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The Legal Framework for Private Sector Development in a Transitional Economy

The Case of Poland

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Poland is rapidly developing a reasonable legal framework to support its transition to a market economy. Yet legal practice lags behind. Precedent and expertise must be built through training and experience.

This paper — a joint product of the Socialist Economies Reform Unit and the Legal Department's Private Sector Development Advisory Group — is part of a larger comparative study in PRE of evolving legal frameworks in Eastern Europe. Copies are available free from the World Bank, 1818 H Street NW, Washington DC 20433. Please contact CECSE, room N6-035, extension 37188 (33 pages). November 1991.

The economies of Central and Eastern Europe are in the midst of a historic transition from central planning and state ownership to development of a market-driven private sector. This transition requires comprehensive changes in "rules of the game" — including the legal framework for economic activity.

A market economy presupposes a set of property rights and a system of laws or customs that allow the exchange of those rights. The legal framework in a market economy has at least three basic functions:

- Defining the universe of property rights in the system.
 - Setting the rules for entry into and exit from productive activities.
 - Setting the rules of market exchange.
- These legal tasks are accomplished by such fundamental areas of law as:
- Real and intangible property rights.
 - Company, foreign investment, and bankruptcy law.
 - Contract and competition law.

Poland has a rich legal tradition dating from pre-socialist times. This tradition was suppressed but not eliminated during its forty years

of socialism, and it is being revised as the country moves toward a private market economy. The current legal framework in Poland closely follows other continental jurisdictions and has a clear and reasonable internal logic. Many of the laws (including the civil code, the commercial code, and the bankruptcy law) are old, but most are flexible enough to permit a wide range of modern, market-oriented activity. Recent legislation (including the antimonopoly, securities, and foreign investment laws) appears to be well-designed for private sector development. Property law, however, remains a "jungle."

Although the legal structure is generally satisfactory in most areas, practice is still very uncertain. The generality of the laws leaves wide discretion for administrators and courts, and there has not yet been time to build up a body of cases and practice to define further the rules of the game. The wide discretion and general lack of precedent create tremendous legal uncertainty that is sure to hamper private sector development. The answer is not a change in the law, but a building of precedent and expertise through training and through dissemination of information.

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The Legal Framework for Private Sector
Development in a Transitional Economy:
The Case of Poland

The economies of Central and Eastern Europe are in the midst of an historic transition from central planning and state ownership to market-driven private sector development. This transition requires comprehensive changes in the "rules of the game"--i.e. the legal framework for economic activity. Markets presuppose a set of property rights¹ and a system of laws or customs that enable the exchange of those rights. The legal framework in a market economy has at a minimum three basic functions:

- (1) to define the universe of property rights in the system,
- (2) to set the rules for the entry and exit of actors into and out of productive activities, and
- (3) to set the rules of market exchange.

Each of these three functions typically involves numerous areas of law. Property rights are defined in practice in most market economies by a wide array of laws regulating the ownership and use of real, personal, and intangible property, as well as shares in going concerns. Company, foreign investment, and bankruptcy laws are among the subset of laws that govern the entry and exit of actors into and out of productive activities. General rules of market exchange tend to be laid out in contract and competition law, while more specific rules of market exchange in particular sectors may be governed by more detailed laws and regulations.

This paper analyzes the evolving legal framework for private sector development in Poland using this general classification.² Poland has a rich legal tradition dating from pre-socialist times. This tradition was suppressed but not eliminated during its 40 years of socialism, and it is being revised as the country moves toward a private market economy. The current legal framework in Poland follows closely other continental jurisdictions (particularly the French system) and has a clear and reasonable internal logic. While many of the laws are old (for example, the company law--the Commercial Code--and the Bankruptcy Law date from the 1930s), most are flexible enough to permit a wide range of modern market-oriented activity. Underlying property and contract rights are laid out in the 1964 Civil Code, modelled closely after the French Napoleonic Code. Although adopted under the socialist regime, the Civil Code was drafted by law professors and--after being recently purged of socialist rhetoric--is suitable for a market economy. Recent legislation--including the 1990 Antimonopoly Law and the recently

¹ As used in this context, the term "property rights" includes rights to real, personal, and intellectual property.

² It is part of a larger comparative study on evolving legal frameworks in Eastern Europe.

adopted Securities and Foreign Investment Laws--appears to be quite well-designed for private sector development. A new personal income tax law was recently adopted, and a new Value-Added Tax law is being considered in Parliament and probably will be adopted in early 1992. The most problematic area is property law, which is still--in the words of one Polish legal practitioner--a "jungle".

Although the legal structure is generally satisfactory in most areas, practice is still very uncertain in all areas. The generality of the laws leaves wide discretion for administrators and courts, and there has not yet been time to build up a body of cases and practice to further define the rules of the game. Although the courts are in general honest and are in fact used by the population, they have little experience in economic matters. Judges are not well paid, and the best lawyers have a strong incentive to go into private practice. The wide discretion and general lack of precedent and competence create tremendous legal uncertainty that is sure to hamper private sector development. The answer is not a change in the law, however, but a building of precedent and competence through training and through dissemination of information.

Rights to Real Property

Property rights reform has lagged behind legal reforms for general business activity in last few years in Poland. The country is now facing legal dilemmas similar to those encountered in its Central and East European neighbors. Across reforming socialist economies compensation laws for prior expropriations are creating tremendous uncertainty, land registration and court adjudication systems are underdeveloped, transfer laws for state property are sparking conflict among levels of government, and privatization laws for real property (particularly housing) are undermining both financial system stability and local government solvency. Many specific procedures for real estate development and transfer are either missing from the current legal framework or are cumbersome and in practice unenforceable. Developing economically and environmentally sensible real property regulations and removing current legal bottlenecks is critical for sustained private sector investment.

While land was always considered a means of production under socialist law, its categorization varied in different socialist systems. For example, the Soviet Union took the position that land must be exclusively under state socialist ownership. In Poland, in contrast, private ownership of land remained the rule, not the exception. Poland placed certain land under state ownership, including all of Warsaw, much other urban land, land occupied by state-enterprises, and about 20 percent of agricultural land (primarily in the northwest area recovered from Germany after World War II). Sale of public land was rare in Poland because of the constitutional protections of state property. Private or cooperative acquisition of state property for construction was instead governed by the principle of perpetual usufruct, a legal form that gave the land user rights similar to ownership, typically for

99 years on payment of a yearly fee. Either private individuals or tenants' housing cooperatives could hold rights of perpetual usufruct.³

Fundamental Concepts of Ownership--Recent Constitutional and Civil Code Reforms

Two fundamental principles, and the regulations that derive from them, distinguish a socialist from a market system of real property rights: (1) the hierarchy of types of property ownership depending on the nature of the owner, and (2) the indivisibility of state ownership. Recent amendments to the Polish Constitution and Civil Code have removed both of these principles.

Hierarchy of ownership. The 1952 Polish Constitution (Articles 7-8 and 11-13) defined the main categories of ownership, while the details were governed by the 1964 Civil Code. Under Polish socialist law, "social ownership"--including ownership by the state, cooperatives, and social organizations--was the highest category of ownership and was protected by the Constitution and the Civil and Criminal Codes. Typically, such property included means of production, including, for example, land, mineral resources, and public utilities. In contrast, property used for personal consumption was individually owned and considered "personal property." Personal property could include, for example, one's dwelling house but not a rental house, which was considered a means of production. Finally, "individual--or private--property" was defined as the individual ownership of means of production, a residue of presocialist economic relationships founded on exploitation and expected to "with away" over time. Individual property received less constitutional protection than social or personal property and was subject to heavy taxation and numerous limitations on use and transfer.⁴

On December 29, 1989, the Polish Constitution was amended to eliminate the socialist property classifications and instead treat all types of property

³ There were four main forms of housing ownership under socialist law in Poland: (1) State rental apartments were typically allocated to families, who then had near-ownership rights of tenancy and inheritance but circumscribed rights to sublease and no right to sell (although they could "trade" for units occupied by other families). (2) Employee housing was allocated according to the employment relationship. (3) Cooperative housing units in multi-family units took one of two forms determined at the time of allocation: (a) tenancy, which was non-alienable, non-transferable to successors (other than those registered as living on the property), and not subject to execution or (b) ownership, which was alienable, transferable and subject to execution. (4) Private housing (individual houses or apartments) was limited to a single unit for family use, i.e. personal property. Additional private units were "private property" and were heavily regulated -- for example by the 1974 Housing and Tenancy Act and the 1985 Land Use and Expropriation Act -- with the state allocating tenants, setting rents, and determining the landlord/tenant relationship.

⁴ Another form of property, "cooperative" property, was considered transitional, to be transformed to social ownership in the future.

equally in civil, administrative, and criminal matters. In particular, Article 7 was amended to read that the Polish state "protects and fully guarantees private property." In 1990, the Civil Code was amended to abolish the distinction between personal and private property.⁵ In addition to protecting private property, the constitutional amendment also states that "expropriation is permitted only for a public purpose and for just compensation." This amendment narrowed state powers contained in the Land Use and Expropriation Act of 1985, and the limits to state power were spelled out further in 1990 amendments to that Act.

