possible. However, due to the lack of domestic savings, and the legal restriction imposed on employees' shares (maximum 20%), and the low participation of foreign investors, that goal was not achieved, even after six

years from the start of the privatisation process in 1990. One can conclude that the Polish policy makers who announced that goal were either over optimistic, or wanted to convince (or even please) some national (workers councils, trade unions?) or international groups[63] (such as the International Monetary Fund (IMF) and the World Bank (WB)).

It is of interest to note that for the first time in the history of broad privatisation philosophy, privatisation is used to create a market economy. When introduced in the Western and developing economies, privatisation was supposed to enhance the functioning of the existing market economies. In the case of Central and East European economies in general, and in the case of Poland in particular, the first goal for privatisation to achieve is to shift their economies from CPEs to open, market-orientated economies to foster efficiency and competition.

2. Bielecki's Government Era (January, 1991-December, 1991)

The **Bielecki**[64] Government came into office after the first Presidential elections of 1990, which were won by **Walesa**[65]. Obviously, when this government took office, the Law on Privatisation was in effect, the Ministry of Privatisation was already established, and the official goals of privatisation were also already announced. What was the role of this government afterwards in shaping Polish privatisation thought?.

This government changed the ambitious plan for privatisation aiming at privatising half of the 8,441 SOEs from three to five years, but stuck with the general aim of changing the structure of ownership along Western Europe lines within five years. **Bielecki** recognised that further delays in privatisation could ultimately jeopardise the success of the whole transformation programme, therefore, his Government introduced a *new philosophy for privatisation.*[66]

In fact, before the formation of Bielecki's government, President **Walesa** adopted the idea of capital vouchers in the election campaign. He promised to give each Pole a credit of 100 million *zloties* to buy shares to accelerate the privatisation process.

However, his idea was not included in the official election propositions "New Beginning" on November 11, 1990. Nevertheless, it was kept in mind by both supporters and opponents of the new President.[67] Then, the idea was developed by Koziewicz, under Secretary of State in the Presidential Office, so that each citizen would receive the equivalent of US$ 10,000 in the form of long term investment credit with a 20-year maturity- free of interest during the first 10 years. In fact, both proposals (zl 100 million and US$ 10,000) were completely unrealistic and irresponsible from the macroeconomic point of view, because they would have deprived the State budget of a possible source of revenue, and increased the total money supply in the Polish economy by 15 times, i.e. it would have added some inflationary pressure.[68]

A new version of this idea was proposed by the Solidarity trade union (the "Network of leading Big Enterprise Union Organisation") at the end of March, 1993, and politically endorsed by President **Walesa.** In the new version, every adult citizen would obtain zl 300 million of credit. Lewandowski encouraged this approach as he believed that it was relatively simple, fast and inexpensive. Neither idea was ever put into practice.[69]

a. A shift towards citizens' ownership

In Bielecki's Cabinet, the new Minister of Privatisation was **Lewandowski.** The first predictable step this Government took, after realising that the whole process of privatisation was progressing very slowly, was to prepare a '*revised programme for privatisation'*. The revised privatisation programme opened the door for the implementation of the original *Lewandowski-Szomburg idea* of free distribution of *vouchers* to all citizens[70]. On 20 June, 1991, Lewandowski- the MoP- introduced his 'Mass Privatisation Programme'. Four hundred SOEs would be chosen for transformation into STCs. Shares in these companies would then be distributed as follows: 10% to employees free of charge; 60% to all adult citizens, also free of charge; and the remaining 30% would be retained by the State Treasury. The shift towards the **citizen' ownership** concept was closely connected with attempts to accelerate the privatisation process, to keep out rapacious foreigners, and to achieve economic justice. Steps had been taken at that time to organise the first mass distribution of shares among

the population. It was expected that they would manage to do that by the end of 1991. But the idea of 'mass privatisation' have not been implemented.[71] That was mainly due to the following reasons: "(1) *the resistance within the government by supporters of 'conventional' privatisation methods.* (2) *the resistance by consultant firms which naturally linked large demand for advisory services with the case-by-case method and not 'mass privatisation'.* (3) *the resistance of the organisers of the capital market: the eventual issue of millions of vouchers and their turnover with millions of people participating drastically changed existing forecasts on the functioning of the Stock Exchange and of the regulated capital market.*"[72] Moreover, some criticisms were directed toward the programme, including: (1) "*the quasi-privatisation character of the programme, as enterprises would not have a real owner as a result of dispersed shareholdings*". (2) "*the threat of inflation: the likelihood that the poorest section of the population would sell their vouchers, using the money for consumption purposes*". *(3) "the uneven accumulation of wealth: the potential threat that a small group of people would acquire assets at lower prices"*. (4) "*the influence of foreign experts: the difficulty in ensuring the national interest with foreign managers in the investment funds*".[73]

b. Adoption of Foreign Investment Law

The other important achievement of this government is the strong belief in the participation of foreign investors in the privatisation process. That is highly explicit in the argument of Bielecki (1992), which states that "*the programme of privatisation - especially of large enterprises- could not be carried out effectively without participation by foreign investors*". In fact, this very strong belief of the Prime Minister of a revisionist government, had a major influence on the Parliament; after six months of Parliamentary debate, a very important Law on Companies with Foreign Capital Participation was passed, in July, 1991. The Law gives foreign investors the possibility of not only participating in the privatisation process, but also the chance of setting new business (greenfield) and establishing joint ventures in the country[74].

c. Sectoral privatisation programme

This programme was unique to Polish privatisation.[75] In fact, Bielecki (1992:329) argues that this approach was an attempt to integrate privatisation with the Polish industrial policy and foreign investment. The core of the programme was to be the synthesis of analyses of the economic situation and competitiveness of specific sectors of the economy, in general, and of particular enterprises in each industrial sector, in particular.[76] The programme involved a comprehensive feasibility study for each industrial branch by Western consulting firms. The aim of the feasibility studies was to evaluate those sectors, branches, and enterprises for restructuring and privatisation. The consultants would then attempt to sell large chunks of stock in the firms belonging to that branch. Theoretically, a number of SOEs could be sold at once via this programme to both domestic and foreign investors, although the programme was oriented mainly toward foreign investors.[77]

By July, 1991, 173 SOEs of various sizes, in 34 industrial sectors were selected for the programme. And by December, 1991, a total number of 250 firms, employing more that 300 thousand workers, had been included in the programme.[78]

The most advantageous points of this programme are: (1) it helps in overcoming the information barrier facing the State as owner of the State sector. (2) it can also lead to a significant acceleration of the privatisation process by broadening the field of operations. And (3) it can improve the reliability of the information base and increase flexibility in the choice of particular techniques.[79] What is interesting in this programme is the fact that it can be implemented either through the use of 'capital' privatisation or the 'privatisation via liquidation' path.[80]

d. Restructuring privatisation programme

This government developed another privatisation programme called "***restructuring privatisation programme***". This programme involves a competitive tender for a management group, the task of which shall be to restructure the company and increase the value of its assets. During the tender, the management groups must include in their offers restructuring plans and a proposed initial value of the company they are bidding for. A successful management group must make a financial contribution, treated as a pre-payment for the shares in the increased share capital of the company. This meant that upon the fulfilment of the contract, the management group obtains shares of the company in return for its financial contribution. The management group receives a commission equal to 70% of the real increase of the company value when selling it to an outside investor. In addition, the management group has an opportunity to participate in profit sharing. Upon successful completion of the restructuring programme (approximately two years) the company will be sold. The management group, by virtue of the contract, is given the option to purchase up to 80% of the shares.[81]

e. Regional offices

This government announced that only the 500 largest enterprises would be privatised by the MoP itself or under its strict control. The rest of State industry and trade would be corporatised and privatised in a decentralised way. At that time the MoP had established regional offices to supervise the process. Privatisation can be initiated not only by the affected firm itself, but also by an outside party willing to buy a stake in the firm.[82]

f. Local government involvement

Another decentralised path is small privatisation, where local government mainly takes care of the organisation of the bidding process. Therefore, special encouragement was given by **Bielecki's** Government to 'small privatisation', a concept which for some time

had also been strongly supported by **Walesa**. It involves, first of all, the enlargement of existing, and the establishment of new, private firms by eliminating barriers that previously restricted the functioning of private enterprises. As will be seen below, many new small private businesses were established, despite the lack of experience and sufficient capital, which demonstrated that there was no shortage of enterpreneurship in Poland.

Local political developments interrupted economic policies in Poland. The Parliamentary elections of October, 1991, resulted in a new government- Olszewski's Government.

3. Olszewski's Government Era (December, 1991-June, 1992)

This was a coalition government, supported by Christian National Unions (ZCHN), the Centre Alliance (PC) and a number of smaller parties, plus PSL. **Gruszecki** was the Minister of Privatisation. He was a strong advocate of the idea of '*commercialisation*'.[83] The government had to frame an economic programme which could come to grips with a number of exceptionally difficult dilemmas. The main dilemma concerning privatisation: " At what pace, and in what new forms to go ahead with privatisation?". The group which supported this government called for a sharp 'breakthrough', a break with the policies of the past two governments.[84] According to Parliamentary groups supporting the **Olszewski**'s government, the '**Balcerowicz** Plan' had led to the decimation of Polish industry and agriculture by exacerbating the recession and refusing to intervene to help stricken firms. The stabilisation programme's anti-inflationary emphasis should therefore be replaced by anti-recessionary policies; a more interventionist, projectionist industrial policy was needed to repair the damage done by the liberals. More importantly, the previous two government's privatisation policies came in for criticism. This government attempted to articulate its economic programme in the White Paper '***Principles of Socio-economic Development***', submitted to the *Sejm* in mid-February, 1992, and in the auxiliary planning document '***Principles of Socio-economic policy for 1992-94***', released in March, 1992.[85]

In fact, **Olszewski** contributed to, and was caught in, a debilitating political struggle with both President and the Parliament. As political manoeuvring began to dominate all else, privatisation activity ground to a standstill: during his Government's short stewardship of national affairs no substantial privatisation took place. Privatisation of large state enterprises was practically brought to a halt.[86] Sectoral privatisation was scaled back by Gruszeck and marginalised after 1991. This government collapsed in June, 1992.[87]

4. Suchocka's Government Era: **(July, 1992 - September, 1993)**

Suchocka[88] was able to form a coalition government. Lewandowski was brought back to head the MoP. The economic strategy of the new government was based on three fundamental principles: a social market economy, privatisation and a pro-Europe orientation. This government believed that the answer to the question; "How to improve the economic situation in Poland lay in executive decrees which would help to put the market economy and privatisation more rapidly in place. Opponents argued that the effectiveness of government action would be much greater if it focused on framing an economic policy oriented to moving the country out of recession.[89]

The main achievements of this government are the so-called *State Enterprise Pact, the adoption of the Mass Privatisation Programme,* and the (almost) completion of *small-scale privatisation, and the adoption of the Law of Financial Restructuring of Enterprises and Banks at the end of 1992. The results of small-scale privatisation are discussed in detail in Section Seven, below.*

a. State Enterprise Pact

This Pact was signed by representatives of the government, trade unions and employers on February 22, 1993. It included a package of new laws and amendments of old ones, aimed at providing new operation conditions for State enterprises, and at winning popular support for those changes. The Pact was to provide for more employee

participation in the process of economic transformation taking place in Poland and , by the same token, to change the prevailing attitude represented by trade unions from that of a demander to one which involves joint responsibility for economic development. The pact's objective was, by its very nature, to mitigate social tensions, create new institutional forms for negotiations and for settling disputes among trade unions, employers and the government. The pact was to contribute to more efficient management, improvement of financial standing and speeding up of privatisation of SOEs. The SOEs Pact covers privatisation matters. The government proposed some amendments to the Law on Privatisation of SOEs of July, 1990, aimed at the introduction of a bigger variety of privatisation methods, in order to speed up this process in the interest of both the State and employees. However, irrespective of what privatisation methods, employees would be given preferential treatment. They were to receive 10% of the equity free of charge, to elect one third of the Supervisory Board and to have an influence on the choice of privatisation methods. The choice of privatisation path would depend on whether the enterprise had or had not lost its financial liquidity. If it still had that liquidity it could choose one of the following privatisation methods: (1) privatisation through sale of shares to a large domestic or foreign investor, or through a management or employee buy-out; (2) sale of shares through public offering; (3) assignment of a control parcel of shares to a trustee (e.g. an investment fund, a bank, etc.).[90]

b. The Mass Privatisation Programme [91](MPP)

The Law on Mass Privatisation Programme won the approval of the Parliament and the Senate for the National Investment Funds in April and May, 1993, respectively. What are the bases of this programme?. What are the main steps of implementing the programme?. What are its implications to the citizens, the NIFs, the companies, and the whole Polish economy?.

1. Basis of implementation

The basis for implementation of the MPP is known as the Law on National Investment Funds (NIFs) and Their Privatisation of April 30, 1993. The Law came into force on June 15, 1993. This means that mass privatisation is a process with a firm legal basis, being implemented pursuant to a decision of a parliament elected in democratic elections. The official name of the programme is "The Programme of NIFs". Mass Privatisation Programme (MPP) is a more common, "working" name, as it is already well-established among the public; this is why both names are used interchangeably. MPP is the only programme of ownership transformation which has been sanctioned by a Parliamentary Act. This was a result of the endeavours of consecutive governments which, though they did not hold a majority in Parliament, attempted to enact the necessary legislation. It was possible thanks to a clear and comprehensive economic concept, developed by the MoP.

2. Aims of the MPP

The official view of the rationale behind the MPP is explained by their document. The MPP Department argue that: the capital privatisation method proved to be insufficient to meet the economy's restructuring needs; there was an urgent need for an active owner for the companies, capable of carrying out effective restructuring of management, capital and marketing; it attempted to avoid valuation, as it is costly, time-consuming and not very reliable, since there is no perfect market mechanism to distribute the assets to all citizens; citizens should receive compensation for 45 years of Communism; they should, however, be burdened with responsibilities/duties which are beyond *their competence*.[92]

3. The structure of the NIFs programme

According to the law of NIF and their privatisation of 1993, the structure contains 5 main steps: commercialisation, the establishment of NIFs, contribution of joint Stock

companies (JSCs), held solely by the State Treasury, distribution of shares, and finally, the introduction of NIFs shares onto the Stock Exchange.

The ***first step*** means that SOEs should be transferred into Joint Stock Companies (JSCs) held solely by the State Treasury. A requirement to qualify for the programme has sales exceeding US $ 5 million and a net profit before tax. The ***second step*** involves the establishment of the NIFs by the State Treasury in the form of JSCs (Article 3). Their assets include shares of privatised firms, contributed by the State Treasury. A selection Committee, appointed by the *Sejm*, Senate, the government and trade unions, selects members of the first supervisory boards of NIFs. It is also responsible for carrying out a tender for fund managers. The ***third step*** involves the structure of share holding of the companies involved in the programme. Each company has the same share holding structure: 33% held by a 'lead' NIF, 27% distributed equally to all other NIFs; 15% distributed free of charge to employees; and 25% retained by the State Treasury. In fact, the companies lose the status of SOCs held solely by the State Treasury and from then on are treated as private entities. The ***fourth step*** involves the distribution of Share Certificates (SCs). Upon payment of a small registration fee, all adult citizens receive bearer securities -Shares Certificates- which give the right to participate in the programme. Those securities can be traded freely, both on and off the Stock Exchange. The ***fifth step*** involves the introduction of NIF shares onto the Stock Exchange. After the Securities Commission admits shares in all NIFs to trade on the stock Exchange, SCs can be exchanged for a portfolio consisting of one share in each NIF.

4. MPP Timetable

As at the end of December, 1995, the following is the status of the Programme:

a. National Investment Funds

15 NIFs were created on December 15, 1994, as Joint Stock Companies (JSCs) and now operating as closed-end fund. Their principle purpose is to increase the value of

their assets- namely the shares of those Polish companies participating in the MPP- for the benefit of their shareholders. Each NIF is controlled by a supervisory Board charged with representing the interests of its shareholders - the Polish citizens who are holding (or will hold until November, 1996) SCs. The supervisory Board members have already been selected by the selection commission and already accepted by the Prime Minister. Each NIF holds 28 lead share holdings (33%) and over 513 minority share holdings in companies in the programme. In addition to the management of the NIFs on a day-by-day basis, fund managers will assist in obtaining access to capital, new technologies and new markets for the companies in the programme.

The fund management team managing each NIF will report to the supervisory Board under a management contract and performance contract which have a ten year term, and will provide them with financial incentives to increase the long-term value of the fund. After the first year it is intended that each NIF will seek a listing on the WSE. The fund manager will also consider listing companies in its portfolio as appropriate.

b. The companies

512 large and medium-size Polish enterprises are participating in the MPP. These companies come from a broad range of industrial sectors, including metallurgy, machinery and precision engineering, chemical engineering, and paper, foodstuffs, construction and transportation equipment. Each company has the same shareholding structure as mentioned above. The distribution of the 33% lead shareholdings is decided according to an agreed procedure designed to ensure fairness. Each company is one of 28 enterprises held as a core investment in its lead NIF.

Shares in the companies may be sold by the NIFs directly to strategic investors and some companies may be sold in their entirety to Polish or international companies or investors. Some may be placed in Joint Ventures or remain as long term investments or funds. Eventually, it is hoped that many of the participating companies will themselves be listed on the WSE.

c. The Polish Citizens

The MPP has been designed to ensure that the Polish citizens are the principal beneficiaries of the mass privatisation process. All resident Polish citizens aged 18 or over are entitled to participate in the programme by purchasing a Universal Share Certificate (USC). The fee for a USC is no more than 10% of the national average monthly wage, currently equivalent to zl 20. On receiving the Share Certificate, the owner will immediately be able to trade it in bearer form and soon after trade it on the WSE. In due course, once the NIFs are listed, the SC can be converted through a broker into one share in each relevant publicly-quoted NIF. Because the value of all SCs is not linked solely to the performance of a single company or group of companies, but represents a broad spread of investments in several hundred enterprises, this approach is expected to offer all Polish citizens a diversified interest in key Polish industries. It will also enable sophisticated investors to choose more targeted investments, such as particular NIFs or companies in the Programme, should they so wish. The SCs are in the form of physical bearer securities, convertible to shares in each of the NIFs. The share certificates are exempted from public trading regulations, and can be traded in their initial issued bearer form. Therefore, intermediaries such as banks, *Kantors* (Foreign Exchange Offices), etc. are trading the Certificates in the same way as they trade currencies. This form of trading serves the needs of those holders wishing to sell or buy further USCs at minimal cost without the overhead of opening or running brokerage accounts. For those holders wishing to take advantage of the inherent security of the National Depository, the USCs will be eligible for deposit and dematerialisation via a brokerage house. In dematerialised form, the USC will be admitted to trading on the WSE. The process of distributing the SCs to Polish citizens commenced on 22 November, 1995, and will last for one year.

d. Overseas Involvement

Institutional, strategic and private investors from abroad can participate in the MPP in a variety of ways: (1) they can purchase SCs from those citizens who wish to trade them, either in bearer form, or in dematerialised form on the WSE. These Certificates are

convertible into shares in individual NIFs once the NIFs have been listed on the WSE. (2) investors can purchase and trade in shares in the NIFs after they have been listed on the WSE. (3) financial and strategic investors can actively participate in the restructuring of individual participating companies by purchasing shares in them as and when they become available, by taking part in new share issues, by providing equity or non-equity finance, by acquiring companies in their entirety, or by forming strategic joint ventures. (4) institutional investors may choose to purchase shares in individual participating companies when they become publicly listed in the future.

5. Implications for companies, citizens, and the whole Polish economy

a. Implications for the companies

The structure of a SOE is particularly impervious to attempts at reform. The director, formally reporting to the State administration, is in practice, a captive of the employees, since his (her) election depends primarily on the Workers Councils. As a result of the extremely powerful position of trade unions, any attempts at transformation of SOE by the management, are only sporadically successful. Support for reforms is fostered by the difficult economic situation of companies, however. Usually, capital assistance from outside the company is necessary. This requires a prior change of the structure of a company (commercialisation) and the sale of some of the shares. Only into such a transformed company can a potential investor "pump in" any financial resources (the costs of purchase are taken by the State Budget).

The MPP eliminates those inconveniences. SOEs become private JSCs as soon as their shares are contributed to a NIF. After that there are various possibilities for direct capital support: a new issue of shares (after invalidating the pre-emptive right of the existing shareholders); a joint venture; credit or credit guarantee provided by an investor.

The ownership structure (33% the leading NIF, 27% dispersed among the remaining NIFs, 25% the State Treasury, 15% employees) is reflected in the composition of the

supervisory Board. The management Board is usually composed of the existing management, which knows the specific nature of the company and its problems. The leading NIF does not limit the independence of a company; its task is to stimulate development through efficient use of financial instruments . Advisory support in the form of a fund management will allow the verification of the plans of the management in a fast and efficient manner. The international connections of a NIF and its strong position in negotiations with foreign partners will allow it to seek investment capital effectively and to develop exports.

It may be reasonably expected that as a result of release from mechanisms limiting wage increases in the State sector, combined with shares in profits and participation in management, employees will, to a great extent, identify themselves with their company. This will also help to reform the employment structure.

b. Implications for Citizens

The MPP offers all citizens the possibility to participate in the emerging market economy system in Poland. SCs are available (since 22 November, 1995) for a fee not exceeding 10% of the average monthly wage (zl 20). For this price a buyer can become a part-owner of several hundred reasonably good companies. There is no restriction on individuals or other persons wishing to trade bearer, physical form Certificates on the basis of private arrangements between themselves. It is expected that various organisations, including certain Foreign Exchange Offices ("*Kantors*") and individuals would organise trading in the Certificates. There is no requirement for special permits to trade in SCs as a business, but they must appear in the Business Register. After all NIFs have been admitted to public trade, shares of the Funds will be subject to more sophisticated trading on the SE. For investors willing to penetrate the over-the -counter market, the programme offers several hundred securities representing a full spectrum of technical parameters and risks. For those who are not interested in investing on the Stock Exchange, an SC will be a safe investment, or a source of additional one-time profit[93].

c. Implications for the Polish economy

The establishment of several strong financial institutions- the NIFs, and simultaneous restructuring of several hundred medium and large companies, will be a strong impulse for the development of the whole economy. One of the major effects of implementation of the NIF programme will be a tremendous growth of the capital market in Poland. Implementation of the MPP will result in issuance of three types of securities: **(1)** shares in the privatised companies; **(2)** Share Certificates convertible in the future into shares of the NIFs; and **(3)** shares of the NIFs themselves. As for the companies shares, eligible employees of the MPP companies can obtain up to 15%, free of charge. It is possible that the companies concerned will deposit these shares with local banks, and will issue depository receipts to the employees instead of physical shares. In most cases, the company shares will be traded privately on restricted, company-managed markets. In most cases, these markets will initially take the form of notice boards maintained by the companies, matching buy and sell orders between eligible counterparts. Later, they may be admitted to public trading on the WSE or possibly the OTC market.

Regarding SCs, they have been available to eligible Poles since November, 1995. For those holders wishing to take advantage of the inherited security of the National Depository, the Certificate will be eligible for deposit and dematerialisation via a brokerage house. In dematerialised form, the certificate will be admitted to trading on the WSE. Shares of the NIFs will be tradable, once they are admitted to public trading. They will take book entry form in the same manner as other shares currently traded on the WSE. Holders of SCs are able to convert each certificate into a single share of each NIF.