Indivisibility of state ownership. The socialist state, as representative of the entire people, owned all state socialist property under the previous system, and such ownership belonged "indivisibly to the State" (1964 Polish Civil Code, Article 128). Under this theory, neither local governments nor state-owned enterprises owned the property they used, managed, or transferred; rather they had the ownership-like right of "operational administration." Because property was indivisible, ownership was indeterminate; those who "operationally administered" property could lease but not sell it.

Assigning state property to specific government owners is proving to be one of the most complex challenges in the transition to a market economy. In Poland it has so far been a three-step legal process. First, a 1989 amendment to the Civil Code (Article 128) named the Treasury or other state legal personae as the legal owner of state property, the first step to making such property alienable. Most state enterprises could then become owners of the land and buildings they previously administered. Second, forty years after abolishing local governments, Poland reestablished them in 1990. The Act on Local Autonomy established a framework--not yet implemented--to assign local governments revenue rights (including taxation) and spending responsibilities (including land use planning, infrastructure provision, and housing management). The implementing regulations transfer without payment certain state property to the local governments, particularly property previously under their "operational administration"--including most urban land, the housing stock, public utilities, and certain state-owned enterprises. Once divided among state actors, state property can then be legally alienated to private investors. Third, 1990 amendments to the Land Use and Expropriation Act gave the state and local governments the right to sell land outright, rather than being limited to granting only rights of usufruct.

⁵ While this equality of property has been incorporated into the Constitution and the Civil Code, distinctions between public and private property have not yet been eliminated in other areas of law.

Remaining Issues in Real Property Law Reform

Although fundamental principles of ownership in the Constitution and Civil Code are now in line with the needs of a market economy, more specific reforms in land and housing law are not well advanced. The area is extremely complex, governed apparently by over 50 different laws, ranging from agricultural land transfer to urban land taxation. Most land formerly under public ownership now lacks clear title. Poland has an opportunity to learn from other socialist economies in transition. For example, East Germany's compensation law is tying up substantial amounts of property in litigation, and Hungary's housing privatization law is destabilizing the financial system while undermining local government solvency. Poland can also learn from good practice: Bulgaria eliminated most socialist rental regulations with little social dislocation.

Reprivatization. Poland is now struggling with issues of compensation for expropriated former owners: how far back in time to go, whether to offer monetary or in-kind compensation, and what form compensation procedures should take. Plans within the government for resolution of outstanding expropriation claims--"reprivatization"--range from no compensation at all to in-kind return of land, with voucher compensation the most likely. The severity of the problem varies in importance in different parts of the country. Warsaw's land was all nationalized after World War II, while land in other cities remained in private hands. On the agricultural side, only about 20% of the land is in state hands, as noted earlier. Until the reprivatization issue is settled, very little land with clear and indisputable title will be available. Unsettled claims on land make land sales difficult and stalls investment. Reprivatization is an area where technical assistance may be particularly appropriate: Poland is in a position to learn from other socialist economies that have already moved ahead with compensation acts, including Hungary and the former East Germany. In particular, Poland must carefully weigh the effect of in-kind compensation on the security of title. Other important concerns include the length of claims periods and the effects of alternative reprivatization schemes on fragile registration and court adjudication systems.

Communalization. The process of transferring state property to local governments--"communalization"--began simultaneously in all 2500 communes but has now stalled. Until the process is completed, with the land inventoried, disputes resolved, and land properly registered, local governments cannot make legal transactions to sell communal property.⁶ Currently local governments are concluding some short-term leases, typically for high rents and only one-year terms. Generally local governments cannot make available land with clear title for sale or long-term lease, an essential element for sustained private sector investment. Communalization is a key area where technical assistance

⁶ In particular, conflicts have arisen between local governments and state-owned enterprises due to the awarding to the latter of their own grounds. Because of undefined land title, capital shortages, and inappropriate taxation incentives, state enterprises have typically built large, low buildings, and claimed and held substantial amounts of vacant land.

may be appropriate, particularly to help streamline the process of registration and the adjudication of plots.

Land Registration. A well-functioning registration system is the legal bedrock of any real property system, essential to securing and financing most investments. Ownership in a civil law system is determined by reference to the real estate register. Poland's registry system is in a state of disarray. Prior to the socialist takeover, three separate registration systems--Russian, German, and Austrian--existed in different parts of the country. Many of these registers are now missing or incomplete. Under socialism, the registration system was largely neglected for land under state ownership. As in other socialist countries, there were significant incentives for both individuals and the state not to comply with registration requirements. Therefore many transfers were not recorded. In Warsaw, for example, the pre-socialist owner is often still listed as the owner of record despite subsequent transfers.

Notary system. The notarial system is considered by many to be a key constraint to emerging markets in land and housing.⁷ All land transactions must by law be notarized to have legal effect. Yet until recently notaries have been state employees; numbers have been inadequate and transactions slow.⁸ A recent positive step has been the privatization of state notaries. The property registers have been moved from the neglected state notary bureau into the court system, which is, however, not yet well-equipped to administer them. A review and streamlining of the notary process is needed, an area where technical assistance could be useful.

Controls on use of real property. Even where ownership is clear at present, many controls on the use of real property remain narrow or unclear. Many of the responsibilities for directing real property use have been devolved onto local governments, but without giving local governments the authority to exercise that responsibility properly. Deregulation should be a high priority. And after stripping away the dead weight of inappropriate regulation, Poland will have to develop economically and environmentally sensible regulation in its place. Appropriate regulation of land use is an area where there has been substantial research and experience in recent years in market economies and an area where technical assistance could be rapidly fruitful. The three main areas for concern are: (1) zoning regulations, (2) building codes, and (3) rent and ownership regulations and price controls.

a. Land Use Planning. Warsaw has emerged from socialism with a highly inefficient pattern of urban land use. The static, end-state socialist land use planning system, coupled with reliance on industrial large panel construction methods, led to relatively high infrastructure and transportation costs with few spatial economies. Currently, the land use system is in limbo. Old regulations are not being followed, authority to regulate has not been

⁷ It is also a bottleneck to the formation of companies, as discussed later in the paper.

⁸ It routinely takes six months to register a transfer.

vested fully in local governments, and no general land use framework has been set. A modern land use planning system is needed, one that offers wide discretion to the market, permits rapid, inexpensive, and accessible dispute resolution, and internalizes environmental and locational costs.

b. Building Standards. A new construction law has yet to be written with affordable building standards for the types of office and residential buildings that market systems are likely to produce. Discussions with legal practitioners suggest that, in the current unsettled environment, side payments are often required to secure location and building permits.

c. Ownership and rent regulations and rent controls. There are numerous restrictions on land use and transfer that need to be reviewed and streamlined. These include, for example, the numerous use and transfer restrictions for agricultural land, including prohibitions on conversion of such land to urban and industrial uses. Another restriction that should be reviewed is the requirement that majority foreign-owned corporations get approval from the Ministry of Internal Affairs to purchase land or enter into long-term leases. Although it is understandable that Poland wants to monitor land purchases by foreigners in the short run, given the currently volatile state of land markets, legitimate foreign investors should have ready access to business premises. The current approval process can reportedly be a lengthy procedure and can force some foreign investors to rely on the limited available forms of short-term lease.

Use of state-owned rental housing is strictly controlled. The many restrictions on subleasing and conversion of rental units encourage massive and inefficient evasion, an experience common to socialist economies. Furthermore, rent levels are still controlled by the central government and do not allow local governments even to recover operating costs for housing stock, much less to service debt on infrastructure. Finally, the lack of a functioning foreclosure and eviction system is a key legal obstacle in Poland requiring priority attention: it prevents emergence of a private rental sector, constrains commercial real estate development, and stunts development of a housing finance system, a system which can be an engine for economic development. While a foreclosure and eviction system is in place legally, it has apparently never been used, despite over forty years of mortgage lending. Even as written, the procedure appears cumbersome and ill-suited to the needs of modern mortgage lending. For example, the foreclosure procedure requires the court auction to reflect an ex ante "market" price. New foreclosure procedures that allow property to be securitized but that also fit in with local cultural norms might include forms of pledge, third-party guarantees, and liens on bank accounts and other movable property.

The legal forms for multi-family dwellings. The legal forms for managing multi-family dwellings will have a critical effect on the emergence of a viable real estate industry and on any eventual housing privatization. Reform of the law on cooperatives has been stalled, but is important for the emergence of housing markets. Cooperatives still have an unclear form within the civil law property clarifications Poland has undertaken, with a status somewhere between public and private. There are numerous restrictions on sale and transfer of cooperative property. Mortgages can not be issued to

individual cooperative members, but only to the cooperative as a whole. At present there is no condominium law, an important legal tool for management of multi-family housing. Poland also has not yet confronted the need to develop clear rules for building management in partially privatized buildings.

Conclusion. Real property rights reform in Poland threatens to become a key bottleneck in the transition to a market economy. Many legal procedures remain untested, others are clearly inadequate, and further gaps are emerging through practice. Unless investors are reasonably assured of ownership, use, and transfer rights in property, they simply will not invest.

Rights to Intellectual Property

A broad framework for protecting intellectual property exists in Polish law. Patents, trademarks, and copyrights are protected under domestic law, and Poland is a signatory to most major international treaties on intellectual property.⁹ Relevant Polish statutes include the Civil and Commercial Codes, the Unfair Competition Law (1926), the Copyright Law (1952), the Law on Inventions (1970s), and the Trademark Law (1985).¹⁰

Although a broad framework exists, certain items--including pharmaceuticals, computer chips, and computer software--are not well protected by existing law, and the need for new intellectual property legislation has been acknowledged. The EC directive on intellectual property is likely to be the model upon which any new laws are based. Foreign treaties have provided much of the impetus for revision of existing law. A 1990 U.S.-Poland Business and Economic Relations Treaty obligates Poland to extend copyright protection to computer programs and to adhere fully to the Paris Act of the Berne Convention by January 1, 1991. The 1991 US-Poland treaty on the protection of investment and intellectual property obligates Poland to extend the coverage of its patent law to cover pharmaceuticals. There has been great resistance to these treaty provisions on the part of the software and pharmaceutical lobbies, which feared incurring liabilities due to their use of foreign intellectual property over the past forty years.

⁹ These include, among others, the Paris Convention of 1883 (1967 Stockholm text) (patents) and the Universal Copyright Convention. To date Poland has adhered to only the administrative provisions of the Berne Convention--1971 Paris text (copyrights), but it is obligated under treaty with the U.S. to adhere fully to the Paris text of Berne by January 1991. Poland is not a signatory to numerous treaties, including the Madrid Agreement for the International Registration of Trademarks of 1891, the Patent Cooperation Treaty of 1970, or the Hague Agreement for the International Deposit of Industrial Designs of 1925, all of which allow for "one-stop" international registration of intellectual property rights.

¹⁰ This study did not go into detail into the letter of the law in the area of intellectual property, and there may be specific problems with the wording of certain provisions in the various laws.

Problems foreseen with this area of law are similar to those encountered in other areas. The administrative body (the patent office) is not prepared for new and more sophisticated problems. There is a lack of qualified individuals and specialists to regulate the area. Investigation procedures are weak. And infringement proceedings are seen as state intervention, which is still politically unpopular.

Company Law

The current applicable company law in Poland is the Commercial Code of 1934. Although the law fell into disuse during the Communist period, it was never formally abrogated.¹¹ However, a variety of governmental restrictions (e.g. lack of necessary permits and prohibitive taxation) made this law virtually unusable. During this period, the Commercial Code was not taught in the universities; neither was it a subject for litigation, offering lawyers and judges no experience with its application. Thus, the Commercial Code faded from Poland's legal memory until the 1980s, when it was revitalized in order to accommodate Poland's economic liberalization. The comeback started with the Law on State Enterprises of 1982, which opened up the possibility of creating joint ventures with foreign or domestic partners.¹² The first Foreign Investment Law (passed in 1986) and the later Foreign Investment Laws of 1988 and 1991 called for foreign investment to be in the company forms provided in the Commercial Code.

While specific provisions in the Commercial Code could be slightly modernized, the consensus of lawyers in Warsaw is that these forms are adequate for the formation of private companies. Until the 1940's the Code was a functioning regulatory framework for companies. The market within which the Code operated, however, differed from current market conditions. For example, no strict rules were seen as necessary for limited liability companies because, at the time, they tended to be smaller, family-type businesses that were self-regulated through personal relationships between partners with personal stakes in the business. As the western market economies developed and more economic actors entered into the marketplace through widespread ownership of shares, the laws developed accordingly in an effort to protect new classes in need of protection. Indeed, the development of most company law reflects the constant shifting of protection for various interests, whether the company, creditors, the investing public, managers, employees, or the national economic interests of the state. The coming years should witness the natural evolution of Polish company law as it seeks to protect newly emerging social and financial interests.

¹¹ Apparently some types of state-owned companies, including Foreign Trade Organizations and some banks, continued to be organized as companies under the commercial code. The Civil Code of 1964 abrogated all but sections 9, 11, and 12, which deal with company forms.

¹² A Law on Creating Joint Ventures was passed in 1979 but never used.

The two corporate forms allowed by the Commercial Code are the limited liability company ("LLC") and the joint stock company ("JSC"). The limited liability company is similar to the French S.A.R.L. (societe a responsabilite limitee), the German GmbH (Gesellschaft mit beschränkter Haftung), and the private corporation in Anglo-American law. The joint stock company resembles the French S.A. (societe anonyme), the German AG (Aktiengesellschaft), and the Anglo-American public corporation. As noted in more detail below, there is relatively little difference between the two (less than between the two analogous forms in other market economies); the LLC is the preferred form for most investors, because it is more flexible and less cumbersome bureaucratically. In addition to these two corporate forms, businesses can operate through one of two partnership forms, the Registered Partnership (governed by the Commercial Code) or the Civil Partnership (governed by the Civil Code).

Characteristics of a Joint Stock Company

Capital and disclosure requirements. As mentioned above, the Polish joint stock company resembles most closely the French SA. At least three founders are necessary, unless the State is a founder. Minimum capital of 250,000,000 zlotys (about US\$23,000) is required.¹³ This may include the value of in-kind contributions, which are evaluated by private auditors and confirmed by court-appointed experts. Valuation of assets in all the eastern European countries has been a great problem in privatization, and the same problems could prevail in valuation for the purposes of determining a company's initial capital.¹⁴

The Commercial Code's provisions on the joint stock company incorporate the principles of transparency common to western corporations statutes. Disclosure requirements make financial data on companies available at both the court of registration and the Ministry of Industry and Trade, and announcements of public subscriptions, including investor information, are mandatory.

Rights and duties of shareholders. Both registered and bearer shares are allowed, and these are exchangeable for one another unless otherwise stipulated in the articles of association.¹⁵ Shares are transferable, but

¹³ Although all shares must be issued, not all capital must be paid-in up-front. Only 25 percent of the value of registered shares must be paid-in. This is considered an advantage over the limited liability form, for which all capital must be paid-in up-front.

¹⁴ If the court-appointed regulators determine a value that is at least 20% lower than that declared by the founder, then subscribers are free to renounce their part in the company.

¹⁵ Bearer shares may only be issued upon full payment. Partial payment may purchase certificates entitling the holder to the shares upon paying the balance. Registered shares may be purchased for partial payment. They may also be issued in exchange for the duty of repeated non-monetary

the articles of incorporation may stipulate that registered shares may be transferred only with permission of the company (i.e. the Board of Directors) or they may otherwise restrict transfer of shares. However, if the article of association does not provide a mechanism for identifying another purchaser, the seller may sell his shares freely.¹⁶

Shareholders are entitled to dividends and to a return of the company's assets in the event of liquidation. However, interest bearing shares are not allowed. This distinguishes Poland's law from those of Hungary and Czechoslovakia (creations of recent years), both of which allow for the issuance of interest-bearing shares. Interest-bearing shares require the company to pay interest on the shares, regardless of how much company profit is earned. Such shares are prohibited in most western countries, because they confuse the basic distinction between bondholders (i.e. creditors) and shareholders (i.e. owners). With ownership comes risk, and interest-bearing shares are an attempt to create ownership without its attendant risk. Yet interest-bearing shares might prove useful in countries trying to encourage private ownership of companies by an inexperienced and risk-averse population.

A share entitles its holder to at least one vote at the appropriate meetings; there are no non-voting shares, although "a company's articles may restrict the voting power of shareholders holding a larger number of shares" (Article 404). Certain shares may be assigned preferences with regard to voting rights, dividends, or claims on assets in the event of dissolution, with terms to be defined by the company's articles of association.¹⁷ Also, certain registered shares (which may be transferred only with the company's consent) may be linked to the obligation of repeated non-pecuniary performance for the benefit of the company. These provisions that differentiate the rights and obligations of various shareholders enable control to be concentrated more than ownership, which may be helpful in addressing the Polish desire for widespread ownership of privatized companies while maintaining strong corporate governance.

Characteristics of a Limited Liability Company

Although not fundamentally different in concept, the Polish limited liability company is a more flexible form than the joint stock company and is

contributions, but only with consent of the company.

¹⁶ This provision allowing the company to restrict the transfer of registered shares removes the characteristic distinction between the joint stock company and the company limited by shares known to the French system. Under French law, only the limited liability company, or *societe a responsabilite limitee*, may condition the transfer of the company's shares on the consent of either the shareholders and the Board of Directors (i.e. the shares are "saleable"). In contrast, the shares in a joint stock company, or *societe anonyme*, are freely negotiable, meaning no permission is necessary to sell these shares.

¹⁷ One share may be assigned no more than 5 votes.

therefore preferred by most domestic and foreign investors. Only one founder is necessary. The minimum capital requirement is only 10 million zlotys. Shareholders are free to negotiate how profits will be distributed, how voting rights will be assigned and exercised, how large the majority vote and quorum must be to validate the shareholders' general meetings, and how rights to choose representatives on the supervisory and management boards will be allocated. A partner's share is transferable by statute, although the law permits the company's articles of association to make transferability contingent upon the consent of the company's board or shareholders. (If consent is refused, the requesting party may appeal in court.) The Polish commercial code is even more flexible than most Western company legislation, where, for instance, majority and quorum rules cannot generally be changed. This flexibility allows partners to a joint venture to arrange a balance of power reflecting their perceived real contribution to the company rather than merely the distribution of shares.¹⁶

That permission may be required to transfer one's shares in a limited liability company--a provision common to analogous company forms in other market economies--reflects the assumed nature of that company. Limited liability companies in most market economies tend to be smaller, closed companies--for example, family concerns. Permission to transfer shares is a way of controlling ownership, which is desired by the participants because shareholders are expected to take an active part in the affairs of the company; passive shareholders are not expected to invest. Because those involved in a limited liability company are small in number and expected to communicate, given their close interest in the company, the legal requirements of the limited liability company are fewer (e.g. less strict reporting requirements, lower capital requirements). Since the investing public at large is not at risk, the state has less of an interest in regulating the company's activities.