It is of interest to mention that certificates will remain tradable for several years at least, as a safe investment which does not require an investor to be familiar with the capital market. NIF shares will also be relatively safe (a NIFs portfolio shall include several majority shares and several hundred minority shares). As the financial condition of companies participating in the programme improves, they will be able to seek capital on

the domestic market through a public investment offer created within the framework emerging from this programme.

For small companies, of local significance, conditions will be created for over - the - counter trade of their shares. In the first stage, as a part of trade among primary shareholders (employees and NIFs), and then as a part of regulated over - the- counter trading. Particular solutions will depend on the specific nature of a given security. Some government officials in the MOP hope that the development of the capital market will foster initiation of the reform of the budgetary sphere: notably Social Security and Health Care. They argue that in order to establish competitive (commercial and/or partially subsidised by the State) insurance and health insurance companies, there must be a deep, stable and efficient securities market of sufficient liquidity. Therefore, the establishment of a strong sector of dynamic private companies, managed in a modern manner, as well as strong new financial institutions (NIF), will help to reduce the burden on the State as the main employer and a party in wage disputes; it will, at the same time, reinforce the State role as an efficient regulator of the economic process.

6. Critique over the MPP

As only a few countries in the world have undertaken such a huge privatisation programme[94], it is extremely difficult to predict the outcome of such a process. I agree with Murrell, 1992 that such a Mass Privatisation Programme provides an element of learning by doing. However, the most serious criticism that one could register against this programme is the fact that, though it was established to help in creating a market economy in Poland, it broke the rules of the market economy. This programme is not based on the very basic conditions of the market, i.e. demand and supply.

c. Law on Financial Restructuring of Enterprises and Banks

The Law on Financial Restructuring of Enterprises and Banks was approved at the end of 1992. This law allows banks to institute accelerated composition agreement procedures in relation to indebted enterprises in order to reduce their debts (including

inter-enterprise ones, as well as indebtedness to the budget and banks and "bad" credits at banks) or spread it out over time on more favourable terms. Moreover, the law makes it possible to convert claims into shares of one-person companies of the State Treasury and state enterprise. Hence, creditors who hold at least 30% of the total claims against a company or state enterprise have the right to use this 'debt for equity swaps' procedure. There were also some influential people, within and outside the government, who warned against selling the country to foreigners.[95]

The government of **Suchocka** was brought down by a non-confidence vote in the *Sejm* in June, 1992, but continued to govern until September, 1993. The Parliament was then dissolved by President **Walesa.** As a result, Parliamentary elections were held on 13 September, 1993. The elections brought a large victory to ex-communists. The question arises; "What would the impact of this major political shift be on the Polish privatisation policy?".

B. Privatisation policy during the ex-Communist Era (September, 1993-December, 1995)

During this period there were two ex-communist governments: the **first,** led by **Pawlak,** came to office in October, 1993 and ruled until March, 1995. The **second** is the **Oleksy** Government, which took office from March, 1995 until January, 1996. The main focus of the ex-communist governments was to reduce the social cost of the transformation process.[96]

1. Pawlak's Government Era (September, 1993 - March, 1995)

This government, which came to power after the September, 1993 elections, was the first ex-communist government. Its economic policy was announced in its medium-term development strategy approved by the Parliament in the Autumn of 1994, in the form of '*Strategy for Poland (1994-97)*', which discussed in Section Three below. Concerning privatisation, this government announced its intention to commence '*mass*

commercialisation programme', which many analysts deem a substitute for, rather than a stepping-stone to, full-fledged privatisation.[97]

One of the main programmes of this government, concerning privatisation, is *'The Stabilisation, Restructuring and Privatisation' (SRP)* Programme, *which was approved by the government in October, 1994.*

a. The Stabilisation, Restructuring and Privatisation Programme[98] (SRP)

The SRP is a medium-scale privatisation scheme that became one of the top priorities of the Ministry of Privatisation. This programme differs from other SRP schemes proposed by the European Bank for Reconstruction and Development in other countries. The programme is targeted at enterprises (so-called SRP companies) that are in a critical condition, thus can be privatised in the immediate future. This can be achieved by providing appropriate cash injections, ensuring appropriate corporate governance and turn-around management expertise. Enterprises that meet specific criteria would be entitled to participate in the SRP programme on a voluntary basis, subject to approval of the MoP.

The first phase of the SRP would include 40 medium-sized enterprises in 1994. The enterprises would be privatised in two stages. In the first stage their shares and assets would be contributed by the Polish banks and at its discretion by the State Treasury and/or Agency for Industrial Development (IDA) to several so called Investment Vehicles (IVs). In the second stage, these shares would be sold to private investors within a limited period of time. If not sold, the IVs would be liquidated to ensure timely conclusion of the programme within five years. It was also intended that the SRP companies would pay dividends to the IVs within the first three years.

Each IVs would be a company created by EBRD jointly with one participating bank. The parties would contribute the equity and debt financing. Each bank would contribute equity (after conversion of the enterprises debts) and/or assets. The State Treasury and the IDA could contribute their assets, shares or cash, at their discretion.

The enterprise would be selected for the SRP Programme under streamlined procedures developed jointly by the MoP and Ministry of Industry and Trade (MoIT). The contribution of shares or assets would be done in a manner to avoid public sales to the extent permitted by the Privatisation Law of July, 1990.

The programme assumes that contributions in cash and in kind would be treated differently. Partners or shareholders (depending on the form of the company) making contributions in kind shall have ordinary rights to distribution of profits, return of capital, distribution of surplus on liquidation and their voting rights may be limited. Others, making cash contributions, shall have cash preferred rights to all the above. It was intended that IVs would be managed by professional management agreed between the EBRD and the banks. Management contacts might be used and management cost would be covered by the IVs, but any profits to the management would only be payable if the IVs are profitable.[99]

2. Oleksy's Government Era **(March, 1995- December, 1995)**

This Government took power in a period where many unknowns and many unanswered questions with regard to the future course of Poland's economic policy, were in place. The most notable are the newly announced '*mass commercialisation programme*', which came in the form of an amendment to the Law on Privatisation of SOEs of 1990, and the long delayed of the MPP. Concerning the amendment of the Law on Privatisation, Parliament did not pass the new amendments. The main achievement of this government is the implementation of the MPP, which started in November, 1995. This government went out of office in January, 1996, after the Second Presidential elections of November, 1995.

4. Conclusions

It was always stressed that the initiatives since the beginning were clearly from the neo-liberals and supporters of self-management. However, the most difficult problem the Poles had always faced was the conflict between the neo-liberals' ideologies and the realities of the Polish economy. Moreover, as the above analysis shows, the only important issue in the privatisation debate was the form of ownership, not how to achieve that form of ownership, that is to say, there was little discussion on the method of management of the SOEs before being privatised.[100]

To sum up, the Polish political environment was always under fire, and unstable. The whole privatisation process was progressing in an environment of strong pressure groups, frequent elections and a fragmented party system, apart from other important external conditions, like the collapse of COMECON.

In contrast to the era before the collapse of the Communist system, the 1990-93 period was not marked by struggle between the ex-communists and Solidarity. Instead, the dominant trend was that of Solidarity's disintegration. This was most evident in the fall of the Solidarity-based Suchocka government in June, 1993. Whereas, the September, 1993- December, 1995 period was marked, on one hand, by struggle between ex-communists and their alliances, and Solidarity, on the other.

Over the past six years (1990-95), Poland has had seven different Prime Ministers, with the negative consequences that had on the privatisation policy. It has been mentioned that privatisation policy has varied with the different views of the privatisation Ministers. The consequences can be seen in the different weightings for privatisation methods and techniques utilised in practice. For instance, **Lewandowski** favoured the MPP and trade sale, but **Kaczmarek** prefers to focus on the MPP and initial public offerings (IPO), and to a lesser degree on trade sales. In addition, Prime Minister **Bielecki** started a *'sectoral privatisation'* programme, but **Olszewski** stopped it.[101]

Box (6.4) summarises the main achievements of the different governments concerning privatisation.

Box (6.4)

The Development of the Polish Privatisation Philosophy (1990-1995)

Government/Political Party /Period	Achievements
1) **Mazowiecki**/*Solidarity* **(September 89- December 90)**	- *Law on Privatisation* - *Announcement of the official goals of privatisation*
2) **Bielecki**/*Solidarity* **(January 91 - December 91)**	- *Sectoral Privatisation* - *Regional privatisation* - *Foreign Investment law* - *Decentralisation of privatisation* - *Privatisation through Restructuring*
3) **Olszewski**/*Solidarity* **(December, 91- June, 92)**	-------
4) **Pawlak**/ *One-man government* / **(June- July, 1992)**	-------
5) **Suchocka**/*Solidarity* **(July, 92- September, 93)**	- *Approval of the Mass Privatisation Programme (MPP)* - *State Enterprise Pact* - *Law on Financial Restructuring of* - *Enterprises and Banks*
6) **Pawlak**/ex-*communist* **(September, 93 - March, 95)**	- *The Stabilisation, Restructuring* - *Privatisation Programme (SRP)*
7) **Oleksy**/ex-*communist* **(March, 95- December 95)**	- *Implementation of MPP*

Endnotes:

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[1] In fact, the third ex-communist-led government of Oleksy went out of office in January, 1996. But our concern in the study is until the end of December, 1995 for data-safe reasons.

[2] Jedrzejezak, 1993:88.

[3] Poznanski, 1992:642

[4] Poznanski, 1992:643-44; Bauman, 1994:21

[5] For instance, in the 1980s, they were challenged by the independent unions, which were interested in self-management, although the imposition of Martial law in December, 1981 curtailed the powers of the unions; nearly 2/3 of the managers were replaced. After the lifting of military rule in June, 1983, managers were subjected to renewed pressures from the workers. Moreover, following the erosion of communist power in 1988, many party units in factories were either voluntarily disbanded or removed by militant workers. As a result, managers were left with even less protection against workers' encroachment on their authority (*Poznanski, 1992:648).*

[6] Poznanski, 1992:644

[7] PPRG, 1991:13-14; Frydman & Rapaczynski, 1994; Poznanski, 1992; Gomulka & Jasinski, 1994:221.

[8] Poznanski, 1992:648-650.

[9] '*Nomenclature*' privatisation in the Polish context can mean 'informal' management-buyout privatisation (MBO).

[10] Blaszczyk & Dabrowski, 1992:13

[11] Lewandowski, 1994:4.

[12] The Polish Constitution, Article 57.

[13] This party is one of the successors to the ex-communist party (PZPR). The PZPR was disband by its delegates on 28 January, 1990, during the XI Extraordinary Congress of the Party, and transformed into the Social Democracy of the Polish Republic.

[14] Box (6.1)
The party Affiliation of Sejm Deputies in June, 1989:

Party / Year	PUWP		UPP		DP		Catholic		Solidarity	
1985	245	(53%)	106	(23%)	35	(8%)	74	(16%)	—	—
1989	173	(38%)	76	(17%)	27	(6%)	23	(5%)	161	(35%)

Source: Lewis, P (1990) Non-competitive Elections And Regime Change: Poland 1989, ***Parliamentary Affairs, 43(1):90-107.***

[15] **Box (6.2)**
The Composition of The October 1991 Parliamentary elections

The Party	% of Seats
Democratic Union	**12.31**
Democratic Left Alliance	**11.98**
Catholic Electoral Action	**8.73**
Citizen's Centre Alliance	**8.71**
Polish Peasant Party	**8.67**
Confederation of Independent Poland	**7.50**
Liberal Democratic Congress	**7.48**
Peasant Alliance	**5.41**
Solidarity	**5.05**
Others	**10.13**

Source: PPRG (1991).

[16] Box (6.3)
The Composition of the September, 1993 Parliament in Poland

The party	No. of Seats	% of Seats
SLD (Democratic Left Alliance)	**171**	**37.2**
Polish Peasant Party (PSL)	**132**	**28.7**
Freedom Union (UW)	**74**	**16.1**
Labour Union	**41**	**8.9**
Confederation of Independent Poland (KPN)	**22**	**4.8**
Non-Party Block to Support Reforms (BBWR)	**16**	**3.5**
German Minority (Other)	**4**	**0.8**
Total	**460**	**100**

Source: Blazyca & Rapacki, 1996: 88.

[17] Blaszczyk & Dabrovski, 1993; Blazyca, 1994:2

[18] Lipton & Sachs, 1990:296

[19] Blaszczyk & Dabrowski, 1993:13

[20] Lewandowski, 1994:7; Blaszczyk, 1995:75.

[21] Gomulka & Jasinski, 1994:221

[22] Poznanski, 1992:615; Slay, 1994:104.

[23] Blaszczyk, 1995:78-79.

[24] Blaszczyk & Dabrowski, 1993:15.

[25] Ibid:15

[26] Sachs, 1990

[27] Blaszczyk & Dabrowski, 1993

[28] Ibid.

[29] Frydman & Rapaczynski, 1994:13.

[30] In fact, the idea of this concept was initiated by the International Monetary Fund (IMF) and the World Bank (WB) mission during their negotiations with the Polish Government on its development policy. This idea was an integral component of a Standby arrangement (SBA) with the IMF, and the Structural Adjustment loan (SAL) Agreement with the WB (*Thumm, 1992:54; Blaszczyk & Dabrowski, 1993:17-18.*

[31] Mujzel, 1991:44; Blaszczyk & Dabrowski, 1993:18-19

[32] 15 drafts had been submitted to the Sejm, and after a long debate the current one was accepted (*MoP, 1995, Personal Communications*).

[33] In fact, the official designation of the Ministry was subject to controversy. The Sejm had rejected the Government's proposal to designate the new ministry the Ministry of Privatisation[33] (MoP). The rationale behind that was that the concept of privatisation is narrow enough and would not include other forms of ownership changes, which should be considered, such as co-operating workers' ownership, commercialised State enterprises and State-private partnership (*Fallenbuchl, 1991:54*).

[34] PPRG, 1991:29.

[35] MoP, 1995, Personal Communication.

[36] MoP, 1995, Personal Communication. During the period 1990-95 the total number of privatised enterprises through the 'privatisation via liquidation' path was 870 SOEs. Whereas the total number of privatised enterprises via all paths (including the number of enterprises handed over to the State Agricultural Agency) was 3,123 SOEs. The share of the first in the second is (32%).

[37] MoP, 1995, Personal Communication.

[38] Lewandowski, 1994:8.

[39] Ibid.

[40] The founding body is either a Minister (in most cases, the Minister of Industry and Trade) or Provincial Governor. In Poland, there are 70 such founding bodies (MoP, 1995, Personnal Communication).

[41] Chèlminski, Czynczyk, and Sterniczuk, 1994:188-190.

[42] Articles 18and 23 of the Law on Privatisation of 1990.

[43] Jones, 1993:110.

[44] This technique of privatisation appears to be unique to Poland (*Duke & Grime, 1994:160*).

[45] Article 37 of the Law on Privatisation of 1990.

[46] Based on Article 61 of the State Enterprise Act of 25 September, 1981, and its amendments.

[47] I tried to get an explanation for this during my visit to the MoP, but my attempts were fruitless.

[48] This is based on an interview in the Department of Small and Medium Sized enterprises, MoP, Warsaw, Poland, on 23 October, 1995. This arguement is confirmed by the findings of some of the survey studies conducted by the Gdansk Institute for Market Economics (GIfME), and Institute of Political Studies (IoPS).

[49] The English translation of the Polish data on Privatisation, carried out by the Polish Agency for Foreign Investment (PAIZ), is misleading. It gives the same headings to different liquidation procedures. After an interview with the Director of the Department of Small and Medium Size Enterprises, the picture became clear.

[50] I was told in the Department of SME, MoP, that this type of bankruptcy in most cases led to insolvency and much of the unemployment caused by layoffs, as shown in Section 4 above, is related to this type of winding up.

[51] Frydman *et al*, 1993:168-169.

[52] MOP, 1995, Personal communications; Frydman *et al*, 1993:169.

[53] In fact, this is confirmed by the MoP (*MoP, 1995, Personnal communications*).

[54] Frydman *et al*, 1993:169.

[55] Fallenbuchl, 1991:54. This issue will be tackled in the following section below. However, it is important to mention that under the Law on Companies with Foreign Participation of July, 1991, we find that foreigners can purchase up to 10% of the assets of the privatised enterprise freely, and up to 100% of the assets, after obtaining

approval from the Ministry, which is expected to be almost automatic except in some special cases. when I discuss foreign involvement in the privatisation process

[56] Kilick, 1995:26.

[57] MoP, 1995, Personal Communication

[58] Program Prywatyzacji ... ,1991:2.

[59] Ibid.

[60] Lipton & Sachs, 1990:127; Frydman & Rapacznski, 1994:12-13.

[61] Frydman & Rapacznski, 1994:12-13.

[62] In fact, Poland started from the beginning of the transition process, an evolution in amending its laws aiming at introducing the European Union, in order to join the European Community as soon as possible.

[63] It was Balcerowicz, the Finance Minister and Deputy Prime Minister at the time, who announced in his speech in the IMF, that the Polish Government aims at privatising 1/2 of the 8,441 SOEs in 3 years' time (*World Bank, 1991*)

[64] Olszewski was supposed to undertake the task of forming a Government, but a disagreement between him and Walesa on whether to keep Balcerowicz as Minister of Finance led to Bielecki forming a Government. Walesa wanted to keep Balcerowicz as a guarantee to the IMF for the continuity of the main directions of the economic reform programme, especially the stabilisation package (*PPRG, 1991:36).*

[65] The first free Presidential Elections were held in November/December, 1990, after a meeting between the ex-President of Poland Jaruzelski, Prime Minister Mazowiecki, The Senate Speaker, The Sejm Speaker, The Solidarity Leader Walesa, and **Primet** Jozef Glemp. The result of the meeting was that Jaruzelski agreed to shorten his stay in office and permit a new free election.

[66] Fallenbuchl, 1991:55-6; Coricelli & Rocha, 1991:106-7; Bielecki, 1992.

[67] Lewadowski, 1994:11.

[68] Myant, 1993:146; Blaszczyk & Dabrowski, 1993:18.

[69] Blaszczyk & Dabrowski, 1993:18; Fallenbuchl, 1991:59

[70] This idea was known in the West and dates back to the writings of Friedman (1976), however, for Eastern European countries, it is unique. This technique of privatisation

has never been attempted in any country the world before the collapse of the Socialist system (*Duke & Grime, 1994:149*).

[71] Blaszczyk & Dabrowski, 1993:16; Fallenbuchl, 1991:59; Poznanski, 1992:645; Frydman & Rapaczynski, 1994:150-51.

[72] Lewandowski, 1994:11.

[73] Ibid:13.

[74] I shall come back to this issue in detail in Sction Seven below, when I discuss foreign involvement in the privatisation process.

[75] Bielecki, 1992:329.

[76] MoP, 1995, Personal communications.

[77] Slay, 1994:106.

[78] Ibid.

[79] Bielecki, 1992:329; Berg, 1994:176-77.

[80] MoP, 1995: Personal Communication.

[81] This information was handed to me after an interview in the MoP, on 23 October, 1995.

[82] Ibid

[83] Blaszczyk & Dabrowski, 1993:20.

[84] Balcerowicz, 1994:80; SLAY, 1994:111.

[85] Slay, 1994:114.

[86] Slay, 1994:116; Balcerowicz, 1994:80.

[87] Ibid.

[88] In fact, **Pawlak** had been asked by President Walesa to form a government in June, 1992, which he failed to do.

[89] Bossak, 1993:10.

[90] Ibid: 171-177.

[91] The information on this Programme was handed to me following some interviews in the MoP, in October, 1995.

[92] MoP, 1995, Personal communication.

[93] An information campaign developed and implemented by a professional advertising agency, contracted by the MoP, will inform the general public of the advantages of treating an SC as a long-term investemnt. The objective of the campaign will be to

convince those who may intend to sell their SCs immediately after they have purchased them, not to do it, since excess supply could result in a temporary drop in the price.

[94] The experiences in other Eastern European countries are also very new.

[95] Blaszczyk & Dabrowski, 1993:28-9; Fallenbuchl, 1991:54; Bossak, 1993:172-176.

[96] Bossak, 1995:10.

[97] Bossak, 1995:9, 50.

[98] The information on this programme was handed to me after an interview in the Economic Department, at the MoP, in October, 1995.

[99] This programme seemed to be highly unsuccessful. My attempts to arrange an interview in the Department of Stabilisation, Restructuring and Privatisation, at the MoP, was fruitless. I was informed afterwards that the Department was unable to complete work on this progamme. Only four enterprises were privatised through this programme.

[100] Myant, 1993:135.

[101] MoP, 1995: Personal Communication

SECTION (7) STATISTICAL & ECONOMIC RESULTS OF PRIVATISATION IN POLAND (1990-95)

The main purpose of this section is to analyse the statistical and economic progress of the different paths of privatisation in Poland during the period 1990-95. The rationale is to assess the Polish privatisation process, by examining some of the main objectives set out by successive Polish governments. Specifically, to assess the following goals: to privatise half of the 8,441 SOEs within five years; to achieve a wider share ownership among the public at large, including employees of enterprises; and to generate funds from the sale of enterprises.

According to the documents of the MoP, eight general paths of privatisation were used in Poland during the first six years (1990-95), utilising 12 techniques of privatisation. The ***8*** general paths are the following:

(1) the privatisation of small local businesses - shops, catering, consumer services, construction, transport and wholesale trade business - is handled at local level by municipalities and communes, through management/employee buyouts, leasing, sale of assets, management contracts, and auctions and tenders.

The privatisation of medium and large scale enterprises is done through the following ways:

(2) 'Capital' privatisation;

(3) Privatisation via liquidation; using the Law on Privatisation of SOEs of 1990;

(4) Bankruptcy liquidation based on Article (19) of the Law on SOEs of 1981;

(5) National Investment Funds (NIFs)and their Privatisation Programme, or the Mass Privatisation Programme (MPP);

(6) Privatisation through Restructuring;

(7) Stabilisation , Restructuring, and Privatisation Programme (SRP); and finally,

(8) Sectoral privatisation.

Box (7.1) shows the 12 different techniques of privatisation utilised in Poland to privatise SOEs.

Box (7.1)

Methods And Techniques of Privatisation Used in Poland (1988-1995)

Method & Techniques	Application in Poland
A) *'Nomenclature'* Privatisation	A) During the 1988-1989 period, before the passage of the Law on Privatisation of July, 1990. Illegal afterwards.
B) Small-Scale Privatisation 1. Sale 2. Lease	1, 2) Carried out in 1990-92.
c) Medium and Large-scale 3. Initial Public Offering (IPO) 4. Negotiated trade sales 5. Public bidding	3, 4, 5) All three methods have been broadly applied since 1990, especially in so-called 'capital' privatisation
6. Leasing and similar methods, usually with the right to buy at the end of the contract period	6) Used very frequently, especially in cases of small enterprises, since 1990.
7. Sales of property in cases of bankruptcy liquidation, insolvency, or arrangements with creditors	7) Used very frequently as a privatisation method since 1990
8. Debt-equity swaps	8) Legally possible since 1993. Not yet applied .
9. Partial privatisation with large shares held by the State	9) Sometimes used, for example in the case of banks
10. Pre-privatisation with Restructuring	10) Begun in 1994 within the framework of the SRP Programme for 40 enterprises
11. Management Contracts	11) Applied very infrequently as a privatisation method.
12. Free distribution of shares	12) Implementation started within the National Investment Funds Programme, in late 1995.

Note: The classification of privatisation methods partially follows Blaszczyk (1995).

Contrasting Box (7.1) with Box (5.1) in Section Five, one notices that Poland applied twelve out of twenty one techniques and methods of privatisation available in the world. Poland, however, added two new techniques, National Investment Funds and Their Privatisation, and Liquidation Privatisation under Article 37 of the Law on Privatisation of July, 1990.

In fact, each path of privatisation has slightly different economic and social goals, and usually also applies to different groups of SOEs. Box (7.2) shows that different procedures could be applied to privatise SOEs, broken down by size and financial standing. For instance, a large SOE (which has 700-1300 employees, and very large with 1300-30000 employees), with poor financial standing (i.e. permanently indebted;

loss-making) could be wound up through the following ways: commissary management, conciliatory and arrangement proceedings; debt-equity swaps, etc.

If the firm's financial standing is average (i.e. moderately indebted; near-zero profitability), it could be wound up through the following procedures: incorporated trade sale, participation in the NIFs programme, etc..

If the financial standing of the firm is good (i.e. receivables are greater than liabilities; profitability is more than 5%), it could be wound up through the following procedures: incorporation, then IPO or trade sale, incorporation without subsequent privatisation, etc..

1. Small Privatisation

This type of privatisation was made possible by the Act on Economic Activity of December, 1988 and the Act regulating the rental of trade premises, as amended in June, 1990.[1] The most important techniques of privatisation used in Poland to privatise small-scale enterprises are leasing arrangements and sales of assets.

This kind of privatisation is the most successful part of ownership transformation in Poland. Table (7.1) shows that during the period 1990-92, the ownership of 31,662 retail shops, 19,690 service and crafts memberships, 1,186 small factories, 54,591 pieces of real estate, and 67,151 apartments were transferred to private hands. That accounts for over 95% of the total number of small-scale enterprises all over Poland. However, progress with small privatisation was rather uneven. Local officials in some areas resisted small privatisation and local governments often seemed to prefer to lease State-owned shops and stores rather than sell them.

Box (7.2) : Recommended Property Conversions of State-Owned Enterprises as a Function of Their Size and Financial Status

Size of the Enterprise	Financial Status of the State-Owned Enterprise		
	Bad (persistent debt, negative profitability)	Average (reasonable debt, profitability near zero)	Good (accounts receivable > accounts payable, profitability > 5 percent)
Large (700-2,000 employees and Enormous 2,000-30,000 employees large property value of more than 300 billion)	1. management by committee 2. bank settlement procedures 3. exchange of debt for equity 4. government guarantees/grants 5. paid-in contribution to the company 6. conversion into a company unit of the State Treasury and "trade sale" 7. liquidation 8. bankruptcy	1. conversion into a company unit of the State Treasury and "trade sale" 2. conversion into a company unit of the State Treasury and National Investment Fund 3. management by committee 4. bank settlement procedures 5. exchange of debt for equity	1. conversion into a company unit of the State Treasury and the sale of shares on the Stock Exchange + "trade sale" 2. conversion into a company unit of the State Treasury (without privatization) 3. leaving it as a state-owned enterprise
Average (300-700 employees small or large property value of up to 400 billion)	1. management by committee 2. bank settlement procedures 3. exchange of debt for equity 4. the enterprise's paid-in contribution to the company 5. sale of the enterprise 6. liquidation 7. bankruptcy	1. conversion into a company unit of the State Treasury and the National Investment Fund 2. the enterprise's paid-in contribution to the company 3. conversion into a company unit of the State Treasury and "trade sale" 4. conversion into a company unit of the State Treasury and management contract 5. management by committee 6. sale of the enterprise	1. conversion into a company unit of the State Treasury and "trade sale" 2. conversion into a company unit of the State Treasury and the National Investment Fund 3. leasing the enterprise 4. paid-in contribution to the company 5. sale of the enterprise 6. leaving it as a state-owned enterprise 7. conversion into a company unit of the State Treasury (without privatization)
Small (20-300 employees small property value of up to 100 billion)	1. management by committee 2. sale of the enterprise 3. paid-in contribution to the company 4. liquidation 5. bankruptcy 6. municipal ownership of the state-owned enterprise 7. conversion into a budgetary unit	1. sale of the enterprise 2. the enterprise's paid-in contribution to the company 3. management by committee 4. municipal ownership of the state-owned enterprise 5. conversion into a budgetary unit	1. leasing the enterprise 2. sale of the enterprise 3. paid-in contribution to the company 4. municipal ownership of the state-owned enterprise 5. conversion into a budgetary unit

Source: Ministry of Privatization

Explanatory Notes:

- Management by committee on the basis of Article 65 of the Law on State-Owned Enterprises
- BFU-bank settlement procedures on the basis of Article 5 of the Law on the Financial Restructuring of Enterprises and Banks
- exchange of debt for equity on the basis of Article 43 of the Law on the Financial Restructuring of Enterprises and Banks
- paid-in contribution to the company on the basis of Article 37, paragraph 1, item 2 of the Law on the Privatization of State-Owned Enterprises
- conversion into a company unit of the State Treasury on the basis of Article 5 of the Law on the Privatization of State-Owned Enterprises and then a "trade sale" or capital privatization for active investors
- liquidation on the basis of Article 19 of the Law on State-Owned Enterprises
- bankruptcy on the basis of bankruptcy law (Executive Order from the President of the Republic of Poland dated October 24, 1934)
- sale of the enterprise on the basis of Article 37, paragraph 1, item 1 of the Law on the Privatization of State-Owned Enterprises
- conversion into a company unit of the State Treasury on the basis of Article 6 of the Law on the Privatization of State-Owned Enterprises and then participation in the National Investment Fund program
- leasing the enterprise on the basis of Article 37, paragraph 1, item 3 of the Law on the Privatization of State-Owned Enterprises
- conversion into a budgetary unit on the basis of Article 16 of the Budget Act
- municipal ownership of a state-owned enterprise on the basis of Article 5 of the law in the prescriptions introducing laws on territorial self-government and the civil servants in autonomous administrations

The end result was that small privatisation often left "privatised" property in state ownership. Leasing arrangements made under small privatisation were more likely to leave the physical structure (and thus official control) intact.[2]

The predominant form of privatisation of retail and service premises and small factories was leasing, while for building lots and departments it was sale. Table (7.1) indicates that only in the case of small factories has there been a clear upward trend in the dimensions of privatisation. Downward trends have occurred in the privatisation of shops and service premises, though there has been an increase in the ratio of sales to leasing. Finally, after a marked downturn in 1991 in the scale of privatisation of building lots and apartments, business on this market clearly recovered in 1992.

Table (7.1)

Properties Sold and Leased Under Small-scale Privatisation

Type of Property	1990 Sold	1990 Leased	1991 Sold	1991 Leased	1992 Sold	1992 Leased	Total Sold	Total Leased
Retail Premises	778	13,101	296	10,587	824	6,076	1,898	29,764
Service Premises	428	7,252	271	6,777	852	4,110	1,551	18,139
Small Factories	38	218	113	224	249	344	400	786
Building lots	16,420	1,788	8,001	5,460	15,698	7,224	40,119	14,472
Apartments	33,930	690	8,384	2,408	17,862	3,877	60,176	6,975
Total	51,594	23,049	17,065	25,456	35,485	21,631	104,144	70,136

Source: ***Own calculations, based on data provided by the Small and Medium sized Enterprises Department, MOP, Warsaw, Poland.***

The most characteristic feature of trade and services privatisation is not only the radical change in ownership and management of former State, co-operative and municipal shops, but the parallel expansion of new trading outlets all over Poland. For example, in 1989, the number of shop premises in the whole country was less than 150,000, and by 1992 it exceeded 540,000. It is of importance to mention that both privatisation and the growth of the private sector in trade and services, plus intense competition from street vendors, radically improved the quality of trade services in Poland.[3]

The sale of small-scale service enterprises has been administered by local councils. Shops, restaurants and building services were legally transferred to local authorities in May, 1990.[4] The sale of the assets of these small businesses started after October, 1990. However, most of them were rented or leased before that. This indicates that

small-scale privatisation was done without a special government programme, because the Government concentrated on the transfer of the real estate on which these businesses had been operated. In Poland, as well as most Central and East European countries, the privatised units did not include real estate. Typically, the buyer purchased inventory and equipment, and acquired the right to lease the premises from the owner, usually the State or Municipality. While this type of arrangement is, of course, normal around the world (and real estate might be privatised separately), it might create disincentive for new owners if the term of the lease is too short or inflexible.[5]

Privatisation of small economic units, such as shops and service outlets, is frequently lumped together with the sale and leasing of somewhat larger production units under the common rubric of small privatisation.[6]

The most important objective of the privatisation of small trade and services establishments is a speedy introduction of owner-management businesses. Frydman & Rapaczynski (1994) argue that such individual or family-run units have some advantages. First, it can quickly adapt to changing circumstances and reallocate the existing stock of consumer goods. Second, it can create room for action by relatively numerous entrepreneurial individuals. Third, it can also create an important middle-class constituency for the new regime.

The process of transferring businesses to what is called 'employee-buyout arrangements' has often been opposed by concerns about the justice, fairness, and efficiency of the process and the commitment to the use of market mechanisms in the course of privatisation.[7]

At the start of the privatisation process, the Polish Government, like other governments in the region, announced its intention to rely on open auctions as the preferred or exclusive method of small-scale privatisation. However, in practice, only a small percentage of the overall number of municipally-owned shops rented during the period 1990-1992 was allocated by auction, despite the fact that prices set at auctions were

often 30-40 times higher than the bureaucratically-set rents. This was for the following main reasons: (1) the strong pressure from the enterprises' 'insiders', which usually resulted in a series of special preferences, either in the form of price reductions or entry restrictions. (2) the municipal and local governments favoured the use of administrative allocations, as it gave them the possibility to favour their political clients, which resulted in some corruption.[8] However, the MoP explains that by saying that the process of preparing an auction (i.e. from the time of opening the auction, until the time of signing the contract) is money and time consuming.[9]

2. *Medium and large-scale privatisation*

a. The pace of ownership transformation

When Poland started the privatisation process, there were 8,441[10] large and medium sized SOEs. By the end of September, 1995, there were 3,500 SOEs.

Table (7.2) shows the number of SOEs included in the process of ownership transformation, by the main privatisation paths, during the last six years (1990-1995). Out of the total number of 8,441 SOEs, 5,208, or 61.7% were included in the process of ownership changes in different stages[11]. However, Table (7.3) shows that only 1,575 SOEs, or 18.7% of the total number of 8441, completed the process of ownership changes, i.e. privatised or liquidated. So, the MoP was unable to privatise half of the 8,441 SOEs in the five years time span[12]. As can be seen from Table (7.2), 1,074 SOEs were transformed into companies solely owned by the State Treasury; 1,098 SOEs were assigned for 'privatisation through liquidation', based on Article (37) of the Law on Privatisation of July, 1990; 1,377 for bankruptcy liquidation based on Article (19) of the Law on SOEs of September, 1981; 1,659 State-owned farms (shown in the Table) were handed to the State Treasury Agriculture Agency to be privatised or liquidated; 513 SOEs and STCs were included in the Mass Privatisation Programme.

As can be seen from Table (7.3), from the very beginning of the privatisation process until the end of December, 1995, only 159 out of 1,074 STCs were completely privatised through the 'capital' privatisation path, and about 350 STCs were included in

the National Investment Funds (NIFs) programme. The remaining 565 STCs are still in various transitional stages of the 'capital' privatisation path.[13]

Table (7.2)

The Number of SOEs in the Process of Ownership Transformation by Path of Privatisation (1990-1995)

Date end of December	Total	Transformed into STCs	Liquidation Article (37)	Bankruptcy Article (19)	Agriculture Agency
1990	130	58	28	44	-
1991	1249	260	449	540	-
1992	2056	480	719	857	539
1993	2526	527	917	1082	1342
1994	3002	713	1041	1248	1595
1995	3549	1074	1098	1377	1659

Source: ***Data provided by MOP, Economic Department.***

As can be very clearly seen from Figure (7.1), both curves which illustrate the number of SOEs that were privatised or liquidated are increasing at a declining base starting from 1993, while the curve which illustrates the number of SOEs which were converted into State Treasury companies, is (almost) increasing at an accelerating rate, especially since 1993. This general trend reflects the ex-communist Governments' privatisation policy, which tried to slow down the privatisation process by adopting a policy of *'mass commercialisation'*.

Table (7.3)

The Number of SOEs Privatised by Method of Privatisation (1990-95)

End of December	Total	Capital Privatisation	Liquidation Article (37)	Bankruptcy Article (19)
1990	6	6	0	0
1991	228	27	182	19
1992	612	51	475	86
1993	977	99	707	186
1994	1,325	134	897	293
1995	1,575	159	1,032	384

Source: ***Data provided by MoP, Economic Department.***

Figure (7.1) illustrates the number of SOEs privatised and liquidated by different paths of privatisation, during the period (1990-95).

Figure (7.1)
The No. of SOEs privatised and liquidated by different paths of privatisation (1990-95)

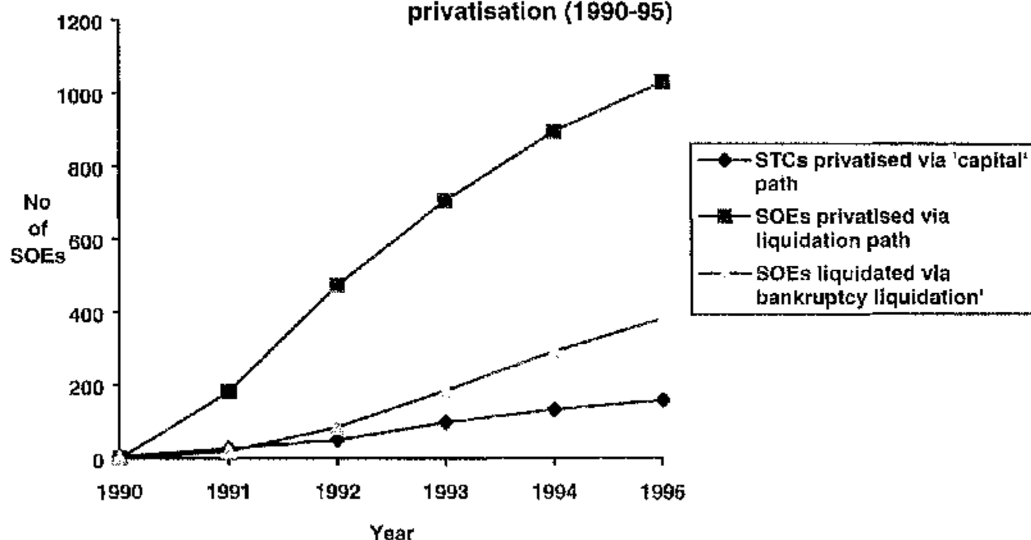

Table (7.3) shows that out of the 1,098 SOEs starting the process of liquidation under Article (37), 88% of them were completed. Out of 1,377 SOEs starting the process of bankruptcy liquidation, based on Article (19) of the Law on SOEs of 1981, only 29% of them were completed. This indicates that the path of privatisation via liquidation under Article (37) is the fastest track of privatising medium and large SOEs, i.e. the most time-effective, and most popular way of property rights transfer in Poland.

To make the whole picture clear, I would like to briefly discuss the other forms of ownership changes.[14] As of December 31, 1994, 263 SOEs were communalised (i.e. handed over to local governments under the Law on Communalisation); 118 SOEs were transformed into 58 companies of the State Treasury under the Law of February, 1993 of Transformation of Enterprises of Special Importance to the State (temporarily they are not subject to privatisation). 449 SOEs were liquidated under bankruptcy procedures. Altogether, up to the end of December, 1994, 5,427 SOEs were subjected to different ownership changes. Including the number of SOEs which were subjected to different ownership transformation as at the end of December, 1995, altogether 5,841 SOEs were subject to different ownership transformation. Hence, about 70% of the total number of 8,441 SOEs started the process of ownership changes, at the start of the

transformation process. One can conclude that the Polish authorities were unable to privatise the 8,441 SOEs in the five years time/span.

Table (7.4) shows the number of SOEs in the process of ownership changes by economic activity and privatisation path, as at December, 1994.

Table (7.4)

Number of SOEs in the Process of Ownership changes by Economic Activity and Privatisation Method (as of December, 1994)

Economic Activity	Total	Capital Privatisation	Liquidation Privatisation Article (37)	Bankruptcy Liquidation Atricle (19)
National Economy	3002	713	1041	1248
Industry	1298	582	341	375
Construction	805	97	371	337
Agriculture	319	2	56	261
Forestry	11	2	3	6
Transportation	158	13	23	122
Telecommunication	1	0	1	0
Trade	269	14	169	86
Other	141	3	77	61

Source: ***MoP, December, 1994, Dynamika Prywatyzacji, No. 23.***

Table (7.4) shows that most of the privatised SOEs via the 'capital' privatisation and bankruptcy liquidation paths are from the industrial sector. Whereas, the construction sector ranks first in the case of privatisation via the liquidation path. The Telecommunication sector seems to be uninvolved in the process of privatisation, except for one case through liquidation.

Table (7.5) shows that most of the SOEs included in the process of ownership transformation are concentrated in 12 out of 49 voivodships in Poland. In the total, Katowic ranks first, followed by Warsaw, Lodz, and Poznan. In the 'capital' path, Katowic ranks first, followed by Olsztyns, Warsaw and Poznan. Warsaw ranks first in the path of privatisation via liquidation, followed by Katowic, Lodz and Poznan. Katowic ranks first in the path of bankruptcy liquidation, followed by Warsaw and Wroclaws.

Table (7.5)

Number of SOEs in the process of Ownership Changes by Viovodship and Method of Privatisation (as at December, 1994)

Voivodship	Total	Capital Privatisation	Liquidation Privatisation Article (37)	Bankruptcy Liquidation Article (19)
Poland	3002	1248	1041	713
Warsaw	191	56	90	45
Bielsko	67	21	15	31
Bydgoszcz	100	41	31	28
Gdansk	108	35	43	30
Katowice	290	105	84	101
Krakow	113	41	43	29
Lodz	140	59	55	26
Olsztyn	115	73	32	10
Poznan	136	56	55	25
Szczecin	77	10	48	19
Wroclaw	115	30	53	32

Source: ***MoP, December, 1994, Dynamika Prywatyzacji, No. 23.***

1. 'Capital' Privatisation

'Capital' privatisation is made possible by the Law on Privatisation of SOEs of July 13, 1990, based on Articles (5), (6), and (19). Capital privatisation, which was intended for medium and large enterprises, consists of two phases of action: first, the transformation of a State enterprise into a single-person company of the State Treasury and secondly, putting its shares up for sale.

a. Techniques of privatisation via the 'capital' path

Table (7.6) shows that, in all cases, enterprises were privatised via the 'capital' path, using mixed privatisation techniques. These techniques combined Initial Public Offering (IPO), employees and management buy-outs (EMBO), foreign investors, domestic investors, and in some cases, the State Treasury kept some stocks[15]. Throughout the period 1990-September, 1995, surprisingly, in only one case, the STC was 100% sold to its employees. That was in 1990, when the MOP's Capital Privatisation Department privatised *Zaklady Miesne Inowroclaw* sp. z.o.o (meat plant) in the town of Inowroclaw to its employees[16]. In addition, two cases were 100%

privatised through IPO, in 1994. The first was in January, *Rafako SA*, and the second was in December, the *Bytom SA*[17].

Table (7.6) shows that out of 146 STCs privatised through 'capital' privatisation as at the end of September, 1995, only 23 STCs were privatised through the so-called IPO, and their shares were traded on the Warsaw Stock Exchange; 53 STCs were sold to domestic investors; while 70 STCs were sold to foreign investors.[18]

Table (7.6)

Number of STCs Privatised By Technique of Privatisation (1990-95)

year	Stock sold by IPO	Stock sold to Domestic Investor	Stock sold wholly or partially to foreign active Investor	Total number of privatised companies
1990	5	--	-	6
1991	6	11	7	24
1992	1	3	17	21
1993	3	18	27	48
1994	7	15	14	36
1995 (Sept)	1	6	5	12
Total	**23**	**53**	**70**	**146**

Source: ***Own calculation based on data provided by the MOP, Department of Capital Privatisation, Warsaw, Poland.***

Figure (7.2) illustrates the number of State Treasury Companies privatised during the period 1990-95.

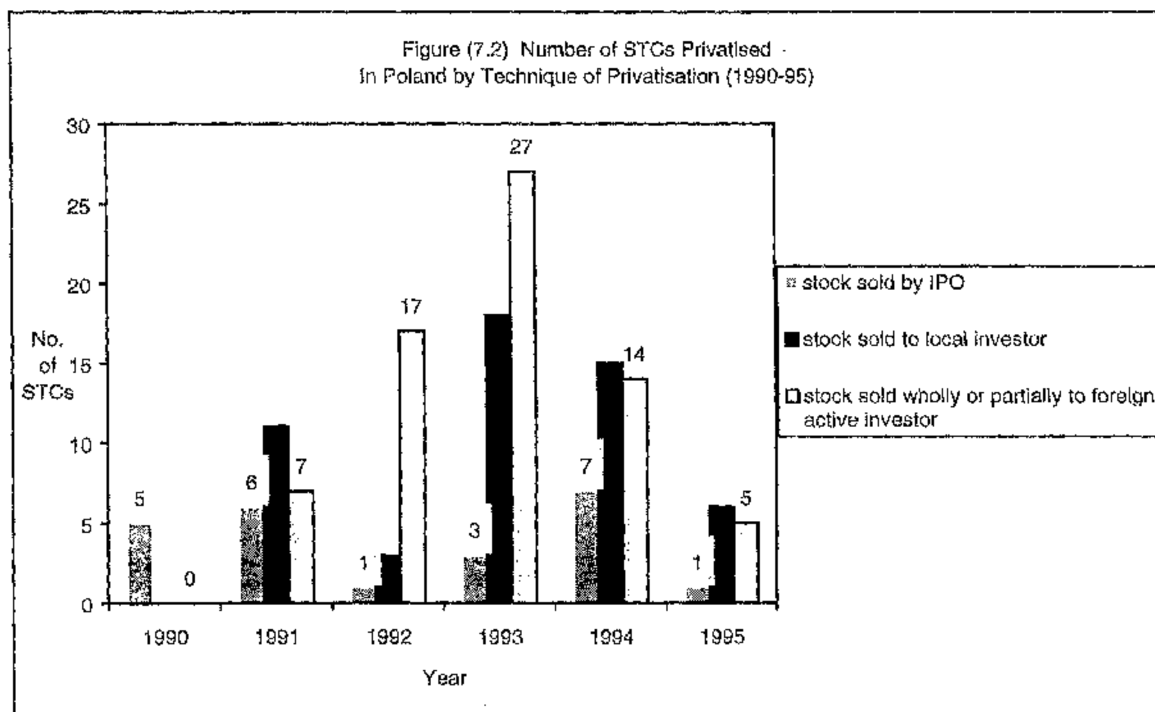

Figure (7.2) Number of STCs Privatised In Poland by Technique of Privatisation (1990-95)

It can be obseved that the direct sale of shares of privatised companies to foreign or domestic investors was generally more prevalent than privatisation through Initial Public Offerings. Around half (70 out of 146, or 48%) of the capital privatisation projects were executed with the engagement of foreign capital. The main reasons behind the fact that 'sale to a strategic investor' is the most popular way of privatisation via the 'capital' path are: (1) the shortages of household savings; (2) to attract foreign investors; (3) the limit which was put on the participation of employees in this path of privatisation; and finally, (4) to improve the corporate governance of these companies.[19] In fact, the participation of foreign capital was the highest in larger projects, where the size of joint stock was above 500 billion zloty.[20]

Did the MoP achieve the goals of wider range of ownership via the 'capital' path of privatisation?. Did it generate funds to the Budget?

b. Privatised STCs via the 'capital' path by the economic sector

Table (7.7) shows that out of 146 enterprises privatised through the capital path as at September, 1995, 116 belong to the industrial sector and 12 to the construction sector. The remaining enterprises belong to transportation and telecommunication, as well as trade sectors. This reflects the importance of having a clear and solid industrial policy in Poland during the transition process, as the high percentage share of the industrial sector in the privatisation process affects the whole process of economic development in Poland.