The Polish Commercial Code places no maximum limit on the number of people who may constitute a limited liability company. This diminishes the difference between the limited liability company and the joint stock company in Poland, making the limited liability company more attractive, particularly to foreign investors. Whereas in most industrialized countries, limited

¹⁶ An example of the importance of this flexibility can be seen in recent negotiations between the Polish Post Telegraph and Telephone ("PPTT") and two foreign investors to create a joint venture to build and operate a cellular telephone system in Poland. Polish telecommunications regulations required that PPTT maintain majority ownership of the venture, yet the foreign partners--providers of both the capital and the technology for the venture--wanted to have de facto control over the decisions of the company. The parties negotiated an arrangement that (a) gave PPTT 51 percent ownership of the shares in the company but (b) gave the foreign investors the right to choose a majority of the members of the supervisory and management boards and (c) increased the threshold for the quorum and majority vote needed to validate the shareholder's general meeting from 51 to 60 percent. This arrangement is not yet final, and has not yet been approved by the court of registration.

liability companies must automatically transform to joint stock companies after reaching a certain membership (for example, 49 in France), the Polish law appears not to set such a restriction. This most likely reflects the period in which the Code was drafted--that is, when the need to regulate growing companies was not yet felt.

In sum, the limited liability form imposes less rigorous requirements on shareholders than the joint stock form. Its minimum capital requirement is lower, not all capital must be paid-in up-front, and the procedures for evaluating contributions and making decisions on corporate governance are less strict than for a joint stock company. Since the limited liability form of the company is favored by both domestic and foreign investors, it is likely to remain predominant for some time.

Characteristics of the Two Forms of Partnership.

The two partnership forms currently in use are the Registered Partnership and the Civil Partnership. The former is more flexible than the latter and is better suited to larger initiatives where partners' contributions, rights, and responsibilities are not necessarily equal.

The Registered Partnership is governed by Section IX of the Commercial Code. It is a general partnership form imposing unlimited ("joint and several") liability on all partners. Partners are free to assign management responsibilities and to define their respective shares in profits and losses through a deed of partnership, but this deed cannot assign management responsibilities to outside third parties to the exclusion of partners, and it cannot limit any partner's access to information about the partnership.

The Civil Partnership is governed by title XXXI of the Civil Code of 1964 and is a less flexible form intended to cover simple initiatives among a few equally-involved individuals. It is defined as a contract (as evidenced by a "deed of partnership") between two or more persons who bind themselves to attain a common economic objective. Each partner may contribute property, rights, or services to the partnership; the partners' contributions are presumed to be of equal value, and the partners are entitled to share equally in both the company's profits and its losses. The main benefit of this form over no company form at all is that it protects the common property of the group from outside encroachment by third parties. Jointly-held property is not divisible among the partners for the life of the partnership, and a partner may not sell his share. Furthermore, jointly-held property may not be used to satisfy a creditor's claims against an individual partner, although a creditor may seek the dissolution of the partnership in order to gain access to a partner's share. A partner may withdraw from the partnership and recover his original contribution in kind (or its cash value) plus an appropriate portion of the partnership's accrued profits. As with the Registered Partnership, partners are jointly and severally liable for the obligations of the partnership. Partners are expected to be active, each being "entitled and bound to manage the partnership's affairs."

Procedures for Establishing a Company

Although the basic framework for company law appears reasonable and admirably flexible, the process of establishing a private company in Poland--while simplified greatly in recent years--continues to require time and expense. Future reforms in the area of company law should in particular address the role of notaries and procedures in the Court of Registration. The following steps are currently required to open a private corporation in Poland.

The articles of association. When establishing a company in either the joint stock or limited liability form, the founder must first draft the articles of association. The articles of association state the company's name and founders, define its object, and set out the specifics of its stock capital (i.e. number, classes, and nominal values of shares). Previously, companies with foreign participation were required to seek approval from the Foreign Investment Agency, which application included a number of documents informing the Agency of the legal and financial status of the foreign partner. Now, however, with the passing of the new foreign investment act of June 14, 1991, such approval is no longer necessary (see discussion below). While the Commercial Code of 1934 requires that foreign-owned joint stock companies involved in areas of state significance or public utilities seek the permission of the Minister of Industry and Trade, it is assumed that the 1991 foreign investment act supersedes this requirement, even though that provision of the Commercial Code is not explicitly abrogated by the new foreign investment act.

Notary approval and stamp fees. Once the articles of association are drafted, they must be approved by a notary. Unlike those of common law systems, civil law notaries take a much more active role in approving official documents. A limited number of notaries have enjoyed a de facto monopoly in the market; they are difficult to find and there is little room for choice of notary. Until recently all notaries were state employees. The profession is now being privatized and opened to entry. Because Polish notaries have little experience in contemporary corporate forms, they may not understand complex or innovative arrangements, and Polish lawyers report that Articles of Association must sometimes be simplified in order for the notary to understand them. Notaries often offer advice on the Articles' content or have difficulty understanding innovative arrangements. Getting notary approval is reported to be at times a time-consuming and frustrating process.

It is also quite expensive. Notarial fees must be paid for every notarial act involved in the founding of a company. Notarial acts include approving a company's Articles of Association and subsequent amendments to them, including increases in capital. Notarial fees equal 3% of equity capital up to 250 million zlotys, plus .01% of the equity capital over 250 million.¹⁹ Debt financing is apparently not subject to notarial fees.

¹⁹ These fees are set out in section 9, para. 1 of the Regulation of the Ministry of Justice dated 10/23/89 (as amended 1990).

Stamp duties are another cost in starting up a company. These are equivalent to the French "droits d'enregistrement" (registration fees). Stamp duties equal 2% of the company's equity up to 50 million zlotys, plus 1% of the amount from 50-100 million, plus .5% of the amount from 100-200 million, plus .1% of the sum exceeding 200 million zlotys.

It is widely agreed that these fees, as percentages, are unnecessarily high and encourage firms to incorporate with minimum capital. Furthermore, they do not facilitate easy modifications of a company's Articles of Association, as locating a notary is itself often difficult, and as the approval process takes days or weeks.

Registration. After the Articles of Association have been notarized, the company must file at the Court of Registration. Registration gives the company legal personality. This application for registration must include the articles of association as well as the identities of the members of the governing bodies. If the initial capital was raised by public subscription, the application must also include the minutes of the organizational meeting, as well as the list of subscribers and their contributions and shares held.

Currently the greatest difficulty with the Court of Registration is its backlog. On the whole, judges are not seen as incompetent. Rather, due to lack of modern equipment and well-trained staff, the court is slow. Having "connections" within the court is said to expedite approval and registration.

The shareholders' agreement. The shareholders' agreement, if there is to be one, must also be drafted during this period.²⁰ Included with this can be the regulamin, or rules governing the supervisory board. As noted earlier, the current Commercial Code leaves parties great freedom to negotiate the terms of these contracts. As a practical matter, however, shareholders' agreements are said better to be left short and precise (20 pages or less), as Polish partners are believed by some lawyers interviewed to harbor a general suspicion for long and complex documents, particularly where foreign investors are involved. Because the shareholders' agreement is a private contract among individuals, it is governed by the Civil Code rather than the Commercial Code, although it may not abrogate mandatory provisions of the Commercial Code. Although shareholder agreements are meant to fill in gaps left open by the codes, short shareholders' agreements may leave some issues unresolved, increasing the potential for future disputes and litigation.

Summary. The general legal framework set out in the Commercial Code does not in itself restrict the development of the private sector. Refinement of the registration procedure and a reduction of accompanying fees would certainly facilitate the registration of companies, but these concerns should be subordinate to other areas discussed in this paper, which are in greater

²⁰ Shareholders agreements are a normal feature of business organization in common-law jurisdictions, but have not been typical in civil-law jurisdictions. They are becoming more common in Poland with increasing foreign investment. They create greater clarity and certainty for shareholders than is possible under Articles of Association alone.

need of attention. There is as yet no limited partnership form; however, the need for this form has been recognized by the legal community and a task force is currently drafting a provision intended to govern this form.

Foreign Investment Law

A new Law on Foreign Investment was promulgated on June 14, 1991. This law establishes the procedures and conditions for setting up a company with foreign participation. It abolishes some of the administrative barriers to foreign investment contained in the former law (dated December 23, 1988). This is not the only law affecting foreign investment, and some important related provisions are included in other laws--including Foreign Exchange Regulations, the Land Management and Expropriation of Real Property Law, sector-specific laws (such as the Banking, Insurance, and Telecommunications Laws), and the Law on Acquisition of Real Property by Foreigners.

Form and Ownership

The foreign investment law applies to investment by non-resident legal or natural persons, including Polish nationals.²¹ Foreign persons (non-residents) may participate only in companies established in Poland, although they may own up to 100 percent of the shares of such a company. Branches of foreign companies are not permitted under this law, although a separate law regulating foreign branches is expected to be passed in the future. Independent personal services are not explicitly forbidden, but they are not covered by the law and do not enjoy the related protections and benefits.

The Approval Process

One of the most important changes introduced in the new law is the abolition of a separate Foreign Investment Agency. A smaller unit will exist in the Ministry of Ownership Changes engaged mainly in promotional activities.²² The authority of government to screen and approve foreign investment is restricted to a small predefined list of "strategic" areas.

Joint ventures with public enterprises will continue to require government approval.²³ The required permission may contain conditions for

²¹ This may cause some problems, as according to the Constitution all Polish nationals are to be equally treated. On the other hand, some Polish nationals may claim they reside abroad in order to qualify for some of the incentives provided.

²² Several administrative requirements were abolished, such as the evaluation of feasibility studies.

²³ The law does not specifically define "state enterprise" though it uses the term, and most assume that this is an enterprise with more than 50 % state participation. Even the Law on State Enterprises does not define the

the establishment of the enterprise (such as the ratio of foreign to Polish participation or the mandatory ratio of voting rights), depending on the "subject of activity" of the company. As formulated, Article 19 in fact requires the prior consent of the Ministry of Ownership Changes for a company to diversify its activities. Furthermore, joint ventures with newly-privatizing enterprises situated on public land will need to deal with the government to acquire land rights, and purchases of land by majority foreign-owned firms require the approval of the Interior Ministry. Even if land purchase is not desired, leasing business premises from the state is itself a cumbersome process. In effect this means that many joint ventures (i.e. all those with state-owned enterprises or on state-owned land) will continue to require government screening and approval. It is unclear to what extent managers of small enterprises will be allowed to negotiate and carry out joint ventures with foreign partners. If extensive foreign investment is desired, the screening process will need to be cursory for smaller projects and serious only for the more significant ones to avoid the re-creation of a large approval body.

In sum, formally unrestricted foreign investment is in reality only possible for 100 percent foreign-owned companies or ventures with private Polish partners that do not lease or own real property. While the Polish private sector is a growing part of the economy in the trade and services, its role in industrial manufacturing is still very small. Furthermore, access to real property is a problem for both domestic and foreign private firms, and in-depth negotiations with government over real property rights will still be required of all investors for some time to come (see earlier discussion on real property law).

Profit Repatriation

The previous law limited profit repatriation to 15 percent of profits except where the firm generated sufficient net foreign exchange earnings to cover the desired repatriation. The new law allows unrestricted repatriation of all profits, a very important change. Another uncertain area under the old law was the transfer abroad of capital gains. The wording of Article 26 suggests that no restrictions are imposed on the transfer of shares inside Poland and the subsequent repatriation of the proceeds as long as the company is not liquidated during the period of tax incentives or within two years afterwards.

Tax Incentives

The 1988 Foreign Investment law provided for three-year tax holidays, which could be extended up to three more years by the Minister of Finance upon request. The new law also provides tax incentives for foreign investors, but with greater limitations. A tax credit may be granted by the Minister of Finance to a company that (a) has a foreign capital contribution of at least ECU 2,000,000 and (b) operates in regions with high unemployment, is engaged in high-technology activities, or exports at least 20 percent of its

term.

production (Article 23). However, the definition of the tax credit to be provided is not clearly formulated, and there are varying opinions on what it means in practice. The translation of Article 23(6) is approximately as follows: "The portion of the amount deducted from profit tax [i.e. the tax credit] may not exceed the value of stock and shares acquired by foreign persons." This provision may have one of two interpretations: either the total amount of the company's tax credit may not exceed the initial capital contributed by the foreign partner, or the proportion of the total tax that may be credited in any one year may not exceed the proportion of total capital contributed by the foreign partner. Under the first interpretation, no time limit on the credit is needed, and the credit may presumably be used immediately or over several years. Under the second, there is a need for some time limit unless the Poles intend the credit to be available indefinitely;²⁴ no time limit is specified in the present law, although some experts apply this interpretation and assume a 3-year limit, as existed under the previous law. In either case, the tax incentives will be difficult to administer and oversee, given the limited capacity of Polish tax administration.

The definition of foreign investor and related rules make it quite easy for Polish firms to qualify for the incentives. The Commercial Code of Poland does not require that capital contributed to the company be deposited in a special bank account, nor is the court of registration in a position to check the value assigned to non-cash contributions (especially when they consist of technology or know-how).

Such a system of specialized tax reliefs will continue to cause distortions and provide incentives for tax evasion and avoidance. It can also lead to political problems because of its favoring of foreign over domestic investment. The experience of other countries (including Bulgaria and Hungary, as well as many developing countries around the world) makes one question whether the uncertain benefits gained by tax incentive schemes outweigh the obvious loss of revenue and efficiency that result.

Dispute Resolution between Investors and the State

An important area not addressed by the law is dispute resolution. Although disputes arising under this law can be brought in Polish courts under Polish law, this avenue is unlikely to give confidence to most foreign investors. Poland does not accede to the Convention for the International Settlement of Investment Disputes ("ICSID"); however, mechanisms for the settlement of disputes between investors and the government are established in a number of bilateral treaties, including treaties with virtually all major capital-exporting countries.

In sum, the new foreign investment law is an important step forward in removing some of the legal and administrative barriers for foreign direct investment. This step needs to be supported by similar progress in

²⁴ This would amount to a perpetual tax holiday for 100-percent foreign-owned firms.

privatization, real property, and tax law and in institutional strengthening throughout the legal system.

Contract Law

Polish contract law is embedded in the Polish Civil Code of 1964. This Code was significantly amended in July, 1990. Presently, a reform commission composed of judges, lawyers, and professors is considering further changes.

Origins of the 1964 Civil Code

Divided and annexed by Prussia, Austria, and Russia in the eighteenth century, an independent Poland re-emerged following the First World War. Civil law at the time of re-emergence reflected a complex mix of foreign laws. The Poles responded with a codification movement designed to unify Polish law. Of relevance to contract law were the 1933 Code of Obligations and two 1936 Acts on negotiable instruments--one governing bills of exchange and the other regulating checks. This codification movement resulted in a contract regime patterned after German and French models. The law was western, complete with doctrines of offer and acceptance, rules of fraud, duress, and undue influence, and a statute of frauds.

Under the new political structure after World War II, existing contract law remained in force except where inconsistent with socialist principles. Initially, most of Poland's contract law and law of negotiable instruments remained intact. Socialist conceptions of property and the practice of central planning, however, soon required changes in the civil law. From 1945 to 1964 adaptations to the 1933 Code of Obligations came through the promulgation of individual acts and decrees. The aim of 1964 Civil Code was to collect and unify these adaptations.

The Polish Civil Code, as enacted in 1964, reflected a mature system of contract law under socialism. This Code maintained many of the provisions found in the 1933 Code but tacked on a variety of socialist adaptations. The amendments of July 29, 1990 reversed this evolution to recreate a civil law attuned to the market rules of the early 1930s.

Central Features of Socialist Contract Law in Poland

Three central features distinguish the Polish contract law of the past twenty-five years from that in western market economies: (1) the presence of central planning and the corresponding distinction between contracts between state enterprises and contracts between private individuals; (2) the socialist conception of property, including the limitations on private ownership and the preferences afforded to state property; and (3) socialist ideology embodied in the constitutional principle of social co-existence.

Central planning. A principal feature of the 1964 Polish Civil Code was the distinction between contracts between private persons and contracts between state enterprises. With regard to the former (and to contracts between state enterprises and private parties), the law of the 1930s remained

intact. Within the realm of activity afforded private persons, parties engaged in contractual conduct in ways similar to that found in western market economies. By contrast, contracting between state enterprises reflected the needs of planning. The "General Conditions of Sale or Delivery" governed state enterprise contracts in detail, and the state (through the plan) had extensive control over whether commercial entities entered into contracts, with whom they contracted, and what conditions would be contained in their contracts. The Civil Code (articles 397-404) established the possibility of "pre-contractual liability" for state enterprises, that is, a legal duty for enterprises to enter into contracts in accordance with state plans. Failure to accept a contract offer in harmony with a state target could result in liability (Article 397). Similarly, failure to create an offer in a timely fashion could also lead to damages (Article 384). In addition, once a contract was executed between state enterprises, each party became a fiduciary for the interests of the other (Article 355). Article 2 provided administrative organs with the authority to suspend the operation of the Code, and hence authorized administrative adjustment of contractual terms. Article 386 imposed a duty on all parties to cooperate with such adjustments. Contractual disputes between state enterprises were to be resolved pursuant to a system of state arbitration, not in the courts (Article 398).

Recent reforms have largely removed the legal distinction between contracts between individuals and contracts between state enterprises. First, Article 2, which grants administrative authority to suspend the operation of the Code, has been repealed. All contracts, whether between state enterprises or between private parties, are now governed by the same set of laws. In addition, in 1989 the system of state arbitration was dismantled, and all contractual disputes are now heard by the judiciary.²⁵ And finally, the system of pre-contractual liability, while still on the books, is seldom used. The first goal of the 1990 amendments was to provide a system of contract law which could be uniformly applied to any type of transaction. This has been largely achieved.