Table (7.7)

The Number of STCs Privatised Via 'Capital' Path by Economic Sector (1990-September, 1995)

Sector	1990	1991	1992	1993	1994	Total
Industry	5	19	20	39	33	116
Construction	1	3	1	4	3	12
Agriculture	0	0	0	2	0	2
Telecom	0	0	2	0	1	3
Transport	0	0	0	2	0	2
Total	6	22	23	47	37	146

Source: ***Own calculation, based on data provided by the MOP, Department of Capital Privatisation, Warsaw, Poland.***

d. Assessment of the effects of 'capital' privatisation path

One may observe that from the quantity point of view, out of all transformed SOEs until September, 1995 (i.e. 1,531), only 9.7% have been privatised through the 'capital' way, or only 1.7% of the 8,441 SOEs at the beginning of the transformation process. One should remember, however, that these enterprises are much bigger than others, employ more people and represent an important part of the former State owned sector. From the quality point of view, one should add that most enterprises privatised on the capital track, especially through foreign equity investment, show very good economic performance, and in many of them, an in-depth restructuring process has been launched.

Thus, one can conclude that this type of privatisation covers a small number of enterprises, and is limited by its cost, which is estimated by the MoP to be up to 10% of the value of privatised assets. Costs cover the valuation and the execution of the

transaction, implementation time (on average about one year) and political controversies. However, this type of privatisation has an important impact on the performance of the whole economy, if one bears in mind that these enterprises were restructured, and their performances improved.[21]

2. Privatisation through Liquidation based on Article (37)

This path of privatisation is destined for medium and small scale sized SOEs in a healthy financial situation. Three main types of procedures (or combinations of procedures) are possible in liquidation under the Privatisation Law of July, 1990: the sale of an enterprise's assets, leasing, or entering them as a contribution in kind into new companies.

Table (7.8) shows the number of privatised enterprises under Article 37 of the Law of Privatisation of SOEs of 1990, by disposal of assets.

Table (7.8)
Number of privatised Enterprises under Article 37 by Method of Disposal of Assets (as of December, 1994)

	Enterprises Privatised by liquidation	
	Total	in %
Total	**1041**	**100.0**
Sale	**179**	**17.2**
Contribution of assets into privatised companies	**46**	**4.4**
leasing	**736**	**70.7**
mixed procedures	**81**	**7.7**

Source: ***Own calculation based on data provided by the MOP, Department of Capital Privatisation, Warsaw, Poland.***

Table (7.8) shows that out of the total number of SOEs privatised through liquidation, as at the end of December, 1994, 70.7% were leased to either employers or managers; 17.2% were sold; 4.4% had their assets contributed to privatised companies, and the rest were liquidated using mixed procedures. The high share of leasing is explained by the relatively simple legal form of such transformation, and the support of employees and managers for this type of privatisation.[22]

The leasing technique can be classified as a quasi-sale method because of the time-shift in payments and different possible purchase facilities foreseen by the Law. The price for such a lease is an effect of negotiations without public bid and the payments are made by instalments. The facilitated access to the purchase of such companies does not mean that this privatisation path is without difficulties. In most cases, the employee-owned firms have a difficult financial situation because of repayment of principal and interest and limited access to credit. They are spending too little on investment. Despite these difficulties this group of enterprises shows better economic results than expected and makes efforts towards more rational use of their assets, and to a more efficient ownership structure of their capital.[23]

3. Bankruptcy liquidation based on Article (19)

This privatisation path is destined for small and medium sized SOEs with a poor financial situation. The assets of these enterprises are sold by the liquidator to third parties in a public bidding by auction, and the proceeds go to pay off the creditors. The Law on SOEs of 1981 states that an SOE with assets insufficient to pay off all its debts may also be declared bankrupt on the basis of the bankruptcy Law that applies to commercial companies.[24]

As can be seen from **Table (7.2),** as at the end of December, 1995, 1,377 SOEs were involved in this type of privatisation. Table (7.3) shows that out of this number, 384 enterprises were completely liquidated. Although the successors to the liquidated SOE under Article 19, are not obliged to take on liabilities in the majority of cases, especially when the State is the creditor, it is noticeable that the percentage share of this type of liquidation projects completed (32%), is smaller than that under privatisation through liquidation under Article (37) of the Law on Privatisation of 1990. That is mainly explained by four major factors: (1) lack of support by 'insiders' to this kind of liquidation, mainly because of the high likelihood of losing jobs. (2) low levels of demand for such assets. (3) the lack of a 'cohesive' group interest in the rapid completion of this procedure for any given SOE. (4) the long and complicated legal and commercial procedures needed for this type of liquidation. For instance, it takes

time to search for and appoint a liquidator, and then it takes time and effort to sell the assets of the liquidated enterprise. Finally, there is some delay in paying of the enterprises' obligations in cases where the creditor is not the State.[25]

Table (7.2) shows that there is a general decline in the number of SOEs privatised starting from 1993. This can be explained by the *new privatisation policy* adopted by the ex-communist Governments. After September, 1993 the MoP tried to slow down the privatisation process, in order to prevent severe unemployment stemming from these privatisations in general, and from liquidations in particular. This conicides with the declared policy of reducing the social costs of the transition process annnounced by the first ex-communist Governmnet of Oleksy in the Autumn of 1993.[26]

3. The involvement of foreign investors in the privatisation process

The history of foreign capital in Poland dates back to the 1970s, as noticed in Section Two. However, no real progress in this field was recorded by the end of 1988. Following the changes in the economic system in Poland, the number of companies with foreign participation started to grow rapidly.[27]

a. The extent of participation of foreign parties in privatisation

The extent to which foreign parties participate in the privatisation of SOEs is determined by: (a) the Law of 1981 on SOEs; (b) the Law of 1990 on Privatisation of SOEs; (c) the Law of 1993 on NIFs and Their Privatisation; (d) and the Law of 1991 on Companies with Foreign Participation. Under the provisions of the Law of 1990 on Privatisation of SOEs, foreign parties may participate in privatisation in the cases of :

1) ***'commercialisation'*** by purchasing the shares of commercialised enterprises through tender, in a public offer, as a result of negotiations undertaken after a public invitation, and in special cases another method is possible, upon the consent of the CoMs on the recommendation of the Minister of Privatisation.

2) **Liquidation**, by purchasing the whole enterprise or organised parts of its assets, by creating a company together with the State Treasury to which the whole liquidated

enterprise or the whole liquidated enterprise or organised parts of its assets are contributed, or by leasing the liquidated enterprise or organised parts of its assets.

3) **Launching** a rescue programme, by creating joint-venture companies with a Joint-Stock Company owned by the State Treasury, or with an SOE, by concluding a managerial contract with a Joint-Stock Company owned by the State Treasury, or by taking part in the Mass Privatisation Programme through participation in Supervisory Boards and management commissions of NIFs.

Most of these transactions have to be approved by the Minister of Privatisation. Another significant limitation of the participation of foreign parties takes place in the process of employee lease of assets, where the scope of persons taking part in privatisation is limited mostly to the employees of privatised enterprises.[28]

The participation of foreigners, according to the Law of 1993 on NIFs and their Privatisation, is limited to not more than one third of the Board. A foreigner may not be the President of the Board. Investment Funds may conclude agreements concerning the management of their assets with firms selected by public tender. Only Polish citizens are able to acquire share certificates in NIFs.

b. The scope of foreign investment in Poland

Taking the investment objective as the main criterion, it may be assumed that foreign subjects are able to engage in four kinds of investment in Poland[29]:

(1) **Direct investment,** in which the main criterion is conducting business activity for profit. These are mostly long-term investment projects of a tangible nature. (2) **Portfolio investment**, aimed at attaining profits from trade in securities and derivatives of financial markets. These are mostly short-term investments. (3) Purchase of **real property**, treated separately due to its specific nature, which can be realised also for purposes other than those mentioned in (1) and (2) above. (4) **greenfield (new) investments.**[30]

In fact this classification is not perfect, as it is very difficult to determine the type of investment without knowing the investors' intentions. To elaborate: a purchase of shares on the Stock Exchange, which can relate to both direct and portfolio investment, is a good example here. In such a case, the nature of investment can only be guessed at from the size of the purchased interest. In the case of Poland, it is assumed (by the National Bank of Poland) that the purchase of shares of 10% or the share capital of a company is a portfolio investment. The purchases above that limit are regarded as direct investment.[31]

Foreign direct investment (which can be either ***direct acquisition (privatisation)*** or ***indirect acquisition (Joint-venture))*** is the most welcome form of investment by all countries. Such investment creates jobs, and contributes to the economic development of the host country. In Poland, the following regulations apply for FDI: (a) the Law of 1920 on Purchasing Real Property by Foreigners; (b) the Regulation of 1976 of the COMs on conditions, mode and organs appropriate for issuance permits for foreign natural and legal persons to settle permanent establishments (branch, representation) on the territory of the Polish People's Republic to perform economic activity. (c) selected provisions of many legal regulations, in particular those pertaining to financial services, telecommunications, transport and maritime economy. Foreign investors may without a permit (with the exception of clearly specified cases in the Law of 1991 on Companies with Foreign Participation or on separate regulations) take up activities in the form of a *joint-stock company, limited liability company, or permanent establishment (branch, representation, etc.).*

In the case of companies, the general rule is the absence of any upper or lower limits on the share of foreign capital in the company. Foreign parties may acquire or purchase up to 100% of the company's shares. They can do this by: "(1) *establishment on their own or together with Polish partners (shareholders) a completely new company, i.e. greenfield investment;* (2) *purchasing shares of companies on the primary and secondary security market;* (3) *entering direct transactions with the owner, especially*

the State Treasury which seems to have a lot to offer to foreign investors in the privatisation process".[32]

Portfolio Investment in Poland is regulated by two laws: **first**, the *Foreign Exchange Law of 1994 and the Regulation of June 18, 1993 of the Minister of Finance on the General Foreign Exchange Permit,* based on the previous Foreign Exchange Law. Accordingly, foreign investors may transfer abroad or reinvest in Poland, only the incomes from securities foreign persons are allowed to trade in, purchased for the Polish currency acquired from the sale of convertible currency to foreign exchange banks, or purchased against the Polish currency being income from these securities. **Second,** the *Law on Public Turnover in Securities and on Trust Funds of 1991.* The scope of purchasing securities may be determined in the prospectus by their issuer, however, the issuer must get a permit from the State Commission on Securities to be able to put securities into public turnover.[33]

In the case of Poland, the opportunities for portfolio investments are provided first of all by the Warsaw Stock Exchange, where securities of several tens of companies, including banks, are traded. Until recently, considerable restrictions were applied to the purchasing of securities on the Stock Exchange by foreign parties. Namely, foreign subjects were required to obtain a permit from the MoP or other competent Ministries for every transaction of purchasing shares of a company conducting activities subject to licensing or permits. It can be assumed that this administrative requirement was a particular barrier to short-term investments (portfolio investments). This issue found an advantageous settlement for most companies represented on the Warsaw Stock Exchange through using the Regulation of the Council of Ministers of July 26, 1994. It specified cases in which the activities mentioned in Article 6 paragraph (1) of the Law on Companies with Foreign Participation do not require a permit. However, permits for the acquisition of shares of companies in public turnover are still required in the case of firms: (a) *managing sea-or airports* or, (b) *operating in real property agency and turnover.*[34]

c. Involvement of foreign investors in the privatisation processes

The concern of this part of the study is to investigate, specifically, the involvement of foreign investors in the privatisation process. This section assesses how successful the privatisation process was in attracting foreign investment into Poland. Therefore, the following analysis focus on companies with foreign participation established as a result of privatisation procedures set forth by the Law on Privatisation of SOEs of July, 1990. Data is only available on two privatisation procedures:

1) the transformation of an SOE into a joint-stock company owned solely by the State Treasury followed by individual sales and their contribution to the equity of the newly established company;

2) liquidation of an SOE enabling contribution of its assets to the equity of the newly established company.

Table (7.9) shows the number of companies with foreign participation established in the process of privatisation of SOEs, by establishment (acquisition of shares of joint-stock companies owned by the State Treasury and contribution of assets of liquidated SOEs), during the period 1990-95.

Table (7.9)

Number of Companies with Foreign Participation By Establishment (1990-95)

Year	Total		Acquisition of Shares of Joint-Stock STCs		Contribution of Assets of liquidated SOEs	
	No.	%*	Number	(As a % of Total *)	Number	(As a % of Total *)
1990	2	20.0	-	-	2	50.0
1991	15	32.6	7	23.3	8	50.0
1992	39	48.8	24	47.1	15	51.7
1993	75	48.1	51	52.0	24	41.4
1994	91	45.6	65	49.6	26	38.3
1995	107	n.a	70	n.a	37	n.a

Source: ***Durka, 1995:86, based on data from the Central Statistical Office, 1994, Prywatyzacja Przedsiebiorstw Panstwowych wg stanu, Wasrsaw, Poland.***
Note: * Total refers to the total number of private companies established through transformation of SOEs or contribution of assets of liquidated SOEs..

As can be seen from Table (7.9), the number of companies with foreign participation set up as a result of the privatisation of SOEs increased from 2 at the end of 1990 to 107 at the end of 1995. Likewise, the share of companies with foreign participation in the total number of private companies established as a result of transformation or contribution of assets of liquidated public enterprises increased from 20% at the end of 1990, to 45.6% at the end of 1994.

As Table (7.9) shows, foreign entities which participated in the acquisition of shares of joint-stock companies owned by the State Treasury is twice the number of cases than in privatisation through contribution of assets of liquidated SOEs.

Table (7.10)

Number of Companies with Foreign Participation By Establishment and Investor Country(1990-95)

Country of Origin	Total	Acquisition of Shares of Joint-Stock STCs	Contribution of Assets of liquidated SOEs
Germany	31	22	9
Netherlands	12	8	4
USA	12	11	1
Austria	3	1	2
Luxembourg	2	2	-
Spain	2	2	-
Denmark	2	-	2
UK	5	3	2
Russia	1	-	1
Switzerland	4	2	2
Sweden	4	2	2
Finland	1	1	-
Hong Kong	1	1	-
Canada	1	-	1
Italy	1	1	-
France	1	1	-

Source: ***Durka, 1995:87, based on data obtained from the Central Statistical Office, 1994, Prywatyzacja Przedsiebiorstw Panstwowych, Wasrsaw, Poland.***

The main characteristic in the participation of foreign investors in the process of privatisation of SOEs was their concentration in the privatisation of industrial firms. As much as 80% of companies established through the acquisition of shares of State Treasury-owned companies (STCs), or through the contribution of assets of liquidated SOEs, operated in industry. During the period under analysis, it is noticeable that only one such company was established in each of the agriculture, transport, trade and communications sectors. This indicates that in the sphere of material production the

role of foreign capital in the privatisation of public assets corresponds with the general tendency whereby foreign capital investment in Poland is concentrated in industry.[35]

Table (7.10) shows that most companies established through the privatisation of state-owned assets involved participation of foreign capital from the European Union countries as well as from the USA and Switzerland. Germany is ranked first, with the USA and the Netherlands joint second.

4. Revenues from Privatisation

Table (7.11) shows that the total stream of revenues from privatisation in 1991-94 amounted to zl 3030.6 million (i.e. some US$ 1.6 billion), its rate of growth considerably exceeding inflation levels. For example, in 1994 total privatisation proceeds increased by 204%, while the GDP deflator amounted to 21.6% and CPI 32.3%. On the other hand, one should bear in mind that during the 1991-93 period, the budgetary goals of privatisation tend to underperform. Also, one should overestimate the weight of privatisation receipts in overall budget revenues: in 1991 the former constituted only 0.8% of the latter, and in 1992 and 1993 it was 1.5% and 1.7%, respectively. It rose to 2.5% in 1994, with an expected 2.9% in 1995.[36]

Table (7.11)

Revenues from Privatisation (1991-94) (zl million)

Path of privatisation	1991	1992	1993	1994
Total	170.9	484.4	780.4	1594.9
Divesture of SOEs	140.5	312.6	493.4	1272.0
Liquidation	30.4	171.8	287.0	322.9

Source: ***Data provided by MoP.***

The percentage share of the total revenues from privatisation to GDP increased from 0.2% in 1991 to 0.5% in 1993, and to 0.7% in 1994.[37] The income resulting from privatisation was disappointingly small in comparison with the expectations of the politicians, who saw privatisation as a financial source which would aid in the

consolidation of the State Budget. This aspect of privatisation, however, comes into coflict with other goals of privatisation, especially those of the restructuring and modernisation of enterprises. Some enterprises (especially those privatised through management buy-out or employee buy-out methods) experience serious difficulties in the payment of the purchase price (which is often to be paid over a period of several years as part of a leasing agreement or a similar arrangement) or limit their investment activity in order to be able to make such payments.

5. Conclusions

Did the Polish privatisation process achieve the goals mentioned at the start of this section?.

Regarding the goal of fast implementation of the privatisation process, the answer depends not only on what we mean by fast or slow, but also on whether we are studying the pace of the different paths of privatisation, or comparing the different sectors of the economy, or even whether we are comparing the pace of the privatisation process in Poland with that in other countries in the region.

A glance at the total *number of privatised enterprises* in the past six years 1990-95 shows that the implementation of the whole process of privatisation was slow. The objective of the Polish Governments to privatise half of the SOEs within five years, has not been realised. Only about 70% of the total number of 8,441 SOEs has been included in the process of ownership changes, while less than one fifth has actually been privatised or liquidated.

The process of privatisation was slow during the period September, 1989-December, 1991, due to the lack of a legal and institutional framework for privatisation. But it was fast during 1992-September,1993, when it can be described as "*revolutionary by the historic experience of the country and the region, and extraordinary by Western experience*". It started slowing down again after September, 1993, due to the ex-Communist Governments' policy of reducing the social cost of the transformation process.

As for the *method of privatisation*, small-scale privatisation was very fast, as Poland was able to privatise more than 95% of the small-scale retail wholesale, and construction enterprises, by the end of 1992.

As for *economic sectors*, the industrial sector accounts for more than 30% of the total number of privatised enterprises. The construction sector ranks second.

Regarding the *path of privatisation*, Bankruptcy liquidation ranks second, while 'privatisation through liquidation' comes first.

As for the *size of enterprise*, small-scale enterprise was the fastest, followed by medium and large enterprises.

Contrasting the pace of privatisation by the *financial standing* of the enterprises, the data shows that enterprises with good financial standing were the fastest, but those which required restructuring (i.e. those commercialised before being privatised) needed more time.

Therefore, one can conclude that Poland failed to proceed with privatisation as swiftly as had originally been hoped.

To sum up, one can argue that lack of capital markets, shortages of households savings, lack of domestic or foreign investors, strategic public opposition, and political constraints, are the main factors responsible for the slow pace of privatisation. See Section Five for other reasons behind the slow pace of the privatisation process.

Regarding the goal of achieving a wider share ownership among the public at large, including employees of enterprises, one cannot tell exactly how many people in Poland as a whole participated in the privatisation process, and have some shares in the privatised enterprises. This applies to employees of privatised enterprises as well. However, one can argue that through the MPP a wider share ownership would be

achieved,[38] but whether this would be to the benefit of privatised enterprise and the economy as a whole, it is difficult to assess. However, one can examine the type of control over firms that has emerged as a result of privatisation, and then recommend one type of control over the other, according to the possible and desired impact on the firms. Hence, there is a need to investigate the impact of the privatisation process on the privatised enterprises.

As for the goal of generating funds from the sale of enterprises, it was to a large extent, disappointing. This was because the vast majority of enterprises were liquidated rather than sold.

In the next section, I shall investigate the impact of privatisation on the performance of enterprises during the period of study.

Endnotes:

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[1] MoP, 1995, Personal Communication.

[2] Slay 1994:107.

[3] MoP, 1995, Personal Communication.

[4] MoP, 1995, Personal Communication.

[5] Frydman & Rapacznski, 1994:151; Ash, Hare & Canning, 1994:229; Blaszczyk, 1995:100.

[6] Frydman & Rapacznski, 1994:149.

[7] Ibid.

[8] Frydman & Rapacznski, 1994

[9] MoP, 1995, Personal Communication

[10] The number of SOEs has increased from about 7,000 SOEs in 1989, to 8,441 in 1990, due to the deconcentration and demonopolisation policies (see *Blaszczyk and Dabrowski, 1993*; and *the Anti-monopoly Office, Anti-monopoly Report 1991-3, 1994*, for more details).

[11] This number includes 1,659 State owned farms transferred to the State Treasury Agriculture Agency.

[12] Section Five analyses the main constraints to privatisation in Eastern Europe in general, with some hints on Poland.

[13] MoP, 1995, Personal Communication.

[14] Data on other forms of ownership changes was delivered after an interview with the Head of the Department of SME, the Ministry of Privatisation, on 23 October, 1995.

[15] In cases where the MoP kept some stocks, 5% was kept for reprivatisation.

[16] Based on information delivered by the Department of Capital Privatisation, following an interview with the Department of Capital Privatisation in October, 1995.

[17] See footnote number 5.

[18] Ibid.

[19] MoP, 1995, Personal Communication.

[20] Ibid.

[21] Ibid.

[22] Ibid.

[23] Blaszczyk, 1995:96.

[24] Ibid:97.

[25] MoP, 1995, Personal Communication; Blaszczyk, 1995:98.

[26] Ibid.

[27] Durka, 1995:41; Kubilas; 1995.

[28] Law on Privatisation of SOEs, of July, 1990

[29] Generally speaking, three basic modes of FDI can be distinguished in the literature: greenfield (new) investment; indirect acquisition through establishment of a joint venture; and direct acquisition which a foreign investor buys a share (partially or entirely) in a local company.

The *greenfield* mode is selected if the production process is labour intensive. High labour intensity lowers the relative cost of a greenfield venture. Furthermore, this mode of investment is chosen when the investor's name and products are widely known in the local markets; when the costs of restructuring an acquired local company prove to be higher than the establishment of a new operation, and when an unresolved ownership status due to the restitution process could be a serious impediment to privatisation.

Indirect acquisition (Joint-ventures) is an appropriate way to gain access to a new business if it is uneconomical or risky for a foreign investor to make a greenfield investment. This type of acquisition works best when pooling resources and competencies produces a competitive advantage. The foreign investor brings technology and know-how; the local partner contributes a plant site, qualified labour, and knowledge of the local laws and government operation.