The socialist conception of property. As noted earlier in the discussion of real property law, the Civil Code (Articles 126-135) provided for various types of property--social, individual (or private), and personal. Administrative regulations strictly limited the subject matter of private market activities and thus profoundly affected the content and reach of contract law. Market-based contract principles were allowed to apply only in the sphere of petty trade (for goods under personal or private ownership), and even there price or other government controls often limited the parties' freedom to contract. In major commercial transactions, the contract principles associated with central planning were in effect. This strictly limited the Polish experience with the complexities of privately structured contractual relations. Furthermore, the state had certain legal privileges in contracting. For example, state claims were not subject to any statute of limitations, which gave the state distinct advantages in the settlement of claims.

²⁵ This was achieved by amending the Code of Civil Procedure.

As noted earlier, the July 1990 reforms changed this property scheme. Articles 126 through 135 were repealed. Today there are three types of property--property held by the state treasury, property held by other public enterprises, and private property. The formal preference for state property has been eliminated, and there is no longer a limitation on the private ownership of property. The second goal of the 1990 amendments was to provide a uniform contract system for all types of property. This, too, has largely been achieved.

The principle of social co-existence. Changing socio-economic practice in the 1950s demonstrated the need for a more flexible enforcement of Civil Law rules in the interest of equity. In addition, socialist ideology seemed to call for a new set of equitable or moral principles to guide business conduct. The Poles responded to these practical and ideological needs by introducing the principle of "social co-existence" into the Civil Code. Article 5 provides: "A right cannot be used in a way which would be in contradiction with the socio-economic purpose of that right or with the principles of social co-existence in the Polish People's Republic." This section has been used as a check on excessive use of individual rights and creates a possibility for introducing moral standards into contractual conduct. Article 4 operates in a similar fashion. It states: "Civil law regulations should be interpreted and applied in accordance with the principles of the political system and the objectives of the Polish People's Republic." Here the Code specifically provides for a political check on the substance of private civil agreements.

These articles have been widely used in judicial practice. For example, Article 4 has been used to protect long-term tenants from the harshness of eviction and to shield debtors against the demands to pay interest accumulated over long periods of time. Article 4 was repealed in 1990. Article 5, a variant of which appears in many civil codes around the world, remains in the Code.

The Current Situation

The Poles are in the process of crafting a set of contract laws appropriate to a market economy. They started with the existing Civil Code of 1964. Most sections were retained, several sections were deleted, other sections are to be added, while still other sections must be reinterpreted in the light of current necessity. Thus far, the amendment process has emphasized deletions. Additions to the Code and re-interpretations of retained sections are yet to come.

Most of the Civil Code does not need to change. Many of the core rules of contracting--such as rules of offer and acceptance or rules relating to performance--were fashioned in the 1933 Law of Obligations and remained in force throughout the era of central planning. These sections, for the most part, reflect current western practice. Their exact meaning will be filled in over time through practice and judicial interpretation.

The major deletions taken to date--regarding central planning, property concepts, and socialist ideology--are highlighted above. Other deletions will

follow. Since the majority of Polish property is still in state hands, some administrative rules regulating exchange of state property are still necessary. These should be phased out in time. The sections creating "pre-contractual" liability for state enterprises provide an example of a set of laws necessary in the present but soon to be obsolete.

Additions to the Code are currently being considered by a group of scholars empaneled by the Ministry of Justice. This group has three areas of concern. First, the present Code does not provide standard terms for certain types of transactions found in industrialized countries. Rules regulating commercial leases, franchises, and factor leasing are conspicuously absent. The commission is considering such additions.²⁶ Second, the state of commercial law may be in need of reorganization. The Civil Code regulates sales (Book 3, Title XI) and pledges of personal property (Book 2, Title III). Another body of law regulates mortgages (Act of 1946). Still another regulates negotiable instruments (Act of 1936 regulating checks, Act of 1936 on bills of exchange). There is some concern that these various sources of commercial law need to be unified or updated. Third, and perhaps most importantly, the Poles wish to harmonize their Civil Code with the laws and customs of the European Community and with the rules of various international conventions. The reform commission envisions a two year study in which these technical matters can be studied and changes made.

The most interesting changes in contract law may come in the form of re-interpretation of existing doctrine. For example, contracting under central planning officially embraced the principle of "freedom of contract," yet in practice there was in fact very little freedom. Contracts were set by the plan and were subject to principles of social co-existence (Article 5 discussed above) and the political needs of the state (Article 4). Practice under a market system will bring new meaning to this principle. Similarly, reinterpretations are likely in most arenas of private interaction.

The task of redrafting formal contract laws is highly complicated and technical. Yet, the problems associated with such a task pale in comparison to the difficulties of teaching an entire society to think in market terms. It will take time to change attitudes and build knowledge, experience, and a body of legal interpretation and thus create adequate certainty in the decentralized contracting process for a market to function effectively.

Bankruptcy

Bankruptcy as practiced in market economies was unknown in centrally planned ones. Western-style bankruptcy procedures were not needed in a

²⁶ The existing Code is flexible enough, however, to permit these types of arrangements on a case-by-case basis. In fact, standard rules for these and other special types of contracts have been added to the French Civil Code over the years, but many appear to have fallen into relative disuse as lawyers find it preferable to craft individually-tailored arrangements under the more general provisions of the Code.

centrally planned system because of the absence of truly adversarial interests. Companies' creditors--whether banks or suppliers--were owned by the state, which also owned the debtor company and would thus arrange to settle financial disputes amicably as they arose (often through additional cash infusions for the debtors or creditors). Furthermore, no comparative law courses on bankruptcy were offered in the universities for 40 years, and thus the concept was virtually unknown to a generation of lawyers trained after the World War II.

As a concept, bankruptcy was gradually reintroduced during the 1980s, but the provisions of the laws did not begin to be applied until very recently. In the Polish case, the relevant law is the Bankruptcy Act of 1934. It was never abolished but was dormant until 3 years ago and has been used recently only for closures of state-owned enterprises (which is still not a true adversary situation). Western-style bankruptcy procedures will only truly be needed as the private sector grows, with private suppliers and banks who face truly hard budget constraints and thus have a strong incentive to collect on bad debts. Conversely, an absence of efficient bankruptcy procedures and other debt-collection mechanisms will inhibit the growth of the private sector.

The Law of 1934

The Polish law (as amended several times, most recently in 1990) appears reasonable in broad terms,²⁷ providing general procedures for both liquidation and reorganization (under the control of a receiver appointed by the court).²⁸ Bankruptcy is overseen by a tribunal of the local court.

²⁷ There may be problems in some of the detailed aspects of the law that are not included in this initial look. Further expert analysis of the current law would be useful.

²⁸ A Law on the Procedure for Mutual Agreement was also passed in 1934 and is still on the books (as amended several times, most recently in 1990). This law, modeled after a 1927 German statute and similar to numerous other European precedents of the late 1800s and early 1900s, was meant to provide an alternative to bankruptcy and liquidation by promoting the amicable settlement of debts between an on-going company and its creditors. The procedure, which can be initiated only by the debtor, is very similar to that of bankruptcy, with (a) the appointment by the court of a judge, (b) the appointment by that judge of a trustee (under a different name), (c) the overseeing by that trustee of the operations of the company while the company prepares a plan to pay off its debts, and (d) the implementation of such plan if agreed to by two-thirds of the creditors (with some protection of the remaining minority from overly onerous terms). The main differences between this procedure and bankruptcy are that only the debtor can bring a mutual agreement case, and the trustee does not have the power to remove the management of the debtor company and take over the enterprise (but can terminate the case and in essence throw it into bankruptcy if the company does not comply with his wishes). It appears that this law (used often before the war) has remained dormant until now because of lack of knowledge of the public, although debtors may choose to

Under the law, either the tribunal, the debtor, or a company's creditors may initiate an investigation. The initiator must prove that the company cannot pay its debts; there are no precise criteria for this standard of proof, although two-weeks of nonpayment is a minimum requirement. The tribunal accepts the case only if the assets of the enterprise are sufficient to cover the procedural costs. This establishes some barrier to legal action and helps to keep trivial cases from clogging the courts. If accepted, the tribunal appoints a judge, who then appoints a trustee (receiver). The new trustee manages the company with the mandatory cooperation of the original managers, who lose their management rights (Article 20) but may continue to be involved if deemed appropriate by the trustee and approved by the bankruptcy judge (Article 98). The value of the company's assets and creditors' claims is determined by the tribunal, after which the tribunal either 1) decides how the company will pay its outstanding debts, or 2) liquidates the company. The bankrupt company has the opportunity to present proposals on the future of the company, and outsiders can submit proposals concerning the management takeover and reorganization of the company.

The Law in Practice

Despite its general reasonableness, the law is now just a shell, as very few bankruptcies have actually been carried out pursuant to it. (We were told that thirty cases are now pending, and only 2 have been completed.) Practice is necessary to establish precedents and fill in more precise rules. Some observers fear the procedure is too complicated to handle the large number of liquidations anticipated in the coming years. As with antimonopoly law, it is important that practice be publicized as it develops to provide guidance to potential creditors, to educate the public and the courts, and to provide an opportunity for debate over the emerging framework.

Court capacity and training is certain to be a bottleneck to the development of sound bankruptcy precedents and principles. The legal institutions are not prepared for the plethora of bankruptcy cases that may be coming their way. Courts and judges are not adequately trained for bankruptcy cases. No training in bankruptcy has been organized for the acting judges, and in the universities this is still developing and very theoretical. The law demands a special judge-commissary to be appointed for every case, which further reduces the already limited operational capabilities of the courts. While special economic courts have been established in Warsaw and some other big cities, the complicated bankruptcy procedures may overwhelm smaller generalized courts.

The availability of receivers (or trustees) is another serious problem. Specialized firms existed in the pre-war period, but the number of present experts is very limited. The law requires that trustees not be associated with the creditors in any way; nor may creditors propose to the court a specific trustee. This is often done, however, for practical purposes.

use it in the future if it remains on the books because it is more favorable to them than bankruptcy.

Statistics on bankrupt companies are not yet compiled; nor are court rulings published (as was the pre-war practice). The Ministry of Justice is supposed to organize this, but the work is in its initial stage and apparently not coordinated with the courts.

Related Concerns: Credit-rating Services and Rules on Collateral

Two broader problem areas related to bankruptcy are (1) creditors' access to information before extending credit, and (2) rules on collateral. The only publicly-available information on a company's financial situation is its registration on file at the Court of Registration. This data is insufficient and unreliable, because only the company's initial capital is registered, and this initial capital figure is not confirmed by the court at time of registration. Credit rating services (a concept hardly known in Eastern Europe) are badly needed.

In the area of collateral, both real and movable property may be used as collateral, but only security interests in real property can be publicly registered (with creditor priority determined by registration date). The only means to secure a loan with personal property is to transfer title to the property while the debt is outstanding. A modern system for registering security interests in personal property would facilitate credit expansion and alternative means of satisfying claims in lieu of bankruptcy. This could include the "floating lien" on inventory and accounts receivable that is prevalent in common law jurisdictions but not generally recognized to date in civil law jurisdictions.

Antimonopoly Law

Clearly one of the biggest impediments to the Polish private sector is the dominant role of the public sector. Small private firms often deal only with public enterprises, who exert market power and may impose unfair or onerous conditions. For example, small private firms are often required to pay for all purchases in cash, while they must supply interest-free credit (in the form of delayed payment) to public enterprises that purchase their products. Privatizing public enterprises and insisting on competition in the market are essential for long-term growth of the private sector. Proper enforcement of competition law is important for private sector development. Low tariffs can themselves go a long way in promoting competition by importing world prices (adjusted for transport costs) as an effective ceiling on domestic prices, but they should be complemented by domestic laws against monopoly behavior.

The Polish Antimonopoly Act of 1990 provides a comprehensive framework for competition law and practice to develop. It establishes broad principles concerning illegal behavior and it sets up a specialized office to prosecute cases (based on complaints filed by individual firms or companies, or on the office's own initiative), with the possibility of appeal to a special antimonopoly branch of the Warsaw district court (and then to the Supreme Court).

The law regulates both market structure and business conduct, and its definition of anticompetitive behavior is all-encompassing. Article 4.1 defines four types of "monopolistic practices": (a) onerous contract terms that yield unjustified benefits; (b) conditioning a contract on the performance by the other party of unrelated services it would not otherwise perform ("tie-ins"); (c) acquisition of shares or property of other companies, if it results in "major weakening of competition"; and (d) interlocking directorates or supervisory councils of more than one competing company if one controls more than 10 percent of the market. Article 4.2 adds to this list (a) direct or indirect price-fixing among competitors; (b) geographical or product-specific market-division agreements among competitors; (c) restriction of output, sales, or procurement; (d) limiting market access of third parties ("group boycotts"); and (e) fixing the terms of contracts with third parties (such as "resale price maintenance"). Article 5 defines as monopolistic the abuse of a dominant position (assumed to exist in Article 2.7 if market share exceeds 30 percent) and names several examples of such abuse--including market division, price discrimination, refusal to deal, resale price maintenance, and predatory pricing. Article 7 forbids monopolies or firms with monopoly-like dominant positions from cutting output or suspending sales to increase prices, or from imposing "exorbitant prices".

While the law is all-encompassing, it adopts a "rule of reason" approach in most cases, giving virtually unlimited discretion to the antimonopoly office to decide which cases to prosecute. Yet the wording implies that the named practices are prima facie illegal, i.e. that, if charged, the burden of proof lies with the company; under Article 6, the practices defined in Articles 4 and 5 (i.e. "monopolistic practices" and "abuse of a dominant position") are prohibited "unless they are indispensable to the conduct of economic activity and do not cause a significant curtailment of competition." The practices of actual monopolies listed in Article 7 are per se prohibited.

If any of these practices are ruled anticompetitive, the Antimonopoly Office has broad powers to order the abandonment of such practices, impose a monetary fine of up to 15 percent of the offender's annual income in the previous year, roll back prices, or even order the break-up or dissolution of violators with a dominant position. It also has the authority to review all proposed mergers and acquisitions (with no minimum size limit). The law gives it broad powers of investigation in line with this broad mandate.

The problem with the law is inherent to the subject; even industrial countries have found it notoriously difficult to differentiate a restraint of trade that reduces efficiency from a legitimate business deal that raises efficiency in the short- or long-run. Sophisticated economic analysis in the U.S. and Europe shows that many vertical restraints (such as tying of sales, resale price maintenance, refusals to deal, discriminatory pricing) may enhance efficiency under certain circumstances--typically when market structure is competitive and the firms imposing the restraints are not in a dominant position. As a result of this economic analysis, enforcement of U.S. antitrust law has softened in the 1980s, and the Department of Justice refuses to prosecute many cases it would have brought in earlier times. The OECD is also recommending that European jurisdictions relax their laws to look at each case on an individual basis (the "rule of reason" approach) rather than

forbidding certain practices under all circumstances (the "per se" approach). Opponents of the rule of reason approach argue that businesses need certainty above all, and that the rule of reason approach leaves too much uncertainty as to what is permitted and what is not, and therefore inhibits business activity.

The Polish Antimonopoly Office is made up of some 100 economists/lawyers in the headquarters and 8 regional offices. Because of the newness of this office, the enormous degree of change required in Polish industrial structure, and the complexity of antitrust analysis in general, the office is likely to make many questionable rulings in the early years. Yet rather than concentrate on legal changes, this office could perhaps best be supported with training and funds to allow them to publicize their studies and rulings. Given the generality of the law, the rulings are going to define what the law actually is, and it is important that business can have access to this developing body of practice so that they can adapt their behavior accordingly (or challenge it if they believe it is inappropriate). In this way the office could play an important role in educating the public and reducing uncertainty.

Judicial Institutions

It is one thing to have a western-style set of laws on the books, and quite another for those laws to be implemented predictably and efficiently. Habits of thought can be slow to change. Expertise develops only through practice. One suspects that Polish inexperience with complex market-oriented legal matters may retard market advances. This inexperience is likely to surface in the judiciary, in the ministries, and in the business community itself.

The Court System

The structure of the Polish judiciary is similar to that in other continental European systems. The Supreme Court, the highest court in the system, is composed of about one-hundred judges appointed by the President for five-year terms.²⁹ It is divided into several chambers: civil, administrative, social (labor and social insurance), criminal, and military. Each chamber is divided into specialized sections. The civil chamber deals with all private matters (commercial and noncommercial), including property law, company law, bankruptcy, and family law. The Supreme Court's role is to review legal issues in final decisions of general appellate courts and the High Administrative Court. Only certain high public officials (including the President of the Supreme Court, the Ombudsman, the Minister of Justice, and the General Prosecutor) can bring cases before the Supreme Court for review ("extraordinary revision"); parties to the dispute cannot bring cases directly but can petition these officials to bring the cases. Most cases are decided by panels composed of 3 judges.

²⁹ Judges in lower courts have life tenure.

Two types of courts are under the Supreme Court: courts of general jurisdiction and courts of special jurisdiction. The latter include the courts for military and social insurance matters and the High Administrative Court. All civil, commercial, social, and criminal cases are tried in general courts (either local or district--"voivodship"--courts, depending on the amount at issue or the nature of the charge), with right of appeal of both factual and legal issues to the relevant court of appeal.³⁰

In addition to these courts, a separate Constitutional Tribunal was established in 1985 to advise Parliament on the constitutionality of laws and to review government regulations to ensure they comply with parliamentary acts.³¹ Only certain high public officials can bring cases to this tribunal. Parliament has the final say over how to treat a decision of the tribunal regarding the constitutionality of a parliamentary act; the judiciary is subordinate to the Parliament (as is also the case in France) and does not have the power to declare statutes null and void as is possible in countries (such as the U.S.) with separation of powers and full-fledged judicial review. The Tribunal's decisions with regard to the legality of sub-statutory regulations are, in contrast, final and binding.

Although the court system has jurisdiction over the whole panoply of commercial matters likely to arise as Poland moves toward a private market system, it has limited competence in these areas. Until 1989, commercial disputes were resolved through state enterprise arbitration (see below) rather than in the courts. Over the past two years the role of the courts has expanded dramatically to include a whole range of commercial matters not considered before. Furthermore, most high-level judges are new. About eighty percent of the appellate level judges have been replaced during the past two years in order to replace old ways with new thinking. Many of the newly appointed judges have been associated with the Solidarity movement for some time. Nonetheless, they lack experience with the various accounting, engineering, and economic problems associated with complex market transactions. Developing such expertise will take time.