Direct acquisition (privatisation) is likely to be successful if the acquired enterprise is in a capital intensive industry, making a greenfield investment very costly. In addition, direct acquisition is appropriate if the local producer has a strong market share and local brand recognition as well as a well developed local supply and distribution network. *(Dunning and Rojec, 1993).*

[30] Durka, 1995; Kubilas, 1995.

[31] NBP, 1995, Personal Communication.

[32] Durka, 1995:23.

[33] Ibid.

[34] Ibid:22.

[35] Ibid:86. In fact, I was informed, both in the Ministry of Finance (which is responsible for the privatisation of the banking system) and the Ministry of Privatisation, that foreign investors are considerably more interested in privatisation of the banking sector.

[36] MoP, 1994; Szomburg, 1995; GUS, 1994.

[37] The World Bank, 1994: 115.

[38] More than 13 million people are participating in the MPP by May, 1996.

SECTION (8) THE IMPACT OF PRIVATISATION ON ENTERPRISES

The main concern of this section is to investigate the impact of privatisation on the performance of enterprises. More specifically, this section analyses the performance of privatised enterprises, the State Treasury Companies, and SOEs, before and after privatisation.

It is argued that it is much easier to initiate reform programmes such as price liberalisation and privatisation than it is to actually change the behaviour of enterprises. Without adjustment in the behaviour of enterprises, however, improvement in economic performance will at best be limited, and the ability of reformers to sustain their reform programmes will be threatened.[1] From this argument, the importance of this section of the study arises.

The hitherto privatisation effects can be analysed either in the context of particular paths of ownership transformations, or viewed from the angle of the ownership structure resulting from privatisation. The question that should be answered is; "What type of ownership system has emerged in Poland?".

1. Who are the new owners?

Legally, the following types of ownership structure can be distinguished in Poland:

(1) Public sector: SOEs, STCs, State legal persons, and mixed.

(2) Private sector: domestic co-operatives; individual proprietorships; domestic partnership; foreign; and mixed.[2]

The degree of *affinity* between these different kinds of nominal private ownership and the typical behaviour of effective private ownership varies. The difficulty in forms of ownership in the private sector are those of "domestic co-operative

ownership", and "domestic partnerships' ownership". The first represents a form of ownership of a kind that was developed within the Socialist economic framework, and basically designed to resemble State ownership. More complicated is the composition of entities classified under the second form, where some of the enterprises in this group arose either as new firms, or as a result of the transformation of individual proprietorships' ownership by means of private Polish capital (or with the participation of foreign capital). However, many of the large firms now assuming this legal form of ownership are products of privatisation of SOEs.[3]

The transformation process in Poland created *de jure* rather than *de facto* private property. However, one should not expect that a change in the form of ownership of an SOE means that overnight, or even from one year to the next, its current and strategic objectives begin to resemble those of private business in advanced market economies.

The criteria for classifying firms according to the different types of corporate control, was provided by Berle and Means (1932). Their classification focused on the stake owned by one party- individual, family, financial group, etc.. Most researchers [4]classify corporations according to the following types of control:

(1) privatised companies with a *dispersed investor*, in which the majority of the equity is dispersed among a wide set of stockholders, none of whom has a controlling interest;

(2) companies in which a *single foreign investor* has a majority holding (51-100%);

(3) a foreign investor has a *majority minority* holding (30-50%) and the rest of the stock is dispersed;

(4) companies in which a *domestic investor* has a *majority* holding (51-100%);

(5) a *domestic* investor has a *majority minority* holding (30-50%) and the rest of the stock is dispersed.

(6) managerial/employee control - if there is no base for external control.

The groups bearing the greatest resemblance to West European private ownership are the second and third; to a much smaller extent, this can be said of the fourth and fifth groups. In the first group, the process of development into effective private ownership is running into numerous difficulties connected with, among other things, the inertia of the old system of ownership and in particular, employee interest. For this group consists primarily of SOEs sold off on a leasing basis to companies formed by their employees. It is often emphasised that if these companies are to become fully-fledged private business enterprises, they have to find a domestic or foreign strategic investor.[5]

In Section Five, we distinguished between two general types of control; '*insiders*' control and '*external*' or '*outsiders*' control. With an increasing number of directors sitting on more than one board of directors, it is difficult to detect the network of interlocking directorates. To detect the existence of monitoring shareholders, some thresholds should be defined for qualified majority control, minority control, blocking minority, and dominating influence. If no one threshold is reached by an individual or a coalition of shareholders, one can conclude that a managerial control prevails.[6]

The whole arithmetic of corporate control relies on the implicit "*one share- one vote*" assumption, according to which any vote at a shareholders meeting has the same weight whatever corporate capital concentration could be. It is of importance to mention that such an assumption is of course debatable, in particular when some shareholders are within the firm (and hold insider information); in this case, although they are entitled to decision-making in proportion to their property rights, they actually enjoy stronger economic power within the corporation than other shareholders. Hence, it is often the case that corporate control increasingly relies on the control of information, and is decreasingly based on capital ownership.[7] What is the case in Poland?

2. *Corporate control and privatisation in Poland*

Bear in mind that one of the main aims of privatisation is to establish legitimate and effective private control over enterprises. In Poland, the main consequence of privatisation of SOEs is the move from a *State* or "*political*" and/or "self-management" Socialist control system, to another system of corporate control.[8] The aim of this part of the study is to examine three privatisation approaches adopted in Poland, in terms of their effectiveness in establishing legitimate and effective private control over enterprises.

a. Corporate control in 'capital' privatisation

The type of control created through this form of privatisation is in two stages: the first is the move from *self-management control* to *State Treasury control.* This new form of corporate control involves the establishment of a board of directors to replace the self-management and workers' councils, new managers, and some forms of enterprise restructuring. In the second stage, there was a move from *State Treasury control* to other types of control, such as '*outsiders' control (domestic or foreign 'strategic' investors)*, or *MEBO 'insider' control.*

As explained in Section Seven, Table (7.6), for the whole period 1990-September, 1995, shares of 70 STCs which were privatised via the 'capital' privatisation path, were sold to *foreign 'strategic' investors.* Also, shares of 53 STCs were sold to *domestic 'strategic' investors.* This means that only about 123 companies in a situation of *external control.*

Table (8.1) shows the distribution of shares of privatised STCs by the percentage share of new investors.

Table (8.1)
The Distribution of Shares by Type of Control

Year	Total	Majority (51-100%)		Majority minority (30-50%)		Majority Management/ Employees	Dispersed Ownership (IPO, DI, ST, EMP, Mgt)
		FI	DI	FI	DI		
1990	6	-	-	-	-	-/1	5
1991	24	6	8	-	2	-	6
1992	23	14	7	-	-	-	2
1993	48	20	12	2	3	- /2	5
1994	36	10	14	-	1	1	8
Total	137	50	41	2	6	1/3	26

Source: ***Own calculation, based on data from MoP, Department of Capital Privatisation, Warsaw, Poland. Note: FI: Foreign investor, DI: Domestic Investor. IPO:Initial Public Offering, ST: State Treasury, Emp: Employees, Mgt: Management.***

As can be seen from Table (8.1), in 1990, only six enterprises were privatised in Poland. The shares of one of these (*Zaklady Miesne Inowroclaw limited liability conpany-* meat plant*)* were 100% sold to its employees. This enterprise is now under an '*insiders control'*. The shares of the other five were sold through IPO. For example, the shares of one of them (*Exbud S.A.* -construction civil engineering) were sold as follows: 45% of them through IPO, 20% to its employees, 17.5% to the management, and 17.5% to the International Trading and Investment company (of the USA). Since 45% of the shares was sold through IPO, in which the exact number of shareholders is unknown, it is difficult to detect exactly who sustains a monitoring position over corporate management.

Table (8.1) shows that in 1991, out of 24 STCs privatised by the MoP via the 'capital' privatisation path, the majority of shares (67-80%) of 6 STCs was sold to *foreign 'strategic' investors*. For example, 80% of the shares of *Polbaf S.A.* (potato processing), at Glowno, was sold to an American food company (Basic American Food Inc.). The other 20% of shares was sold to its employees. So, one can assume that these 6 companies are under '*external control'*.

Table (8.1) shows that the majority minority of shares (30-50%) of 2 STCs was sold to *foreign 'strategic' investors*. In this case, it is difficult to assess who exactly has the power of controlling these companies.

In addition, Table (8.1) shows that the majority of shares (60-80%) of 8 STCs out of the 24 was sold to *domestic 'strategic' investors*. For example, 80% of the shares of *Norblin Walcownia Metali* (rolling mill), in Warsaw, was sold to the well-known Polish '*Universal*' Company. The other 20% of the shares; 19.9% was sold to the employees, and 0.1% was sold to the State Treasury. So, one can assume that these 8 companies are under "*external control*". Finally, the shares of 6 STCs were dispersed among a wide set of stockholders. It is difficult, therefore, to identify exactly who has the power of controlling these enterprises.

Table (8.1) shows that in 1992, out of 23 STCs privatised via the 'capital' privatisation path, the majority of shares (51-80%) of 14 STCs was sold to foreign 'strategic' investors. The majority of shares (53-80%) of 7 of the 23 was sold to domestic 'strategic' investors. And shares of one STC were dispersed among a wide set of stockholders.

The general trend is almost the same in 1993 and 1994. The majority of the shares of the privatised STCs went to 'strategic' investors (domestic and foreign). Therefore, one can conclude that most of the SOEs that were privatised through the 'capital' privatisation path are now under *external control.*

b. Corporate control in 'privatisation via liquidation'

The type of control created through this form of privatisation was a move from State or self-management control, mainly to *MEBO 'insider' control*. The picture looks approximately as follows:

By the end of 1994, 1041 SOEs were privatised through the 'privatisation via liquidation' path. Out of these, 736 SOEs, 70.7%, was leased mainly to their

personnel, and are now under '*insider' control.* It is expected that companies that have the character of an MEBO '*insider' control* nature will change to 'insider' MBO or 'outsider' control nature companies.[9]

c. Corporate control in Mass Privatisation Programme

Mass privatisation in Poland means a move from State Treasury control, in the case of STCs, and/or self-management control, in the case of enterprises which were not participating in the 'capital' path, to a new structure of control. Although this is explained in Section Six, it is worth remembering that the initial shareholding structure of companies directly after the contribution of their shares to NIFs is as follows: 33% to the "*lead*" NIF, 27% to the other NIFs, 15% to the employees of the company, 25% to the State Treasury. In fact, this programme involves an extreme separation of ownership and control. It ensures that control over each firm is attributed immediately to an NIF, in which citizens will own shares. In addition, to avoid an excessive concentration of risk, these mutual funds are partially diversified with minority stakes in other companies, ensuring some contest over corporate control.

One cannot tell how the final picture of the ownership structure (of the enterprises participating in MPP) will look when the Universal Share Certificates are traded on the Stock Exchange. So the most worrying aspect is that the dispersion of ownership may fail to create the private control over enterprises necessary to harden firms' budget constraints. However, one should bear in mind that the main rationale for 'mass' distribution of shares is the limitation of "*political*" (State) interference in the day-to-day economic management of the enterprises.

How is the performance of the enterprises under the new form of control?. Or, what is the impact of privatisation on the performance of enterprises?.

3. *Privatisation impact on the performance of enterprises*

This part of the study relies heavily on a number of *survey studies* done by certain Polish institutions to evaluate the impact of privatisation on the behaviour and performance of privatised enterprises, commercialised enterprises, and SOEs. The following is an analysis of the findings of some of these studies.

a Study number one[10]

This study is based on 187 enterprises (of which 171 were transformed through the so-called liquidation privatisation path, and 16 were commercialised) based on a questionnaire technique. The main purpose of the study is to investigate the following issues, after the transformation process: the economic and financial performance of these enterprises; the participation of employees in the ownership transformation; the main barriers that confronted the ownership transformation; and an appraisal of the activities of State enterprises taking part in the privatisation process. The study covers the period 1990-1991. It is of importance to note that the way of presenting the findings of the study looks like a comparative analysis between the performance of commercialised and liquidated enterprises, however, it should only be read in a way to compare the performance of these enterprises before and after privatisation. The main findings of the study can be summarised as follows:

1. The commercialised procedure embraces mainly large enterprises, whose parent body before transformation into a Joint Stock Company was the appropriate Ministry. By contrast, the liquidated enterprises are typically small or medium single-plant enterprises, subordinated to voivodships, and transformed mainly into Limited liability companies.

2. The study confirmed the belief that privatisation leads to a reduction of employment. The average drop in employment in the commercialised firms was 10% and in those liquidated, 15%. In the commercialised enterprises, the cuts in employment in individual groups of workers were similar and did not lead to shifts

in the pattern of the relationship between the number of people in managerial positions and actual workers (11 workers to a manager, on average). In the liquidated companies, the cuts affected managerial staff in the first place (down 25%) and administrative personnel (down 20%).

3. Regarding the question; (a) "Who initiated the scheme for transformation?". The answer is: directors in three-quarters of commercialised enterprises, and one-half the workers' councils. (b) "Was the transformation process followed by a change in the position of the managing director?". The answer is: Yes, 9% in commercialised enterprises, and 18% in those liquidated. It was found that in enterprises in which the director was replaced after the transformation, the initiative came from workers councils in double of the cases where the initiative came from the director. This was observed both in the commercialised and in the liquidated enterprises. In other cases, the initiative came from the director. (c) "What are the sources of financing of employee stock ownership?. In most cases the employees earmarked their savings, equivalent to one-third of the average monthly wage, for the purpose. In some 30% of enterprises, the employees took advantage of the possibility of using the funds of the transformed enterprises as credit for the purchase of stock by employees. By contrast, only in 10% of enterprises did the employees resort to expensive bank loans.

4. The performance of the commercialised and liquidated enterprises after the change of the ownership, is shown in Box (8.1).

As can be seen from Box (8.1), the economic performance of the commercialised enterprises deteriorated more than that of the liquidated ones. Moreover, the commercialised enterprises showed a less frequent tendency to remedy the economic situation, which is confirmed by shifts in the pattern of costs, the value of fixed assets and the smaller drop in the value of sales than among the liquidated enterprises. In fact, if we realise that the general trend in the whole economy showed a decline in the growth rates, one can have a clear picture on the performance of the transformed enterprises. The rate of return in SOEs in 1990 and the first half of 1991

shows that the overall drop was bigger than among the liquidated enterprises, and similar to the level recorded in wholly owned Treasury companies.

The fact that the number of loss-making commercialised companies was growing considerably indicates that commercialisation alone, without further structural and ownership transfer, will not significantly improve the economic situation of the enterprises. In fact, this is a very early result at a very early transformation stage.

Box (8.1)

The Performance of the Commercialised and Liquidated Enterprises

(1) Commercialised Enterprises	(2) Liquidated Enterprises
i) Applied to large enterprises	**i)** Applied to small enterprises .
ii) Converted mostly into LLCs	**ii)** Mostly converted into JSCs.
iii) Indebtedness of assets compared to the value of their assets was 1/2 of the liquidated enterprises.	**iii)** Indebtedness is twice that in the commercialised enterprises
iv) A deterioration of sales of financial products and collection of payment for them.	**iv)** showed the same behaviour as that of the commercialised.
v) The value of inventories of financial products rose by 50%.	**v)** The value of inventories fell by an average of 38%.
vi) The growth of receivable was fast.	**vi)** The growth of the receivable was slow.
vii) No information on the value of the assets is given.	**vii)** The value of fixed assets dropped by 13.3%, which would be a sign of an attempt dispose of redundant assets.
viii) The value of the completed investment rose ... slowly.	**viii)** The value of the completed projects rose quickly.
ix) The relation of the value of investment projects to the value of the assets of the enterprises suggests that the level of investment spending was low.	**ix)** same performance.
x) Costs rose by 58% .	**x)** Costs rose by 55%.
xi) Wages grew by 13.3%.	**xi)** Wages grew by 18.6%.
xii) Net profits fell by 87% before tax and by 73% after tax.	**xii)** Net profit fell by 68% before tax and by 37.6% after tax.
xiii) Lower rate of return.	**xiii)** Higher rate of return.
ivx) The number of loss-making companies grew at a higher rate.	**ivx)** The number of loss making enterprises grew at a lower rate.
vx) Foreign participation was low (2.5%).	**vx)** Foreign participation was low as well (3.0%).

Source: This is a summary of the findings of the study of **Olko-Bagienska, Pankow and Ruszkowski, 1992, "*Privatisation of State Enterprises 1990-91: Results of Empirical Studies*", (FES:Warsaw), Poland.**

b. Study number two[11]

This study is based on interviews with the managers of 20 enterprises, and on data provided by the companies surveyed. The chosen enterprises represent different paths of privatisation, different regions in Poland, different industries, and different sizes of enterprises. 13 enterprises were operating in a free market, and most of them operate in quasi or full market competition.

The main goals of this study were to investigate the impact of the different paths of privatisation on the efficiency of companies' performance prior to, and after privatisation, as well as finding the main barriers to, and distortions of the privatisation process. The main findings of the study can be summarised as follows:

1. According to the interviews conducted with the managers of these enterprises, it was found that the expectations of wage rises were among the most common reasons for embarking on transformation processes. The study confirmed that hypothesis. In most enterprises, wages increased immediately after the new economic entity had started its operations. Only one enterprise showed a temporary decrease in wages. In half of the surveyed enterprises, wage increases and the change of the legal form of enterprises operating were accompanied by simplification of the wage system. In only two, the wage system was inaccessible to the researchers.

2. In most of the surveyed enterprises privatisation was not accompanied by mass employment reduction, because that had happened before the privatisation took place-except in two liquidated enterprises.

3. As for the enterprises transformed using the capital, liquidation, and commercialisation paths, the supervisory councils were not changed. In an enterprise privatised through the contribution of assets to a joint venture company, it seems that the foreign partner is more active in working out a strategy, although all decisions are made together. This is an example of full co-operation between the supervisory council and the board.

4. In enterprises privatised through the liquidation path, on the basis of the Law on SOEs of September 24, 1981, the structure of initial capital resulted in diversified participation by domestic and external capital, and various proportions of capital distributed among management and other employees.

5. In all of the analysed cases of the sample, a member of the former management, usually the managing director, was appointed Chairman of the Board.

6. Banks continued to extend credit to firms which were customers prior to privatisation, although banks were unwilling to participate in the privatisation process or to finance restructuring programmes or investments undertaken by privatised enterprises.

7. The study found that in only 3 out of 20 surveyed enterprises, privatisation contributed to expansion in the number of selling outlets (mostly foreign markets) thanks to assistance from the new institutional co-owner. But in general, privatisation did not influence the configuration of supplies and customers.

8. Regarding new capital and know-how, the surveyed enterprises showed no changes, because priority was given to the transformation of ownership rights.

From the above findings, one cannot rely on these results as they are too early, and the sample is very small. However, some lessons can be learned.

c. Study number three[12]

This study covers the period 1992-93. The findings of this report are more reliable than those of the first, as it covers a period when the conditions of a market economy in Poland have already started functioning.

This study investigates the responses of the SOEs and commercialised enterprises to the process of economic transformation. The study is based on the findings of the

questionnaire technique, and on open interviews repeated in half-year cycles. It follows the standard pattern of questions on financial standing, wage and employment policy, organisation structure, production and sales pattern, changes in market position, the composition of ownership control transformation, and prospects for the future of the enterprises. 50 enterprises were chosen to represent different regions, different branches and industries of the economy (heavy industries and municipal companies were not included, owing to the clearly specific features of their operation and different sizes of enterprises. Out of the 50 chosen enterprises, 33 were still SOEs, and 17 were commercialised. One weak assumption in the study is that SOEs and commercialised companies were assumed to be the same. This is not true, because the second is now subject to 'hard budget constraints' (HBC) not to 'soft budget constraints' (SBC). The main findings of the study can be summarised as follows:

1. The profitability of SOEs has declined at the beginning of 1992 for the first time in 4 years, but improved in 1993.

2. Loss-making SOEs increased in 1991 by 30%, in 1992 by 40% and in 1993 by 50%. According to the data of GUS, at the end of 1989 and during the first half of 1990, profitability of SOEs was 40% and 30% respectively. That is because of SBC and a sharp price increase and a one-step devaluation of the zloty against the US dollar. However, these extremely advantageous operating conditions disappeared when the switch was made to tough financial policies, which provided for a real interest rate and the introduction of the internal convertibility of the zloty.

3. The sample shows that profits decreased by 15%, 20% and 9% in 1990, 1991 and 1992 respectively, because of shock stabilisation. But in the first half of 1993, profits in the sample increased, and according to GUS, profits of the SOEs grew as well. The study argues that these changes merely unveiled the actual capabilities of SOEs in the conditions of an open market and real competition. As soon as the sources of easy revenues ran dry, the seller's market was over, and methods of cost and income calculation became rationalised, it transpired that many goods were

unstable, their manufacturing costs were excessively high, and that firms were unable to cope with the new conditions. Most of these enterprises were too slow to adjust their structures, being either over-expanded or ill-organised.

4. Regarding profitability, the study argues that medium-sized enterprises performed best. It seems that large enterprises, operating for many decades in the advantageous conditions resulting from financial and political support, have turned out to be vulnerable giants, unaccustomed to market conditions and unable to respond sufficiently quickly and flexibly to the changes in their environment. For most of them, the new operational conditions became a source of mounting difficulties, and for many of them, the cause of financial collapse.

5. The study found that small firms were the first to overcome a financial crisis.

6. The economic situation of firms holding a monopoly position was not substantially different from that of other firms, and in the case of several large enterprises it was definitely worse than the average.

7. The most advantageous economic situation was reported by enterprises which were the first to embark on necessary adjustments, regardless of their market position or their size. Adopting a "wait-and- see" attitude caused mounting difficulties, which as a consequence, blocked any restructuring of their financial system.

8. The worst affected, in terms of sectors, were the light (mostly clothes) and the electro-engineering (mostly electronic) industries.

9. Economic Situation: The best economic situation was enjoyed by the mineral industries (mostly construction materials) and chemical industries (mostly pharmaceutical).

10. Financial Liquidity: The observations of the study were as follows: the ratio of inter-company debts to firms' turnover has been rising steadily and during the last

three years has increased more than threefold. The larger the firm, the more acute the arrears problem. The total value of payable and receivable of a typical small firm almost equals that of its 3 month turnover. The study found that this figure did not change much during more than 3 years. However, it more than doubled for medium-size enterprises, despite being equal for the two groups of companies at the starting point. The figure was a fivefold rise for the large enterprises, which indicates that the problem of payment arrears is primarily the concern of large firms. Moreover, the growth of inter-company bad debts in this group of economic entities is definitely faster than that for the whole public sector, and showed no signs of slowing down.

The study found a specific correlation between the level of payment arrears in companies and their profitability. For example, both in firms showing high or very high profitability and those characterised by average or even low profitability, the amount of outstanding payments did not, as a rule, exceed the value of their two or three month turnover during the last three years. Firms which were permanent loss-makers contributed most to a substantial rise in this ratio within the whole group of companies surveyed. The study shows that in the period 1990-93 their payment arrears to turnover ratio increased more than threefold, and hence concluded that large companies and firms in a very poor financial condition contributed most to the creation of payment arrears in the sector of SOEs.

The study concluded that large but economically non-viable firms have for a long time been looking for a chance to *survive* by avoiding paying their debts. Within a system of inter-connected channels linking up the whole economy, it is very difficult to find the primary source of losses. Quite often social and political reasons are taken into account, protecting large enterprises from liquidation. This shows that the system of payment arrears has, from the very moment of the introduction of tough economic policies, taken over the role of subsidising and rationing which used to be the case under the so-called SBC. On the other hand, in 1992, there was a change in the attitude of main creditors within the public sector, as many of them were encouraged to fight hard to regain their property, because of the deteriorating financial liquidity. The study concludes, therefore, that the problem of payment

arrears cannot be solved within the sector of State enterprises, and there is a need for new regulations to help this situation[13].

11. Credit Facilities: The study shows that the number of uncreditworthy enterprises again rose considerably. In the whole economy, this figure increased by 80%, although in the second half of 1992 this trend was clearly slowing down. SOEs which in 1990 abstained from taking credits are now more eager to benefit from external sources of financing. It is the large and least viable firms that take most credit in relation to their turnover. In the case of small enterprises, during the period 1991-93, the amount of credits obtained approximately equalled the value of their monthly turnover, and this ratio turned out to be relatively stable in the same period. This led to the conclusion that small and more prosperous firms have, since the beginning of transformation, been the most cautious in availing themselves of external financing sources, carefully calculating their chances of repaying any credits taken. Secondly, large enterprises entered the period of transformation with the burden of very sizeable debts, resulting from 'old credit obtained in the 1980s, which seriously affected their economic situation in the 1990s. In order to rescue their situation, they were forced to seek new credit facilities or to defer payments of their obligations, with interest capitalisation adding to their debts. Trying to avoid a total lack of financial resources, the weakest firms kept on taking credits as long as they were able to find creditors. For these firms, credits were the only chance for survival, hence their costs had, in this case, only marginal significance for the firms in question.

12. Production adjustment and investment: The study discovered that 30% of the surveyed enterprises undertook no adjustment, because most SOEs had already started to run out of resources. 30% of them introduced new products. Large enterprises were quite active in this aspect. The incidence of "no adjustment at all" was only slightly higher among monopolies than other firms.

Medium-sized enterprises were the most active in the field of investment. Their increased adjustment activity, and to some extent their relatively better opportunities

for developing financing, were the main factors responsible for their active achievement.

Intensified efforts to cut production costs, coupled with environmental protection measures, represent a new phenomenon in the field of investment during the period of study. In ten enterprises, investment projects were aimed primarily at cutting energy and material consumption. One firm even decided to purchase a research and development centre. In eight other firms, investment projects were expected to contribute first of all to environmental protection, such as sewage treatment plants, acoustic shields and dust collection facilities. In the latter, both outside pressure in the form of penalties, claims by residents, etc. and also a changed attitude among company management and employees towards this issue, due to better recognition of environmental hazards, were of special importance.

Regarding sources of investment financing at an enterprise level, the study showed that firms' own resources still account for a major part of investment outlay in the case of 20 out 50 enterprises covered by the study.

13. The study found that the proportion of exports in the value of sales of surveyed enterprises amounted to 25%, ranging from 18 to 20% in the following years, and reaching its lowest level in 1991. There are numerous causes for a decline in the proportion of exports in turnover. The major ones include: the loss of sales to the East (the former Soviet Union) and over-valuation of exports in the first half of 1990, due to the exchange rate policy, i.e. a relatively high dollar to zloty exchange rate at the start of the programme, followed by the constant depreciation of dollar revenues until May, 1991.

The study points out that there was a drop in domestic sales, and attributed it to the opening up of the economy, the marked growth in competition on the domestic market, the decline in effective demand, and the disintegration of the COMECON and USSR, besides the EC market restrictions.

13. Regarding employment, the study of the sample shows that cuts in employment affected only some manufacturers, and was the result of the drop in sales and the deteriorating financial situation of the enterprises, rather than from an action planned as part of market strategy or as an attempt to meet future challenges. Although medium-sized enterprises experienced the lowest drop in employment, they enjoyed the highest profitability per employee.

14. As for wage policy, the study noticed that among the surveyed enterprises wage differentials were growing. Generally wage policy is shaped by the need to eliminate tensions among employees. Enterprises affected by poor financial standing attempted to stay within the statutory government limits for wage growth tax (EWGT) in their financial plans.

15. Did '*commercialisation*' have any particular significance, according to the size of enterprise?. In this study, there was an attempt to test the hypothesis of government officials that commercialisation, apart from paving the way for privatisation, would contribute to better management, following the liquidation of Employee Councils and introduction of Supervisory Boards in commercialised firms. The findings of the study indicate that no such improvement has occurred. Regarding the performance of large enterprises, commercialisation itself has not had any significant impact them. Small enterprises showed the same attitude. Medium-sized enterprises presented a different case. In many respects, non-commercialised medium-sized enterprises out-performed (their profitability was 10.8%) the commercialised ones (their profitability was 7.9%). The investment activity ratio for non-commercialised enterprises amounted to 3.1 on average, compared with 1.9 for the commercialised ones. Only the wage spread (measured as a maximum to minimum wage ratio) was somewhat smaller in non-commercialised enterprises than the commercialised ones (7.3 to 1 and 8.6 to 1, respectively).

From the above analysis, one could conclude that since 1990, the management of Polish State enterprises has been radically altered by a powerful combination of internal and external forces. On the one hand, macroeconomic stabilisation and entry

to the free market has subjected firms to competitive pressures for the first time in 45 years, forcing management to transform, rationalise, and streamline existing practices. On the other hand, the collapse of the Communist Party, the renewal of the legal recognition of Solidarity, and the reinvestigation of dormant Employee Councils unleashed an internal struggle over managerial roles and competencies. Small and medium-sized enterprises were the first to be exposed to the competition environment. Conversely, large and monopolistic enterprises have been slower to adjust to the rigours of the market, and less capable of transforming the internal struggles that accompanied political change into adjustment strategies. Moreover, one could also argue that the steep decline in overall economic output during 1990 and 1991 was principally the result of internal struggles over management and the combination of "competing trade unions", "powerful Employee Councils" and "weak managers" created a "Bermuda Triangle" that blocked the ability of reforms to pursue socially painful, but economically necessary policies.

4. Study number four[14]

This study covers the period January, 1990 until the first quarter 1992. The sample covers 55 enterprises- 18 joint stock company, 11 limited liability companies, 9 companies owned by the State Treasury, 15 privatised through the liquidation path, and 2 other legal status. The study states that 9 of these companies are monopolistic, 30 competitive, 16 not specified. Different paths of privatisation are represented in this study: 7 enterprises were privatised using capital privatisation, 7 through liquidation privatisation, 8 through bankruptcy liquidation, and 7 through commercialisation. The aim of the study was to investigate the impact of the different paths of privatisation on enterprises, using different measures, like profitability, assets/liability ratio, and liability/net profit ratio. The main findings of the study are summarised in Box (8.2).

Box (8.2)

A Summary of the Impact of Different Paths of Privatisation on Enterprises

Path of Privatisation	*** Profitability**	*** *R/P ratio***	*** Changes in Field of Prod.**	*** Strategy** Before	During	After
1) *Capital*	Smallest decline	***After commercial***	Second	**A**	**A**	**A**
2) *Liquidation*	After Bankruptcy	***Biggest decline***	The biggest	**P**	**A**	**A/P**
3) *Bankruptcy*	Biggest decline	***After Liquidation***	Third	**P**	**P**	**P**
4) Commercial	After Capital	**Smallest decline**	Fourth	**P**	**P**	**P**

Source: Own work, based on the findings of **Dabrowski, Federowcz and Szomburg, 1992, *"Privatisation of Polish SOEs"*, Second Report. GIfME:Warsaw, Poland.** ***Note: A = Active, P = Passive. R/P = Receivable/ Payable.***

1. The study found that firms privatised following the 'capital' path best managed to come to terms with the stabilisation shock, and their financial performance is still much better than that of an average firm and those of firms transferred in another way. The companies in question were not immune to problems affecting all other Polish firms (payments arrears, recession, collapse of the Eastern market), but due to their position attained in the past, the good quality of their products, and their presence on Western markets, they were in a better position. Enterprises privatised following the capital path were able to pass relatively smoothly through the first two stages of the systemic transformation process. The study argues that it would probably be, unjustified to claim that privatisation was the primary cause of the financial troubles of many of those firms (e.g. repayment of leasing instalments), but it surely had an impact on the financial standing of analysed firms.

2. Although there was a decline in the ratio of receivable to payable in the last year of the survey, the study shows that there was a balance in the receivable and payable. The study attributes this improvement to the measures that were taken to execute the dues, or as a result of privatisation. Moreover, the study argues that the main reasons for the steep decline in economic indicators of the liquidated firms are the dramatic drop in domestic demand for their products caused by opening up the economy (imports) and, consequently, a major rise in competition on the domestic market, a

collapse of exports to the Eastern markets and a relatively high burden of taxes levied by the central budget, due mainly to a drop in output.

3. The study stresses the fact that during the period of their analysis, enterprises transformed into companies owned solely by the State Treasury enjoyed a relatively favourable financial condition. In 1990 they clearly showed the highest profitability ratios. Only a year later, the standing of those firms was subject to a serious deterioration, although their situation was still better than that of other privatised firms. At this point I argue that when the second step is taken, i.e. when these commercialised firms are privatised using the 'capital' path, their economic performance improves significantly. Thus, one can conclude, bearing in mind the short period of time, that commercialisation did not bring about a significant improvement in the financial standing of those enterprises.

4. The study argues that capital privatisation gave the enterprises transformed this way a chance of financial restructuring, and halted, at least for the time being, the drop in profitability of those firms. On the other hand, the first phenomenon accompanying privatisation along the liquidation path and commercialisation was a quick drop in profitability in those firms, and constantly deteriorating financial liquidity. Bankruptcy liquidation is quite different: in this case the transformation resulted from the bad economic condition of those enterprises. Quite often, however, there was an improvement in the conditions of liquidated firms due to employment reduction and sale of fixed and variable assets.

5. In the groups of enterprises privatised by the force of the Privatisation Law, responses concerning changes or expansion of the scope of economic activities are much more diversified than those in the case of enterprises privatised following the capital path. The study states that those actions were taken in a direct connection with privatisation. Still, the prospects of changing the ownership status of an enterprise was one of the main reasons for looking for spare capacities inside a firm.

6. The study found that the rise in average wages (salaries) occurred in enterprises privatised following the capital path. Wages (salaries) in commercialised firms were lower and wage costs in those firms higher than in their counterparts privatised in the capital way. Moreover, enterprises privatised through liquidation following the provisions of the Privatisation Law also show a higher than average rate of wage increase.

7. The study found that the ownership transformation processes had a substantial impact on intensifying the behaviour of analysed firms. Prior to undertaking privatisation processes in 38 of 50 entities surveyed (69%), they found a passive approach and conservative strategies. Most firms in all privatisation paths, except the capital, were not very active before privatisation. All firms included in the bankruptcy liquidation category were passive, which surely had a marked impact on their poor economic condition in later stages. At that time the highest level of activity was shown by firms to be privatised later following the capital path and firms liquidated following the provisions of the Privatisation Law. This points to the fact that many of those firms implemented numerous adjustment measures even prior to privatisation and that in their case, privatisation was not a breakthrough, but just another stage of their dynamic strategy. Therefore, the study concludes that entering a chosen privatisation path resulted in very considerably intensified activities of enterprises privatised following the capital or liquidation path. The above supports the hypothesis that firms in those two groups regarded privatisation as a chance to intensify their activities that had, to at least some extent, been undertaken before.

e. Study number five[15]

The study comprises a sample of 75 large industrial enterprises. It was conducted in mid- 1991, and again in mid-1992. A number of findings were made:

1. The budget constraint facing enterprises visibly hardened from 1991 onwards, with banks or enterprise loans diminishing and taxes rising;

2. Managers played a larger role, and emphasised profits and marketing over productivity targets;

3. Wages were not set to exhaust profits, but were the result of Western-type bargaining;

4. Enterprises became cost-conscious and began to reduce input use.

Within the sample, substantial variations were found, with some firms being profitable while others were not. The profitable firms could be found in a variety of sub sectors, which indicated that managerial performance in the face of market pressures was an important determinant of profitability. Profitable firms had a better productivity performance; but , encouragingly, even unprofitable firms took measures to control labour, energy and other material costs- this finding indicated that capacity utilisation was an important determinant of profitability.

Financial flows became tighter for both sets of firms when the nine State Banks were commercialised in late 1991. Profitable firms continued to have access to investment loans and were able to service their debts, whereas unprofitable firms, while maintaining some access to loans, found the interest burden was a very substantial problem. The sample was also stratified according to whether a given State enterprise was commercialised or not. It was difficult to draw definite conclusions, both because enterprises were commercialised for only a year before the study began, and because there was considerable self selection amongst those enterprises that became commercialised (they tended to be larger employment wise and had a bigger initial debt burden). Managers surveyed expressed a preference for commercialisation as a way to restructure prior to being fully privatised.

These findings have some bearing on the question of incentives to maximise profits for workers-controlled enterprises. Not all worker controlled enterprises have exhausted profits by distributing them as wages- as was expected by some observers at the beginning of reform. Since this finding was true for some enterprises that were not commercialised, it cannot be explained by claiming a loss of institutional power for workers' councils. One reason why worker- controlled firms might be interested

in profits is to promote employment. The unprofitable firms tended (as the study shows) to reduce employment by a greater amount than did the profitable firms. Profits tended to provide some cushion from unemployment levels that reached an economy- wide 15.7% by end-1993. Another reason why worker- controlled firms might be interested in profits could be an expectation of receiving part of current profits in a future privatisation deal which gave workers equity at a discount.

e. Study number six[16]

The study was carried out on a representative sample of Leveraged lease-buy-out companies (LLBO) or management employee buyouts (MEBOs). The sample included 130 companies; 24% were involved in manufacturing, 45% in construction and 31% in trade and services. The following is a summary of the main findings:

1. Revenues and costs

The research showed that the situation in the companies is varied. While the general trend is for the cost to revenue ratio to be on the rise, the manufacturing companies were better off. They had a considerable increase in revenue, with the costs incurred growing at a slower rate. A decrease in real revenue occurred in construction companies and especially in trade companies, where the drop was most evident. The cost to revenue ratio in the selected enterprises rose from 91.8% in 1992 to 93.0% in 1993.

2. Profitability

Average gross profits for 1993 rose by 40.8%, net profits by 25.8%, compared to 1992. Good returns have been achieved principally by large companies (including large construction companies) and those manufacturing companies employing over 300 people. They generally have returns on capital (77%) and on assets (11%).

Total profitability (gross profit to cost ratio for achieving revenue) in the selected companies increased from 7.0% in 1992, to 7.55 in 1993. Profitability of sales (sales profit in relation to production costs of goods sold) increased from 25.2% in 1992, to 29.1% in 1993. In 1992, State enterprises had total profitability at 2.2 and profitability of sales at 9.3%, while in 1993, the indicators were 2.9% and 8.5%, respectively.

There was a considerable difference among the companies between the profitability of sales and total profitability, and it is clear that the payments due as part of the lease arrangements (under the LLBO privatisation technique) to the State Treasury are responsible for this. Table (8.2) shows the profitability indicators by industry.

Table (8.2)

Profitability Indicators by industry

Industry	**Total Profitability %**		**Profitability of sale %**
	1992	**1993**	**1993**
Manufacturing LLBOs	6.3	10.0	32.6
Manufacturing in general	1.9	3.1	13.5
Construction LLBOs	9.5	9.6	17.0
Construction in general	4.1	2.4	3.6
Trade LLOBs	2.4	2.0	53.8
Trade in general	0.7	1.3	2.2

3. Capitalisation

During 1993 the capital of the LLBOs increased by 44%; allowing for both inflation and the devaluation of the Polish currency in relation to the US$, real increase lay at 7.0%. The greatest increase in capital took place in construction companies (72.2%), followed by manufacturing (22.2%), and then trade companies (18.8%). The companies as a whole used 74.4% of net profits to increase their capital.

4. Liquidity indicators

Current ratio indicators for all companies under review rose from 1.20 in 1992, to 1.28 in 1993, whereas for the State enterprises sector there was a drop from 0.96 to 0.92 (this includes 1,700 State enterprises subject to liquidation or bankruptcy proceedings). Table (8.3) shows liquidity indicators broken down by industry.

Table (8.3)

Liquidity indicators by Industry

Industry	LLBO companies		State Enterprises	
	1992	1993	1992	1993
Manufacturing	1.28	1.18	0.87	0.87
Construction	1.29	1.42	1.31	1.19
Trade & services	1.03	1 .11	1.48*	1.30**

***) trade only **) services only**

The quick ratio indicator should in general lie at about 1, and when it drops below 0.75 things become worrying. It should be noted, however, that some reserves may additionally be of considerable liquidity, and the indicator makes no allowance for this. Table (8.4) shows the quick ratio indicators by industry.

Table (8.4)

Quick ratio indicators by Industry

Industry	LLBO companies		State enterprises	
	1992	1993	1992	1993
Manufacturing	0.82	0.75	0.51	0.51
Construction	1.10	1.21	1.06	0.99
Trade & Services	0.48	0.52	1.02*	0.66**

***)Trade only **) Services only**

5. Financial Liabilities

The LLBO privatisation procedure gives rise to the companies starting off with considerable liabilities (to the State Treasury). Any difficulties faced by them on the market may mean that they rapidly lose liquidity and become insolvent. It is thus important to keep an eye on potential threats and any delays in payments due to the State Treasury, the banks and suppliers. Table (8.5) shows the relation of financial liabilities broken down by industry, in 1993.

Table (8.5)

The relation of Financial Liabilities by Industry

Industry	**Arrears to third party liabilities**	**Arrears to own capital**	**Arrears to net profit**
Manufacturing	12	25	44
Construction	24	47	75
Trade & Services	16	47	135

Manufacturing companies are least threatened, trade companies are at greatest risk.

6. Assets turnover ratio

This indicator shows the relation of the value of sales to the value of assets used by the companies. The study showed that there was an improvement in these indicators for 1993, compared with 1992.

7. Adaptation of products to the market

The moves to adapt products to markets in the companies under review were largely concentrated on more intensive promotion of their goods and services. Besides posters, and press and radio advertisements, they also went in for active promotion, such as making offers, acquiring customers, participation in tenders and fairs, etc..

The fact that both the company's logo and its name are important to the companies is noteworthy.

Activities to strengthen the company's competitiveness have also grow in importance. Around 27% of the companies have undertaken the provision of new products and services (in 1992 there were about 18%). Around 17% of the companies undertook partial improvement of these (in 1992 it was about 12%). New improved products made up 16.5% and 13.1% respectively of products sold. In 1992, these lay at 20.4% and 21.6%. In eight of the companies, adapting to the market led them to give up the production of 7.6% of goods sold the previous year. The same was true for four companies in 1992. Production of new products generally went hand-in-hand with finding new partners (18 firms in 1992, 24 in 1993). In 1993, six companies started to co-operate with a foreign partner. The part played by new and improved products sold by companies modernising in 1993 is shown in Table (8.6) broken down by industry.

Table (8.6)

Modernising Products by Industry

Industry	**% of LLBO companies with new products**	**New products as part of production sold (%)**	**% of updated production**	**Improved products as part of production sold (%)**
Manufacturing	47.6	15.8	42.9	19.1
Construction	20.0	15.5	9.0	8.1
Trade & Services	25.8	17.5	6.5	4.7

Manufacturing companies are clearly aiming to modernise, whereas due to the specific nature of both construction and trade companies, there is less indication of such a trend.

8. Employment

Average employment in the companies under review at the time they began operating (the end of December, 1991) was at 285, and fell to 242 in 1992- ranging from 3 to 1,276. In 1993, employment continued to drop steadily (the greatest fall came in the first half of 1993) to reach an average 209- ranging from 2 to 1,170.

In 1992-93, employment in the companies under review had decreased by about 12.0%. The fact that employment fell at a rate greater than revenues gives an indication of increased productivity. In 1993, the average increase in productivity lay at about 2.9%.

The general fall in employment was more marked among the production workers- for 1992 the rate lay at 13.0%, for 1993 it was 12.3%. The fall in employment took place in all the companies regardless of industry- in manufacturing, construction, trade and services.

The research showed very sharp falls in employment among the construction companies. In 1992, the drop was about 16.4%, in 1993 by a further 16.7%. By the first half of 1994, the drop was only 3.0%, which allows one to expect a levelling off of the fall and a reversal of the trend. For the construction industry as a whole, the average fall was 3.1% in 1992, and 6.6% in 1993.

A considerable reduction of employment also occurred among the trade and services companies. The greatest drop took place in 1992 and the first half of 1993. After that it was limited to 3.0% for every half-year period. For all the trade companies the drop in employment lay at 8.4% in 1992 and at 12.2% in 1993.

The manufacturing companies had the most stable employment situation. After a 5% drop in 1992, the next half-yearly indicators show a fall of about 1.0% (the total for 1993 was 2.11%). Starting in the second half of 1993, there was a growth in the numbers employed even among the non-qualified workers. The general figures for

all manufacturing companies in Poland for 1992 and 1993 show falls of about 7.8% and 1.7%, respectively.

9. Wages

At the end of 1991, the average wages in the companies under review were similar to the gross wages for the economy as a whole when compared to the appropriate industry. In 1992, the wages rose, but did not match the national average rise (99.8% of the national average). The increase in 1993 was smaller than the national average (88.8), before catching up again in the first half of 1994 (92.1%).

The level of real wages continues to fall in Poland, at least according to official data. In real terms, allowing for the consumer goods and services index (143.0 in 1992, 135.3 in 1993), average gross income rose by about 5.3% in 1992 before falling by about 1.9% in 1993. In the first half of 1994 there was a slight rise of 1.4%.

The wage trends provide evidence of considerable wage discipline in the companies under review. Analysis also allows for the opinion that in principle the wage strategy over the period under consideration was to guarantee the real value of the wages. This goal was achieved, even at the cost of large reductions in the work-force. The link between wage increases and an increase in revenue was secondary. While these were moving in the same direction, they differed by between 2% and over 10%.

10. Ownership

On average, company ownership is spread out unevenly. As a rule, one quarter of the shares comes to about a dozen or so people from the management or the supervisory board, while on the other hand, a group of about ten times as many employees holds about half the shares. On top of that, the number of shares held by the small elite continues to rise in proportion to a decrease among the employees. Table (8.7) shows this trend.

Table (8.7)

Ownership structure in LLBO companies

Ownership groups	% of shares owned	
	At day of establishment	At time of reproach
Management	10.9	13.7
Supervisory board members	12.6	12.2
Individual employees	67.6	54.1
Polish companies	0.22	1.19
Polish individuals	7.5	16.1
Foreign companies	--	0.4
Foreign individuals	--	0.3

From 1991 to June, 1994, the average employment in the companies fell from 284 to 209. The average number of employee-shareholders fell from 248 at the moment the company was registered to 148 in June, 1994. Thus, part of the shares was bought up by management and the supervisory boards, as well as by Polish citizens not employed in the companies. As a result, there has been, and probably will continue to be, a concentration of share ownership with those already holding a considerable packet of shares. Companies that have the character of *an "MEBO 'insider' control"* type would most probably change to a type of management buy-out , or "MBOs-insider" control companies.

11. Companies' control

The research showed that the management of the companies is on the whole made up of the directors and management of the former State enterprises. Nothing really limits their freedom of decision-making for the management of he companies. The make-up of the supervisory boards is subject to greater fluctuations than that of the management. Thus, a stable management is responsible to a far less stable composition of supervisory boards. The influx of people from outside the company is an indication of the increased participation of outside capital in the companies. Management is not sharing real operational control with any "outsiders" (the make-up of management has petrified) whereas representatives of outside investors have been allowed on to the supervisory boards.