Lack of experience and expertise creates uncertainty in the business population; other problems with the court system include cost (in both money and time). In the case of commercial disputes, courts require the party bringing the claim to deposit with the court a sum equal to 12% of the disputed amount. This sum is supposed to be returned upon the decision of the case. This deposit does not earn interest, nor is the return of the sum (if it occurs at all) adjusted for inflation. As many cases take around two years, this deposit imposes a significant financial liability for plaintiffs.

³⁰ The District Courts play the appellate role for the local courts, while several Courts of Appeal review decisions of the District Courts.

³¹ In contrast with Anglo-American models, Continental European constitutional tribunals are typically separate from the courts of general jurisdiction and have exclusive jurisdiction in constitutional matters.

Arbitration in Poland

In light of the problems attendant to the Polish court system, arbitration may be an attractive and efficient alternative form of resolving domestic commercial disputes.³² Arbitration is already the preferred form of international dispute resolution.³³ In more advanced market economies,

³² Moving toward arbitration away from litigation in effect "privatizes" dispute resolution itself, which can be highly desirable when government capacity is severely stretched as in much of Central and Eastern Europe. When discussing arbitration in Poland, it is important not to confuse ad hoc arbitration with state economic arbitration, the previous administrative mechanism by which disputes between state-owned enterprises were resolved (now defunct). During the socialist period, state economic arbitration was the mechanism for settling disputes between state-owned enterprises. This form of arbitration was centralized in the Chief Arbitration Commission. The Chief Arbitration Commission was a hybrid institution, embracing both judicial and administrative functions; this was reflected in its subordination to the Ministry of Finance, as opposed to the Ministry of Justice. In its judicial capacity, the commission settled individual disputes. In its administrative capacity, it had rights and duties to discover and remedy the cause of the dispute, in an effort to insure fulfillment of the state economic plan. In this dual role, the Arbitration Commission was committed to socialist legality, or adherence to the state economic plan, which held the status of law.

³³ Poland is a signatory to the following international conventions on arbitration:

(1) 1923 Geneva Protocol on Arbitration Clause. This allows Polish parties to submit claims against foreign parties to arbitration in other signatory countries. Poland ratified the protocol in 1931 with the reservation that it apply only to contracts declared commercial under Polish law.

(2) 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. This convention ensures the cooperation of all signatory countries in recognizing and enforcing arbitral awards granted in other signatory countries. Poland was an original signatory, ratifying the convention in 1961.

(3) 1961 Geneva European Convention on International Commercial Arbitration. This convention lays out general guidelines on arbitration in Europe. The guidelines, however, are meant to accommodate both national and ad hoc arbitration guidelines. Poland ratified this convention in 1964.

Poland is also a signatory to a number of bilateral investment protection treaties that provide for arbitration. However, as noted in the earlier discussion of foreign investment law, Poland has not yet ratified nor signed the Convention on the Settlement of Investment Disputes between States and

domestic arbitration is increasing in popularity, as it often circumvents problems common to national court systems. Arbitration is usually speedier than that of the court system, not only because tribunals are set up ad hoc (thus avoiding court back-log), but also because arbitral decisions are final and not subject to appeal. Arbitrators are usually well-versed in commercial matters, as opposed to judges sitting in courts of general jurisdiction. Although Poland's court system includes an economic branch, the judges' lack of experience in private sector disputes makes arbitration more attractive, because parties can choose arbitrators with specific experience with private sector disputes of various types.

The Polish Code of Civil Procedure³⁴ provides for formal arbitration similar to that in other western systems. Parties may design their own procedure; alternatively, the arbitrators may determine the procedure or the parties may submit to arbitration run by an organized forum with its own procedural rules (such as the Court of Arbitration at the Polish Chamber of Commerce, discussed in detail below). In ad hoc arbitration, the arbitrators' fees may be agreed upon in the arbitration agreement or will be fixed by an ordinary court upon request of the parties. The winner may request that the loser pay his costs. Unlike in the courts, no earnest money must be deposited with the arbitration tribunal.

Arbitrators usually have broad powers; the only thing they cannot do is take evidence or testimony under oath (a common aspect of arbitration). Arbitrators must give reasons for their decisions unless otherwise agreed upon by the parties. The award is then signed by the arbitrators and the parties and filed with an ordinary court. The award becomes enforceable, however, only when the successful party procures from a court of law an enforcement order. Arbitral awards may not be appealed; they may, however, be set aside if the award falls out of the scope set down in the agreement, the rules of procedure have been breached, or the award is redundant with a court award.

The Court of Arbitration at the Polish Chamber of Commerce provides one interesting forum for private arbitration. This originated as the Court of Arbitration at the Polish Chamber of Foreign Trade, which was established in 1950 to resolve international trade disputes. Although it was an office of the Polish Chamber of Foreign Trade, the Court of Arbitration was (and still is) an independent body. Until 1990, disputes with CMEA countries averaged around 200 per year, while the number of cases involving non-CMEA countries (including Yugoslavia) averaged 10-15 per year (or less than 10 percent of all disputes brought to the tribunal). This later figure is disproportionately low, considering that trade with non-CMEA countries amounted to approximately 30 percent of all of Poland's foreign trade volume. Most disputing parties

Nationals of Other States (1965). The ICSID convention guarantees a forum in which private citizens of signatory states may arbitrate against governments of other signatory states. Parties must have consented to ICSID's jurisdiction before the dispute in order to be heard there.

³⁴ Act of 17 November 1964 (Dziennik Ustaw, no 43, Item 296 (as amended)).

chose instead to present their cases in a neutral forum (such as Switzerland or Austria), Western parties were particularly hesitant to submit to any socialist legal body. Despite this prejudice, however, the Polish Court of Arbitration of the Polish Chamber of Foreign Trade was reputed for being fair and objective in adjudicating trade disputes brought before it.

In 1991 this tribunal was renamed the Court of Arbitration at the Polish Chamber of Commerce. The court remains available for the resolution of international commercial disputes, but through its transfer to the Chamber of Commerce its jurisdiction has been expanded to include disputes between Polish economic subjects. As of yet, this court has not been commonly utilized by domestic parties. Few private parties have sought alternatives to the court system. There seems to be a lack of awareness about the availability of arbitration among domestic parties and a lack of confidence in the enforceability of arbitral awards.

Parties may submit to the Court of Arbitration only if they have agreed to do so in their commercial contract or by subsequent agreement; the clause must specify this court as the locus of arbitration. The Court keeps a list of qualified and available arbitrators, both Polish and foreign. These candidates include professors, practicing lawyers, economists, and others with expertise in commercial matters. State judges are prohibited from arbitrating disputes. This list is offered to assist parties in choosing arbitrators; it is not compulsory, and parties are free to choose anyone whom they wish. In keeping with standard arbitration rules worldwide, each party chooses one arbitrator. The opposing party may object to a party's choice if that arbitrator is related to one of the parties or is otherwise interested in the dispute. Arbitrators may also be refused for the same reasons a judge may be excluded for a court proceeding, which reasons are set out in the Code of Civil Procedure. Together the two chosen arbitrators chose a third, who acts as the presiding arbitrator. Parties may agree to a panel of five or seven as well.

Arbitration fees must be paid before proceedings begin. An arbitration is not considered commenced until all arbitration fees are paid. Fees are based on a sliding scale measured by the amount in controversy.³⁵ Fees may be partially returned depending upon the length of the arbitration.

The arbitrators have the power to admit and exclude both evidence and testimony, regardless of whether it has been admitted by the parties. The rules of the Court of Arbitration also allow for the parties to apply the rules for "ad hoc" arbitration, which allows them to determine their own procedure. In the event the parties cannot agree on the procedural rules, UNCITRAL rules are applied.

Arbitral decisions from both the Court at the Polish Chamber of Commerce and ad hoc panels are published annually without the parties' consent.

³⁵ Three percent up to US\$10,000, plus 2 percent of the excess up to \$100,000, plus 1 percent of the excess of up \$200,000, plus 0.5 percent of the remainder.

Confidentiality is maintained, however, by not identifying the parties involved.

Conclusion

This paper has surveyed some of the fundamental areas of law that are critical to the development of the private sector in Poland. The general conclusion is relatively optimistic: Pre-war Poland had a reasonable legal framework that is being revived, amended, and supplemented by committed and intelligent law professors, legislators and administrators. The result is a set of laws that, although still needing careful study and revision in some key areas (most notably property rights), provides a cohesive legal framework to support the growth of the private sector. Practice and experience are needed to add detailed content to this framework and establish the precedents that reduce uncertainty in everyday transactions.

In addition to a developing legal framework, Poland has a legal history and legal institutions firmly embedded in the European tradition despite a forty year detour along the socialist path. Courts and judges are used and respected; they have not lost their reputation for honesty and integrity, although they may have trouble attracting the best talent given the burgeoning opportunities in the private sector. With time there is every reason to believe that they can develop the competence and expertise needed to give them a central role in interpreting and shaping the law and in providing the private sector with a reliable means for the resolution of disputes. It would be wise, however, for the Poles also to promote alternative means for dispute resolution--most notably, private or quasi-public arbitration--that place fewer demands on the scarce legal talent in the public sector.

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