Trade unions do not play any significant role in MEBOs. A percentage drop in the number of union members is evident. The decrease in the number and role of the trade unions in MEBO companies is obvious.

To sum up, the above research showed that Poland's LLBO companies made much better use of their means of production than was the case in the State enterprises prior to privatisation. On the other hand, these companies showed a number of weaknesses, such as a lack of capital for investment or a great risk of losing liquidity in case of some market misfortune, in other words facing bankruptcy. The threat of bankruptcy motivates their management to undertake energetic marketing and innovatory actions. This threat makes employees hold back from making increased wage demands, which is beneficial both for the company (its competitiveness) and for the economy as a whole (inflation).

The recapitalisation of companies is possible through a stock increase when Polish institutional or foreign investors show interest; the government allows for this where the company has proved maturity in the market, and once the shareholders and the management have learned and understood their role in a market economy. This maturity is clearly evident in management's bolder and positive business approach as their company's fortunes develop.

4. *Critical assessment of the studies and conclusion*

As noted in the second part of this section, different modes of corporate governance were established. One of the main consequences of the privatisation process is the move from "S*tate corporate control*", to either an "*insiders*" or "*outsiders*" system of corporate control. However, what is more important is to evaluate whether or not the new types of corporate control, which were established as a consequence of the privatisation process, have some positive impact on the performance of the privatised enterprises. To assess the impact of privatisation on the performance and behaviour of enterprises, the remainder of this part of the Section critically analyses the findings of the Six survey studies discussed above. The main questions I focused

the findings of the Six survey studies discussed above. The main questions I focused on are; "To What extent can one rely on and generalise the conclusions from each study?"; "What is the contribution of each study to an assessment of how far privatisation has played a central role in measurable, or unmeasurable, aspects of transformation?"; "What is the contribution of each study to an assessment of the relative advantages and/or disadvantages of the different methods of privatisation?"; "What further information might be desirable to make a more complete assessment of the specific contribution of privatisation as opposed to other policy measures?".

Different **methodologies** were applied to do these studies: some are based on questionnaires (studies number one, four, five, and six); others on interviews with the managers (study number two); and one is based on questionnaire technique and interviews with managers in half-year cycles (study number three). Different **stages of transition** periods were considered (beginning of transition, 1990-1991 (studies number one and four); after economic recovery 1992-1993 (studies number three and six). Varying **lengths of sample** periods were considered (two years and three years). Varying **numbers of sample** enterprises were studied (20-187 enterprises). Finally, different **types of comparative** studies were done (SOEs with commercialised (study number three); commercialised with liquidated (study number one); capital with liquidated, bankrupt, and commercialised (studies number two, four and five); MEBO with SOEs (study number six)).

The **weaknesses** of the studies are: **(1)** the periods of the sample studies are short; **(2)** the samples of the enterprises are relatively small (less than one hundred enterprises, the exceptions are studies number one and six); **(3)** and most importantly, the studies are not "like-for-like". That is to say, none of the studies compared the performance of enterprises that produce similar products, have similar size, operate in the same market environment, privatised through the "capital" path, with others that produce the same type of products, have the same size, operate in the same market environment, but privatised through different paths of privatisation. All six studies were done to evaluate the impact of different paths of privatisation, and different types of enterprises. The exception might be Study Number Six. It

compared the performance of enterprises in three different sectors (industry, services, and trade), privatised by the "MEBO" method, with the performance of these sectors in general; **(4)** the findings of the six studies are mixed; **(5)** to evaluate the impact of privatisation on the behaviour and performance of privatised enterprises, the state sector should be a natural point of reference. The point is, however, that in many respects those sectors are incomparable. It stems for instance, from different conditions of enterprises' selection for a given privatisation track. For example, comparing the good financial standing of capital SOEs selected for capital track privatisation with those with a poorer financial status liquidated under Article (19) of the Act on SOEs, makes it very difficult to find a similar reference group among public firms; **(6)** moreover, from 1993, the Polish Classification of the National Economy (KGN) was replaced by the European Classification of Activities (EKD), which obviously gives a different picture of the financial situation of the economy, from the former. The EKD was elaborated on the basis of the publication of European Communities Statistical Office. There are differences between the two methods of classification; the public sector now includes units of mixed ownership, i.e. economic units with public sector majority. Indirect taxes cover turnover tax, gambling and betting tax (introduced from 10 December, 1992), Value Added Tax (VAT) and excise tax (introduced from 5 July, 1993) and import tax (from January, 1994). Sales of industrial products are calculated on the basis of a monthly sample survey on price changes of products and services actually received by economic units. Price indices published before 1993 are based on net prices, that is, excluding VAT encumbrances, while those published starting from 1993 are based on the gross price survey, that is, including VAT tax.[17] As a consequence of these methodological changes data are not directly comparable with those for previous years. Therefore, the performance of enterprises is not a wholly accurate reflection of the financial performance of enterprises; **(7)** besides the fact that "window dressing" or "creative accounting" practices aimed at reducing tax liabilities, and deflating wages bills so as to lower the liability for social security contribution, were responsible for the poorer financial performance of the private sector. Private firms tended to over-report costs and under-report profits (see Section Four); **(8)** finally, the increases in the profitability and productivity figures might be a result of a

reduction in the employment figures, rather than a result of a real improvement in the performance of the enterprises.

The **strengths** of the studies are: **(1)** they covered enterprises by size, type of privatisation, and different stages of transition; **(2)** some of them considered other factors that might have some impact on the behaviour of enterprises (such as their monopolistic advantage (for example, Study Number Three, and Four); initial financial situation (for example, Study Number Six); and regional location in Poland (for example, Study Number Two)); **(3)** the findings of some of these studies (for example, Study Number Three concerning the employment figures) confirmed some theories of privatisation; **(4)** most importantly, these studies provide an early indicator of the impact of privatisation, bearing in mind the following observations.

The sample of **Study Number One** represents only two techniques of privatisation (commercialisation and liquidation, based on Article (37) of the Law on Privatisation of SOEs of July, 1990), but gives no information to assess whether it is representative of the different regions of Poland. The study is representative of the different sectors of the economy, as it resembles the average trend of the whole privatisation process, as shown in Table (7.4) of section seven. Besides that, the sample is relatively big, representing 61% of the total number of liquidated enterprises, and 82% of the total number of the commercialised enterprises. Some of its findings confirm certain theories of privatisation and the findings of Section Four, i.e. concerning the general performance of the Polish economy. For example, the study confirmed that privatisation might lead to an increase in wages and salaries, and to a drop in the employment figures. Because these findings were in a very early stage of the transition process, and the study was not "like-for-like", therefore, one can hardly generalise. One can, however, consider these findings an initial indication or evidence of the impact of privatisation as well as other economic policy measures, because it is very difficult to divorce the impact of privatisation from that of other policy measures.

The study showed that the performance of the commercialised enterprises deteriorated more rapidly than the performance of the liquidated enterprises. However, commercialisation helped to restructure enterprises, which is an important aspect in the transition process although it is a costly process. Commercialised enterprises did not show a tendency to remedy the economic situation, which might be explained by the fact that, commercialisation gives priority to restructuring rather than focusing on improving the enterprises' competence. The fact that liquidated enterprises are now mainly owned by the "insiders" of these enterprises means that the "insiders" tend to care more about improving the performance of their enterprises than in the past when they were owned by the State. The findings of the study confirmed this argument, as the liquidated enterprises performed better than commercialised ones, and helped enterprises to adapt themselves to the new economic environment.

The sample and the period covered by **Study Number Two** are very small (20 enterprises, i.e. 8.8% of the total number of the privatised enterprises, covers only one year). Different techniques of privatisation were considered (commercialisation, initial public offering, sale, employee buy-out, liquidation, etc.). The sample covered different regions of Poland and different economic activities. Although the sample contains sufficient techniques, geographical, and economic activity variations, its findings are broadly presented. Moreover, some of these findings contradict those of other studies analysed in this section and some theories of privatisation. For example, the study found that privatisation was not accompanied by a mass reduction of employment, because that had happened before privatisation took place, and the members of new management are the previous managers of these enterprises. Moreover, the study showed that no changes have happened regarding new capital and know-how, because priority was given to the transition of ownership rights. Therefore, one can hardly assess the contribution of this study to the relative advantages and/or disadvantages of the different methods of privatisation, because of the generality of its findings.

The sample of **Study Number Three** is relatively small (50 enterprises, less than one percent of the total number of the privatised enterprises), the period covers two different stages of economic transition (June, 1990 - June 1993); the first takes place in an environment of economic collapse, and the second takes place in a period of economic recovery. This study adopted different classification of firms by their size; small firms that employ less than 500 persons; medium which employ 501-2,000, and large which employ more than 2,000. The researchers argue that the proposed classification provides better chances of finding economically and socially relevant differences in adjustment mechanism between various groups of companies, than the traditional division. In my opinion, this makes the findings less comparable with other studies. The study was not representative of different regions. Moreover, it considered SOEs and commercialised enterprises the same, which is not true, because commercialised enterprises are subject to harder budget constraints and to a financial managerial restructuring. The study did not compare the performance of "like-for-like" enterprises, and covers only one type of privatisation (i.e. commercialisation, which is the first step of "capital" privatisation). It is very difficult to evaluate the contribution of this study to assess the relative advantages and/or disadvantages of the different methods of privatisation. Because SOEs performed better than commercialised enterprises, except in respect of wage spread, which was somewhat smaller in non-commercialised than commercialised enterprises, this study raised the questions; "What is the main reason behind the weak performance of commercialised enterprises compared to SOEs?"; and "Is privatisation necessary?". In fact, the answer to the first question might be explained by the clearly defined aim of commercialisation, which states that priority should be given to the restructuring of companies in the first two years before being sold to third parties, rather than focusing on improving their competence. This could confirm the argument that restructuring is necessary, but alone is not enough to improve the performance of enterprises.

In fact, the strong position of SOEs sampled in the studies might be explained by the fact that wages of SOEs are low, their budget constraints are harder, and SOEs have been in a viable holding pattern, which depends on the expectation that privatisation

will eventually take place. Besides that, firms realised that there would be no bailout, and that managers' future jobs are dependent on the viability of their enterprises. In other words, managers believed that good performance will be rewarded at the time of privatisation and their reputation, and hence compensation, will depend upon their performance today. Manager's awareness that competition in their products market comes mainly from imports, was an important additional factor. Many SOEs, which were included in the studies, had reorganised their management structures to make finance and marketing rather than production their most important priority.

The study found that the performance of these enterprises deteriorated in the first two years of transition, 1990-1991, and improved after 1992. These results coincide with the general performance of the Polish economy, in Section Four. That is to mean, the rapid elimination of relative price distortions that flowed from "big bang" liberalisation of prices and foreign trade, the imposition of "hard budget constraints" on enterprises, and the implementation of macroeconomic stabilisation measures, were effective techniques in inducing enterprises to change their behaviour.

Study Number Four analyses different paths of privatisation; covers a short period of time; focuses on a variety of different types of enterprises; and considers different regions of Poland and different economic activities. The findings of this study showed that privatised enterprises through the "capital" path showed the best performance compared to those commercialised, and privatised through other paths of privatisation, such as liquidation and bankruptcy. However, it is very difficult to generalise and argue that the change in the behaviour of the privatised enterprises was a result of privatisation alone, especially when one remembers that these enterprises had a better initial position (i.e. some of them acquired monopolistic advantage and a better initial financial position). The findings of these studies concerning the performance of commercialised enterprises confirm those of Study Number One, that commercialisation alone is not sufficient to improve the performance of enterprises.

The sample of **Study Number Five** is relatively small (75 large enterprises), covers only the manufacturing sector, represents different regions all over Poland (both in big industrial centres and in smaller cities). The sample contains sufficient product and geographical variance to draw some initial conclusions. The main findings of the study is that, in terms of profit relative to output and various other measures, SOEs performed much better than commercialised enterprises. This study raises the same question concerning the necessity of privatisation. The findings suggest that hard budgets and import competition- essential ingredients of Poland's reform programme- can exert adjustment pressures even when changes in ownership and governance lag behind.

Study Number Six was carried out on a representative sample of Leveraged Lease-buy-out (LLBO) companies, covering four different sectors (manufacturing, construction and trade and services). The study confirms that LLBO companies made much better use of their means of production after privatisation. This result confirms the findings of study number two, four and five, that "insiders" now care more about their companies than in the past, when these companies were owned by the State. Therefore, one might conclude that among the advantages of leasing or selling SOEs to their employees are that, pressure from "insiders" on the government, is absorbed, and the performance of the enterprises has improved. This confirms the findings of Study Number One (see Page 313). I believe that the finding of this study is logical and can be generalised at least in the short run.

Which method of privatisation led to better results?. Theoretically, as noted in Section Five, it is argued that the performance of privatised enterprises would be improved if the privatisation process was able to create an efficient corporate governance structure. More specifically, it is preferable to establish an "outsiders" control system, rather than "insiders" control structure. However, none of the above six studies directly tested this argument, i.e. compared the performance of privatised enterprises controlled by "outsiders", i.e. foreign or domestic strategic investors, with privatised enterprises controlled by "insiders", i.e. owned by the management and/or the workers. But, as shown in the first part of this section and section seven, most of

most of the enterprises privatised through the "capital" path are now owned by foreign or domestic strategic investors (i.e. "outsiders"), but most of the "liquidated" enterprises are now owned by the "insiders". Therefore, one might argue that only studies number Two and Four compared the performance of enterprises privatised through the "capital" path (i.e. owned by "outsiders"), with those privatised through other paths, including "liquidation" (i.e. enterprises owned by "insiders"). Both studies showed that the best performance was achieved by enterprises privatised through the "capital" path. Although this result confirms the above discussed theoretical argument, one should not forget that those enterprises which were privatised through the "capital" path, were initially in a better financial and economic situation, and some of them acquired a monopolistic advantage. So, one can hardly generalise and argue that the improvement in the performance of those privatised enterprises (i.e. those controlled by "outsiders") was purely a result of privatisation. Because it is very difficult to divorce the impact of privatisation from that of other elements of the economic transformation programme, and it is very difficult to separate the impact of the initial situation of the enterprises (i.e. their monopolistic advantage, and better financial position), from the impact of privatisation, it would be very hard to relate the change in the behaviour of enterprises to privatisation alone. One should bear in mind that privatisation is one element in the whole transformation process, and therefore, **should not** be treated in purely functional terms, but must be included in the whole process of structural changes (see below).

To make a more complete assessment of the specific contribution of privatisation as opposed to other measures, these studies should have been done on a larger sample and longer period. Moreover, these studies should have covered all methods of privatisation, and included very detailed microeconomic data to enable researchers to run an **econometric regression analysis**, which would help separating the impact of privatisation from that of other factors. For example, in order to investigate the impact of privatisation on output of one privatised enterprise, an econometric regression could be run, to include all the variables that have some impact on output, like exchange rate, interest rate, investment, exports, and

privatisation (where revenues from privatisation would be taken as proxy). Therefore, the regression equation will approximately be as follows:

Change in Output = Constant Variable + (a) Exchange Rate + (b) Interest Rate + (c) Privatisation + (d) Exports + (e) Investment + (f) Others ....(1)

Where output is the dependent variable, while the variables on the right hand side of the equation are the independent variables. The letters in the parentheses are the coefficients of the independent variables. Assuming that the results of the regression analysis is the following:

£250 = 50 + 0.23 (Exchange Rate) + 0.44 (Interest Rate) + 0.12 (Privatisation) + 0.15 (Exports) + ...(2)

Then, it is very clear from equation (2) that a change in the exchange rate, for example, by one unit is responsible for the change in output by 0.23 of the unit, and a change in the privatisation revenues by one unit is responsible for the change in output by 0.12 of the unit, etc..[18]

The difficulty in the Polish case is the fact that even the performance of the SOEs has improved. Then, it is obvious that in this case privatisation was not responsible for the improvement of the performance of these enterprises which are still owned by the State (see page 315, for the possible explanation for the improvement of the performance of SOEs). In this case, one should compare the performance of privatised enterprises, with those owned by the State, on the basis of "like-for-like". The question to be answered; "Is it possible to carry out such a study in practice?". In the case of Poland, it very difficult to find two enterprises (one privatised and the other owned by the State), working in the same economic environment (i.e. competitive market), having the same size, producing the same type of product, operating in the same industrial sector, etc.. Bearing in mind the difficulties of the different methods of analysis, therefore, one should take the findings of the various analytical studies as indicators, considering all the possible weaknesses of the these studies.

To conclude, one can argue that different types of ownership structure can be distinguished in Poland: public sector; SOEs, STCs, State legal persons, and mixed. Private sector; domestic co-operatives, individual proprietorships, domestic partnership, and mixed. The type of control created as a result of "capital" path privatisation was the move from "State corporate control", to "State Treasury corporate control" in the first step, and from "State Treasury corporate control" to either "*outsiders*" (domestic or foreign investors) control, or MEBO "*insiders*" control, in the second step. The type of corporate control that was established as a result of adopting the "liquidation privatisation" path was mainly an "*insiders*" control structure.

It was found that the behaviour of both State owned and privatised enterprises changed after the implementation of the economic transformation programme of 1989/90. It is difficult to generalise and argue that the improvement in the performance of those privatised enterprises (i.e. those controlled by "outsiders") is purely a result of privatisation. Therefore, privatisation should be treated as an integral element in the whole transformation process. However, it can be concluded that, **the main initial privatisation results** are the following: more active adjustment strategies in firms after their privatisation (mostly in JVs with foreign capital); substantial strengthening of the ownership control in firms that were divested under the capital track; improvement of management efficiency brought about by a new ownership structure and a better corporate governance structure; and better financial management (mainly in companies privatised through the "capital" path); and finally, an increase in work discipline and employees' identification with their firms.

Endnotes:

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[1] Ickes, Ryterman, 1994:83.

[2] Lubinski, 1996:110-111.

[3] Ibid:110.

[4] Larner, 1966; Kamerschen, 1968; Herman, 1981; Peev and Hare, 1995.

Dabrowski (1996) talks about *four models of ownership systems* that can be created as a result of privatisation: *closed scattered* and *concentrated*, and *opened scattered* and *concentrated*. He calls the type of ownership that occurs in companies based on lease agreements (management/employee buyouts (MEBOs)), "*closed ownership system*", where employees become the sole proprietors. He argues that "*deterring the entry to such companies of outside investors usually results from a conscious choice, strengthened with a statutory inscription and a specific distribution mechanism of property rights (only among employees). This trend stems from employees' fear that they will lose control over the firm, their belief that this kind of capital investment is highly profitable, and from their reluctance to share benefits with outsiders. The concentration of ownership in lease companies reflects the power and financial capabilities of the management. In smaller companies, endowed with a low initial equity, the managers' stake tends to be strongly concentrated (about 30% or more), which allows them in practice to exert full control over the firm*".

In general, the *closed ownership structure* results from good financial standing of the firm, its sound industrial relations and a strong position of transformation champions prior to privatisation. Experience shows that lease companies have performed quite well in their current operations (both before and after privatisation). In addition, in many MEBO companies the organisational structure has been improved, the majority of shallow reserves has been used for product and market adjustments, and the most needed and obvious changes in employment have been introduced. However, some of those quantitative changes were undertaken prior to ownership transformations, since they were forced, on the one hand, by a new systemic environment and on the other by stronger competition from the private sector.

"The scattered system is usually established when the management and other influential groups in the firm (a part of the middle-level management, leaders of the workers' council) do not have the possibility to buy out the controlling stake in the company at the starting point. Over time, however, a trend to concentrate property rights within the group of managers can be easily traced. Instead, cases of "opening" the ownership system are much less frequent. They occur most often when a firm starts to display a dramatically poor performance, and recovery prospects worsen."

In the case of *open ownership structures*, the scattered system is usually derived from SOEs sale through an IPO. This type of ownership tends to develop in companies showing good financial performance, and enjoying a stable position and a good product mix. In this type of ownership structure, privatisation meant a total withdrawal State interference in the company's operations, and an upgrading of its status- first, joining the prestigious group of public companies, and next, the firms listed on the Stock Exchange.

[5] In 1995, some employee-controlled companies succeeded in finding such domestic or foreign (*Lubinski, 1996:111*).

[6] Andreff, 1995:4.

[7] Aoki, 1990; Harris & Raviv, 1988.

[8] Boycko, Shleifer, and Vishny, 1996:313; Perotti, 1994:54; Canning and Hare, 1994:179-180; Frydman and Rapacznski, 1994.

[9] MoP, 1995, personal communication.

[10] Olko-Bagienska, Pankow and Ruszkowski, 1992, *"Privatisation of State Enterprises 1990-91: Results of Empirical Studies"*, (FES:Warsaw), Poland.

[11] Dabrowski, Federowicz, Levitas and Szomburg, 1992, "State Enterprises in The Process of Economic Transformation (October - December, 1991)", The Gdansk Institute for Market Economics, Warsaw, Poland.

[12] Dabrowski, Federowicz, and Levitas, 1993, "State Enterprises in The Process of Economic Transformation, 1992-93: Research Findings". GIME, No. (38), Warsaw, Poland.

[13] The Law on the financial restructuring of enterprises and banks, which took effect in March, 1993 is seen as a part of such new regulations.

[14] Dabrowski, Federowicz and Szomburg, 1992, *"Privatisation of Polish SOEs"*, Second Report. GIME:Warsaw, Poland.

[15] Pinto et al, 1993, "Transferring State Enterprises in Poland: Evidence on Adjustment by Manufacturing Firms, *Brooking Papers on Economic Activity, 2:213-270.*

[16] This study was carried out by The Institute of Political Science of the Polish Academy of Sciences in Warsaw; and the Gdansk Institute for Market Economy, in 1993 and 1994.

[17] For more details on the new methodological notes see, *Central Statistical Office, 1991, 'European Classification of Activities', Second Edition, Warsaw; and Central Statistical Office, 1995, Statistical Bulletin, August, Vol.XXXIX:6-17.*

[18] The difficulty is the fact that privatisation might have a direct impact on the other independent variables such as investment, and exports. In this case, problems of econometric regression would complicate the situation. Besides the fact that the period of transition is too short to run such an econometric regression, and it is very difficult to find enough microeconomic data needed for such this type of work.

Conclusions

The general purpose of the thesis is **to examine the contribution of privatisation to economic transformation** in Poland, during the period 1990-95, and to **assess the relative merits of different privatisation methods.** In order to accomplish these goals, the origins, development, and initial impact of privatisation were studied in some detail. It is of importance to remember that it is hard to unequivocally assess the effects of the six year privatisation of the Polish economy, first of all due to the complexity of the process itself, and also because the period considered was too short to be able to draw a clear picture or "profit and loss account". However, a preliminary evaluation is attempted.

According to the findings of the study, one can argue that **Poland is on the right track.** Poland was the first country in the region to break the recessionary forces accompanying the Eastern European transition. Since March, 1992 Poland has been one of Europe's fastest growing economies. The restoration of growth occurred simultaneously with sustained declines in inflation rates, which in 1989 had reached hyperinflationary levels. Poland has made progress in attaining external balance and increasing external creditworthiness. Poland's foreign trade has been definitively reoriented away from the former members of the COMECON toward the developed capitalist countries of the OECD. Poland has established the region's largest private sector, and the Warsaw Stock Exchange showed some progress in 1993, 1994, and 1995. The behaviour of State owned and privatised enterprises has changed. Unemployment appears to have peaked, and started declining in the third quarter of 1994. In addition, Poland has attracted FDI. The whole purpose of the *economic reform programme* of 1989/90 is to transform the Polish economy from a Centrally Planned economy, to a market orientated one. What was the role of privatisation?.

The study discussed the main features of the CSS to serve as a general framework for the discussion of the Polish Socialist system during the period 1945-89. It was found that the inefficiency of the CSS, in general, and the need to create an efficient corporate governance structure, to replace the State in monitoring the behaviour of the management of the enterprises, are the main reasons behind the urgent need for privatisation. The study, then, discussed the **macroeconomic features of the** Polish economy during the Socialist period, focusing on the development of the *corporate control* structure. Before 1956, SOEs were controlled by the *"industrial ministries"*, which were responsible for the operation of large-and-medium-scale nationalised enterprises in their sector. In 1956, when Gomulka came to power, Workers' Councils were established, and given a few unequivocal rights to monitor the behaviour of the managers of the enterprises. However, these measures were interrupted by strong pressure from the Soviet Union. In 1970/71, Gierek's regime took another step toward decentralisation by setting up what is called "Large Economic Organisations", or *Wielka Organizacja Gospodarcza* (WOG), as intermediate agencies between the individual plants and the economic ministries. The main purpose of those associates was to assist in planning investments and production and in allocating resources. In the early 1980s, Kania's regime embarked on a new economic reform programme. The main achievement of this programme concerning corporate governance was that enterprises were to be self-managing, self-determining, and self-financing. According to these rules, enterprises were given certain powers to organise their daily business. However, the imposition of Martial Law on 13 December, 1981, interrupted the self-government movement that had been gaining momentum in the second half of 1981, especially in big industrial plants. Therefore, the 1956/7, 1971, and 1980/81, attempts at reform aimed at variously conceived decentralisation and marketisation, and were concerned almost exclusively with improving the Decision-Making processes, but not at transforming the economy. Section two ended by discussing the legacy of the Socialist System in Poland in the late 1980s, and concluded that there was a need for a radical transformation programme. It was possible at that period of time due to four main reasons; the disappearance of the political factors that had constrained change in the past 45 years; the severe economic crisis that hit the Polish economy; the

support that Poland received from the international community; and the lack of political will among the ruling Party leaders to continue with the same Socialist system.

Economic theories say little on how to transform an economy from a socialist to a market orientated one, though they offer some models for stabilisation. Most of the proposed models agreed that six broad elements of any comprehensive economic reform scenario must be in place for the reforms to be considered successful: (1) macroeconomic stabilisation; (2) microeconomic liberalisation; (3) enterprise restructuring and **privatisation**; (4) institutional reforms; (5) development of financial markets and institutions; and (6) a new system of social security. It is agreed that privatisation is one of the main elements for any *economic reform scenario* to be successful. In other words, successful transition to a market economy results from, and requires, the resolute and clear-sighted pursuit of a policy strategy having three essential and interdependent components: freeing the economy, decentralising decision making, and allowing individuals to assume responsibility for their economic decision and actions. Stabilising the economy; to ensure, essentially through appropriately tight fiscal and monetary policies, that decisive progress is made toward low inflation, together with sustainable external and budgetary balances. Restructuring, and creation where necessary, the institutions and markets needed for a competitive market economy to function effectively and to serve the broader and higher objective- high quality growth. This includes adaptation of the Social Safety Net to help address the social costs of transition.

It was found that the **sequencing of economic reform** has only recently emerged as a topic of theoretical analysis. The fundamental reason for sequencing the reforms is that some changes are preconditions for others. For example, macroeconomic stabilisation is needed if price reform is to be successful. The systems and skill, which have to be in place for the markets to work, need to be developed. So, financial liberalisation is extremely risky, unless a sound system of accounting, auditing, prudential regulation and supervision is in place, and unless the economy is reasonably stable. The most important conclusion concerning the sequencing of the reforms is that a linear sequence of

individual policy changes is not likely to succeed. In addition, no single reform sequence will fit all the transitional economies.

The **Polish authorities formulated their *ERP* of 1989-90 after a very long** political, social, and economic debate with the different conflict groups. Poland adopted a "big bang", or "shock therapy" approach in 1989/90, to transform its economy into a market orientated one. The Polish *ERP* had two packages; (1) a *macroeconomc stabilisation and microeconomic liberalisation package,* aimed at bringing down inflation and restoring market equilibrium in the commodity market, and equilibrium of the current account balance; and (2) an *institutional (system) transformation package*, aimed at creating a modern market economy. **Privatisation** is an element in the second package.

The stabilisation package can be defined as ***heterodox***, with two nominal anchors, the *nominal wage* and the *exchange rate*, and *fiscal and monetary* tightening. Prices and trade were liberalised, the zloty became fully convertible, and the tax system was changed.

The study thoroughly analysed the **meaning,** the **main issues,** the **main methods**, and **constraints to privatisation** in Eastern Europe, to serve as a general framework to the Polish privatisation experience during the period 1989-95. In Eastern Europe privatisation can be seen as a process that takes the State out of the decision making over the allocation of the returns from SOEs; and a way to create a new ownership structure that would effectively oversee the management of the newly privatised enterprises.

The **main issues of privatisation** in Eastern Europe are the overall role of privatisation in the transition process, the compartmentalisation of privatisation policies; property rights and corporate governance, and the problem of privatising large enterprises. Theoretically, SOEs can either be directly sold, or freely distribute their shares, to the "insiders", "outsiders", or to the previous owners. More than 20 techniques of privatisation are available worldwide. Each technique has certain advantages and disadvantages. The

study found that the main constraints to privatisation in Eastern Europe in general are politics, identification of enterprises chosen for privatisation, valuation, low levels of demand for shares of the privatised companies, the lack of a capital market, and low levels of credits to the private sector.

Poland was the second country after Hungary, which adopted privatisation as an "official" economic policy in 1990. To be able to assess the contribution of privatisation in the transformation process, the study thoroughly analysed **the development of Poland's philosophy on privatisation**, within the framework of the political, social, and economic environment prevailing at the time - as Polish privatisation does not operate in a vacuum. It has been found that the different conflict groups in Poland (the managers of SOEs, Workers' Councils, Trade Unions, the Parliament, different governments, and the President) have an important impact on formulating Polish privatisation policy. The first technique of privatisation "officially" adopted in Poland, by the first Solidarity-led government was the "British-model", which is based on the idea of offering shares to the public (IPO). Disappointment at the slowness of the privatisation process, in the second half of 1990, revived the idea of the free distribution of vouchers to all Poles, presented by Lewandowski and Szomburg in 1988. In addition, this alerted the government to the necessity of combating pressure from enterprises "insiders".

On 13 July, 1990, the Law on Privatisation of SOEs won the approval of the Parliament. The Law accepts the idea of a "***multi-track***" approach to privatisation. The main methods of privatisation provided by the Law on Privatisation of 1990 are "capital" privatisation and "privatisation via liquidation". It is possible to implement mass privatisation based on vouchers through Article 25 of the Law, but mass privatisation was implemented in Poland through a special law; the Mass Privatisation Programme of 1993. Another type of liquidation is applied in Poland, based on Article 19 of the Law on SOEs of September, 1981. Each path of privatisation in Poland has slightly different economic and social goals, and usually also applies to different groups of SOEs, broken down by

size and financial standing. For example, the rationale behind privatising small trade and services establishments was to introduce an ownership management business.

The Polish privatisation process is highly decentralised. For example, the MoP is responsible for privatising medium and large scale enterprises, while the MoF is responsible for privatising the banking and financial sector. The Agriculture State Agency is responsible for privatising State agricultural enterprises.

The Law on Privatisation of 1990 did not fix specific targets for privatisation to be achieved. Later, at the end of 1990, the first Solidarity-led government officially announced its main goals of privatisation. The goals published in January, 1991, are the following: privatising half the present SOEs within three years; achieving the same ownership structure as Western Europe within five years; shifting the economy from a centrally planned system to an open market system to foster efficiency and competition; reducing the size of the public sector and the burden on the public budget and administration; promoting wider share ownership among the public at large, including employees of enterprises; developing entrepreneurs and managers with initiative, drive and a keen sense of opportunity; and generating funds from the sale of enterprises, which can be used for enterprise restructuring.

Apart from the fact that these goals are broadly defined, it is very clear that not all these objectives can be achieved at once, and trade-off and compromise are inevitable. The first two objectives are over optimistic, therefore, the second Solidarity-led Government changed the ambitious plan for privatisation aiming at privatising half of the 8,441 SOEs from three to five years. Moreover, this Government introduced a new philosophy for privatisation. Another two privatisation programmes were formulated; the "*Sectoral Privatisation Programme (SPP)*", and the "*Restructuring Privatisation Programme*".

Before collapsing in June, 1992, the third government managed, to scale back the *SPP* of the previous government. The most important achievement of the last Solidarity-led

government (Suchocka's Government) was the adoption of the Mass Privatisation Programme, which won the approval of the Parliament and the Senate in April, and May, 1993, respectively. However, only in November, 1995, did the real implementation of the programme start. The conflict among the different Solidarity members brought a large victory to ex-communists in the Parliamentary elections of September, 1993. The study examined whether or not there was a change in the attitudes towards privatisation as an economic policy. It was found that the first two ex-Communist Governments announced their intention to begin a *"mass commercialisation programme"*, which many analysts deem a substitute for, rather than a stepping-stone to, full-fledged privatisation. This programme came in the form of an amendment to the Law on Privatisation of SOEs of 1990, and the long delayed MPP. Parliament did not pass the new amendments to the Law on Privatisation. Another privatisation programme was introduced by the first ex-communist Government; "the Stabilisation, Restructuring and Privatisation Programme (SRP)", but was unsuccessful.

As the study shows, the only important issue in the privatisation debate was the form of ownership, not how to achieve that form of ownership, that is to say, there was little discussion on the method of management of the SOEs before being privatised. The Polish political environment was always unstable. The whole privatisation process was progressing in an environment of strong pressure groups, frequent elections and a fragmented party system, apart from other important external conditions, like the collapse of COMECON.

The **progress of ownership transformation** is very differentiated as it depends on the privatisation track adopted, firms' size, their financial standing, and economic sector. It has been shown that the total ***number of privatised enterprises*** in the past six years (1990-95) was less than one fifth of the 8,441 SOEs. The objective of the Polish Governments to privatise fifty percent of the 8,441 SOEs within five years, has not been realised. In total, only about 70% of the total number of 8,441 SOEs, has been included in the process of ownership changes. As for the ***method of privatisation***, small-scale

privatisation was very fast, as Poland was able to privatise more than 95% of the small-scale retail wholesale, and construction enterprises, by the end of 1992. Regarding ***economic sectors***, the study showed that the industrial sector accounts for more than 30% of the total number of privatised enterprises. The construction sector ranks second. Regarding the ***path of privatisation,*** "privatisation through liquidation" comes first, and "bankruptcy liquidation" ranks second. As for the ***size of enterprise***, it has been found that small-scale enterprises were the fastest, followed by medium and large enterprises. Contrasting the pace of privatisation by the ***financial standing*** of the enterprises, the study showed that enterprises with good financial standing were the fastest, but those which required restructuring (i.e. those commercialised before being privatised) needed more time. **To sum up,** one can argue that lack of capital markets, shortages of households savings, lack of domestic or foreign investors, strategic public opposition, and political constraints, are the main factors responsible for the slow pace of privatisation.

The study investigated **whether the Polish privatisation process contributed to economic transformation. The goal of achieving a wider ownership among the public at large,** including employees of enterprises can hardly be examined, because one cannot tell exactly how many people in Poland as a whole participated in the privatisation process, and have some shares in the privatised enterprises. This applies to employees of privatised enterprises as well. However, one can argue that through the MPP, a wider share ownership would be achieved, but whether this would be to the benefit of privatised enterprises and the economy as a whole, it is difficult to assess.

The impact of privatisation on output was through its impact on exports and the development of the private sector. This was thanks mainly to the privatisation process in its broadest sense of the word, i.e. the "grass-root" or "bottom-up" privatisation, as well as "up-down" privatisation. In 1994, the private sector was responsible for more than 50% of the total Polish exports, compared to 5% in 1990. This was mainly due to the favourable changes in foreign trade regulations, and the privatisation process. GDP growth rates declined sharply in the first two years of the transition process, and have

started to recover in 1992, reaching 6.8% by 1995. Privatisation cannot be sustained unless the political leadership is committed to it. And, for privatisation to be successful it must reflect a shift in the preferences of the public. The positively explosive growth of the private sector in Poland can be regarded as the most conclusive proof that Polish society is really in favour of a private economy. The **findings of the studies on enterprises** (Section Eight), confirm this fact. For example, the productivity, receivable to payable ratio, and sales of enterprises studied during the period 1990-1991, have declined (studies number one and four), while the same variables showed positive growth rates during the period 1992-93 (study number six).

The impact of privatisation on State budget, which mainly came from the divesture of SOEs rather than liquidation. The weight of privatisation receipts in overall budget revenues was only 0.8%, 1.5% and 1.7%, in 1991, 1992, and 1993, respectively, and rose to 2.5% in 1994, with an expected 2.9% in 1995. The percentage share of the total revenues from privatisation to GDP increased from 0.2% in 1991 to 0.5% in 1993, and to 0.7% in 1994. The income resulting from privatisation was disappointingly small in comparison with the expectations of the politicians, who saw privatisation as a financial source which would aid in the consolidation of the State Budget. This was because the vast majority of enterprises were liquidated rather than sold. The impact of privatisation on expenditures came as a reduction in the government subsidies to the privatised enterprises. The main positive impact of reducing subsidies was the reduction of government deficits. This was also intended to ensure that the SOEs would be able to operate on the basis of a hard budget constraint. However, in effect this was mitigated by the fact that some enterprises continued to have access to credits from state owned banks, while others merely adjusted their investment strategies.

The impact of privatisation on creating a capital market came after reopening the Warsaw Stock Exchange (WSE). The first five privatised enterprises had shares listed on the WSE, and by the end of November, 1995, there were only 50 companies quoted in the basic market of the WSE, and 12 companies were quoted in the parallel market. The

reason the companies listed are growing slowly is because the process of privatising State owned assets through public offer of shares has proved to be more difficult than was expected. Most importantly, companies are not interested in being listed, since it is costly and requires the full disclosure of financial data on a regular basis. On November 22, 1996, the National Investment Funds (NIFs) created as part of the Mass Privatisation Programme will be listed on the Warsaw Stock Exchange. As a result, one can expect a considerable increase in capital market activity. Three different types of securities will be available in the capital market; the shares of the privatised companies; shares Certificates; and shares of NIFs themselves.

There was no impact from privatisation on foreign debt although the regulations permit using the Debt-equity swap operation. The decline in the Polish external debt was a result of the agreements with Paris and London Clubs.

The impact of privatisation on FDI arose as a result of the participation of foreign investors in the various methods of privatisation; commercialisation; liquidation; the creation of joint-venture companies with companies owned by the State Treasury, or with an SOEs. In some cases, FDI arose as a result of foreign companies taking part in State designed rescue programmes. The study showed that the number of companies with foreign participation set up as a result of acquisition of shares of STCs increased from 7 at the end of 1991, to 70 at the end of 1995. Likewise, the number of foreign companies established as a result of contribution of assets of liquidated public enterprises, increased from 2 at the end of 1990, to 37 at the end of 1994. 80% of companies established through both the acquisition of shares of STCs and the contribution of assets of liquidated SOEs, operated in industry. The study showed that most companies established through the privatisation of State owned assets involved participation of foreign capital from the European Union countries (mainly from Germany) as well as the USA and Switzerland. The study argued that foreign investment, although increasing, has been less than expected or needed. The **findings of Study Number One (in Section**

Eight) showed that foreign participation in the privatisation process of the sampled enterprises was low.

The impact of privatisation on the labour market was mainly on the levels of employment figures and nominal and real wages. The main negative impact of privatisation is the increase in the unemployment rate, due to layoffs, which were mainly a result of the insolvency of bankrupt enterprises. The study showed that the percentage share of mass-layoffs in the total number of unemployed people was 18.9% in the first quarter of 1991, decreasing to 16.5% in the second quarter of 1994. At the same time, the study showed that one of the main positive impacts of privatisation, in its broad sense, is the growth of the private sector, which helped to absorb mass lay-offs, which arose as a result of the bankruptcy liquidation of SOEs. The findings of Studies Number One and Three showed that there is a drop in the employment figures after privatisation, while Study Number Four showed that privatisation was not accompanied by a considerable reduction in employment as that had taken place before privatisation.

Real wages in Poland decreased during the first four years of transition, but have started increasing since 1994. The findings of Studies Number One, Two, Three, Four, and Six showed that wages in the surveyed enterprises were increasing. This confirms the argument that one of the main incentives to privatisation is the expectation that wages would increase.

The study found that one of the **main consequences of the privatisation process on enterprises** is the type of corporate governance, which was established after privatisation. As a result of privatisation, there was a move from a structure of "*State corporate control*", to either an "*insiders*" or "*outsiders*" structure of corporate governance. More specifically, the type of control which was created as a result of adopting the "*capital*" privatisation path was the move from "State" control to "State Treasury" control in the first step, and from "State Treasury" control to either "outsiders" (domestic or foreign investors) control, or MEBO "insiders" control. The type of corporate control which was

established as a result of adopting the "liquidation privatisation" path was mainly "insiders" control structure. The study tried to evaluate (in Section eight) the impact of the new types of corporate control on the performance of privatised enterprises. The findings of the survey studies analysed in Section Eight, argue that the performance of the privatised enterprises as well as SOEs improved. But one can hardly argue that this was purely a result of privatisation, because even SOEs have changed their behaviour after implementing the stabilistion and liberalisation measures without ownership changes. **To make a more complete assessment** of the specific contribution of privatisation to economic transformation, in general, and the performance of privatised enterprises, in particular, an econometric regression analysis, based on like-for-like analysis could be done (see Section Eight, page 318-319, for detail).

Bear in mind that the transition process is still ongoing, **the relative merits of different privatisation methods** can be summarised as follows: **"Capital" privatisation** created the most efficient *corporate governance* structure, which is reflected in the performance of privatised enterprises via this path. The highest level of funds to the budget was generated via the "capital" path. Most of the enterprises listed on WSE were privatised through this path. All privatised enterprises through this track had to be restructured in the first step. This path attracted the highest share of FDI that came into Poland through privatisation.

The "**liquidation privatisation**" path was the fastest path of privatisation, accounting for more than two thirds of the total number of privatised and liquidated enterprises. This path helped to reduce pressure from enterprise "insiders" on the government, because most of the privatised enterprises via this track were leased to their personnel, and are now under "insiders" control. At the same time, this path helped to reduce the burden on the public budget and administration, and fostered the growth of entrepreneurs and managers with initiative, drive and a keen sense of opportunity. The study showed that this type of privatisation improved the performance of enterprises, because "insiders" who are the owners of the liquidated enterprises care more about improving the

performance of their enterprises, than in the past when these enterprises were owned by the State.

The **Mass Privatisation Programme** is the best in achieving wider share ownership among the public at large, including employees of enterprises, however, one cannot assess, at this early stage, the relative merits of this programme concerning ownership and performance issues, as the programme only began in November, 1995.

Commercialisation ensures a more rapid programmes of restructuring, but cannot be considered a full method of privatisation. Finally, **bankruptcy privatisation** helped to rid the Polish economy of a large number of poor enterprises.

Finally, **the importance of this study** comes from the fact that it analysed the Polish privatisation experience, which is the richest in Eastern Europe. Poland adopted a "multi-track" approach to privatise its economy, avoiding the risk of adopting one single method. The study investigated the relative merits of the different methods of privatisation, and the initial contribution of privatisation to economic transformation. The study noted that it was very difficult to separate the impact of privatisation from that of other factors. However, it is the first to analyse the origins, development, and initial results of privatisation in one work. The originality of the work appears mainly in sections three, six, seven, and eight. This study analysed in detail the development of Polish privatisation philosophy within the framework of the political, social, and economic environment. The impact of privatisation on corporate governance structure has never been analysed before in the case of Poland. Data and information used in the study were provided directly to the researcher, after some interviews with well informed experts in the Ministry of Privatisation (see bibliography).

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INTERVIEWS:

The following is a list of the names of the persons that I have interviewed in different Polish institutions, during the period **6th October - 3rd November, 1995:**

A. ***Ministry of Privatisation***

1. **Mr. W. Limont,** Protocol Section Manager, Department of Foreign Relations, Ministry of Privatisation
2. **Mr. A. Wask,** Director, Department of Foreign Relations, Ministry of Privatisation
3. **Ms. A. Czerwinska,** Department of Capital Privatisation, Ministry of Privatisation
4. **Mr. J. A. Tudruj,** Environmental Unit, Department of Capital Privatisation, Ministry of Privatisation
5. **Mr. J. Bukowski,** Director, Department of Small and Medium Sized Enterprises, Ministry of Privatisation
6. **Mr. S. Rogulski,** Director, Department of Joint Ventures, Ministry of Privatisation
7. **Ms. M. Jakubowska,** Department of Joint Ventures, Ministry of Privatisation
8. **Mr. P. Calski,** Economist, Economic Department, Ministry of Privatisation

B. *Central Statistical Office (CSO/GUS)*

1. **Dr. Roman Popinski,** Press Spokesman of GUS-President, Department of Information, Central Statistical Office.

C. ***National Bank of Poland (NBP)***

1. **Prof. A. Slawinski,** Advisor to the President, Research Department, National Bank of Poland.
2. **Mr. P. Wyczanski,** Advisor to the President, Research Department, National Bank of Poland.
3. **Mr. P. Durjasz,** Deputy Director, Research Department, National Bank of Poland.

D. ***Polish Agency for Foreign Investment (PAIZ)***

1. **Mr. R. Zakrzewski,** Research Assistant, PAIZ.
2. **Mr. T. L. Krawczski,** Research Assistant, PAIZ.

E. ***The Gdansk Institute for Market Economics (GIfME)***

1. **Dr. J. M. Dabrowski,** Vice President, DIfME, Warsaw.

F. ***SBC Warburg***

1. **Mr. M. Moroz,** Researcher, SBC Warburg.

G. ***Ministry of Finance (MoF)***

1. **Mr. P. Sota,** Senior Specialist, Department of Banking System and Financial Institutions, Ministry of Finance.
2. **Dr. B. Durka,** Director, Foreign Trade Research Institute, Ministry of Finance.

H. ***Warsaw University***

1. **Dr. J. Wilkin,** Professor, Department of Economics, Warsaw University.
2. **Dr. J. Kubilas,** Professor, Department of Economics, Warsaw University.

I. ***Warsaw School of Economics***

1. **Dr. R. Rapacki,** Professor and Head of Department, Department of Economics, Warsaw School of Economics.
2. **Dr. E. Chrabonszczewska,** Professor and Director, World Economy Research Institute, Wrsaw School of Economics.

J. ***The World Bank (WB) (Poland Resident Mission)***

1. **Mr. M. Reyes-Vidal,** Senior Operations Officer, The World Bank, Warsaw.
2. **Dr. A. Czyzewski,** Macroeconomist, The World Bank, Warsaw.

K. ***The International Monetary Fund (IMF) (Poland Resident Mission)***

1. **Mr. R. Sierhej,** Economist, The IMF, Warsaw.