# Privatization And Economic Restructuring in Poland:

## *An Assessment of Transition Policies*

*By* DENNIS A. RONDINELLI *and* JAY YURKIEWICZ*

ABSTRACT. *Poland* was among the first of the Central European countries to attempt to transform its economy from a centrally planned *socialist* system to a market-oriented one. Although its International Monetary Fund-inspired "*shock therapy*" approach sought to transform the *economy* quickly, Poland's implementation of *privatization* of *state enterprises*, a keystone of the reform strategy, lags seriously behind other economic changes. Poland's experiments with privatization were derailed by economic, political, social and administrative problems. The lessons of experience from Poland's transitional period during the early 1990s are that the development of small- and medium-sized enterprises and the spread of entrepreneurial activity were far more important than privatization of state enterprises in moving Poland toward a *market system*.

I

### Introduction

AFTER THE FALL OF THE COMMUNIST REGIME in 1989, Poland's new government faced the difficult task of restructuring an economy suffering from four decades of socialist central planning. Although its stabilization became the immediate objective, privatization of Poland's more than 8,400 state-owned enterprises (SOEs) was seen by many reformers as a key to the country's transition to a market economy. While Poland's macroeconomic reforms have generally been successful, they have not been implemented without social and political obstacles. The transformation to a market economy has been slowed by political ambivalence about the accompanying economic hardships. Public dissatisfaction resulted in frequent changes in government from 1989 to 1994. The Solidarity government's defeat in the September 1993 elections that followed a no-confidence vote in Parliament the previous May, came after continuing bickering among factions of the ruling party over the pace and scope of economic reform

* [Dennis A. Rondinelli, Ph.D., is Glaxo Distinguished International Professor of Management at the Kenan-Flagler Business School and Director of the Center for Global Business Research at the Kenan Institute of Private Enterprise, University of North Carolina at Chapel Hill, NC 27599-3440. Jay Yurkiewicz is a research assistant at the Kenan Institute of Private Enterprise and a doctoral candidate at the Kenan-Flagler Business School.]

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and privatization. The Solidarity government was succeeded by a coalition of leftist parties dominated by former communist leaders and functionaries who were elected on promises of slowing the privatization process.

Since Poland was among the first of the post-communist countries to embark on economic and political reforms, its experiences during the early 1990s illustrate the variety of factors that affect the implementation of privatization policies. This article reviews Poland's experiments with privatization during its early economic transition period from 1989 to 1994. Experience indicates that Poland's economic transformation owes far more to the creation and expansion of small- and medium-sized enterprises than to the rapid privatization of large SOEs. This article identifies the problems and challenges Poland faced in implementing privatization, and examines the implications for economic transformation.

## II

## "Shock Therapy" Economic Reforms as a Context for Privatization

THE ROLE OF THE PRIVATE SECTOR in the economy was extremely limited in 1989 when the Communist regime in Poland collapsed. Nongovernment enterprises contributed only about 15 percent to gross domestic product.[1] Old, large, state-owned companies produced about 80 percent of national output and accounted for nearly 88 percent of employment in the nonagricultural sectors. Only 300 of the largest SOEs accounted for 59 percent of the net income of Poland's 3,177 state industrial firms. Most economic reformers in Poland understood from the outset that both developing the private sector and privatizing state enterprises were essential for creating a market economy. But for a variety of reasons, government policies focused more heavily on the latter. Privatization was considered essential to reallocate the public resources used to subsidize money-losing SOEs. Financial resources were needed to extend infrastructure and "social safety net" programs, to increase the size and dynamism of the small existing private sector, to achieve broader property ownership, and to promote foreign and domestic private investment.[2] The International Monetary Fund (IMF) and other financial organizations insisted that privatization could generate revenues needed by the state to create new jobs for workers displaced by industrial restructuring. Privatization could reduce the state's administrative responsibilities and the burdens of government intervention in enterprise management. Also, after SOEs were privatized, they could provide consumers with more efficiently produced and lower-cost goods. At the same time, SOEs could benefit from private ownership, which was expected to make them more productive and profitable.

After 40 years of economically debilitating socialist rule, however, the success of privatization in Poland depended initially on restoring efficiently operating markets. Poland's approach to economic reform in 1989 and 1990 was drastic and far-reaching, but even the Communist government during the 1980s had been under economic and political pressures to make some reforms. As early as 1983, it replaced obligatory production targets with a system of contracts and orders. In 1986, the laws were amended to allow state enterprises to issue bonds and to enter into joint ventures with foreign investors. By 1988, a two-tiered banking system had been authorized. Restrictions were lifted on the creation and size of private enterprises and the government passed *The Law on Economic Activity* granting equal status to all forms of ownership.[3]

Despite these changes, little progress had been made in reversing economic recession. Declining economic output, scarcities of consumer and durable goods, and deteriorating living conditions triggered protests against the Communist government led by the Polish labor union, Solidarity. After the communist regime collapsed and Solidarity took power in 1989, it announced a rapid and wide-ranging stabilization program largely based on International Monetary Fund prescriptions to address urgent problems plaguing the economy.

In 1990 and 1991, the economy showed the devastating results of both nearly a decade of economic stagnation and what since have become known as "adjustment shocks."[4] National income fell by 13 percent; investment growth dropped by 10 percent; and industrial production declined by 22 percent from 1989 levels. Inflation reached an annual rate of 585 percent, and unemployment rose to more than 6 percent.[5] Prime Minister Leszek Balcerowicz's IMF-based plan sought to reduce the high levels of inflation and rapid depreciation of the Polish *zloty,* to reverse the deepening state budget deficit, and to stem the deterioration in national output. The macroeconomic reform program, devised and implemented rapidly, freed almost all administrative price controls, devaluated the *zloty* almost to the level of the black market rate, increased taxes substantially, limited wage increases, relaxed restrictions on trade and payments, cut government spending, limited monetary and fiscal expansion, and restricted credit.[6] The drastic and swift reforms pushed by the IMF lowered inflation and stabilized the *zloty* but brought wrenching economic consequences for many people in Poland, especially state employees, farmers, and unskilled workers.

The Polish government followed its "shock therapy" reforms in 1990 with a program to change the country's legal framework in order to promote privatization and create a market-oriented business climate. It amended the *Law of Economics of State-Owned Enterprises* to allow SOEs to suppress the employee-council management system as a prelude to privatization. It defined more clearly the responsibilities and powers of the national Treasury and the SOEs, and permitted SOEs with severe financial problems to be turned over to a recovery commission. The government also expanded the *Law on Financial Management of State Enterprises* to allow periodic revaluation of enterprise assets. It changed the Civil Code governing property ownership rights and modified the Commercial Code regulating the organization of commercial companies. Parliament later enacted a bankruptcy law, allowed the public trading of securities and mutual funds, and established rules for foreign investment in Poland. In addition, Parliament enacted antimonopoly legislation and a land law that regulated real estate transactions.

In 1993, the last Solidarity government, headed by Prime Minister Hanna Suchocka, consolidated reform programs and outlined an integrated program for continued economic and business reforms.[7] Four objectives were considered essential to keep Poland on the path to a market economy. First, the government had to continue to stabilize the economy and promote growth through budgetary, monetary, and taxation policies that would strengthen the *zloty* and encourage privatization of SOEs. Second, it had to develop a stronger role for its social partners—local governments, employers' organizations, and labor unions—in transforming the economy. Third, it had to reform public administration by decentralizing national agencies and strengthening local governments in order to promote democracy and free enterprise. Finally, Poland's transformation would depend on its inclusion in Western political, economic, and security institutions such as the European Economic Community and NATO by the end of the decade.

## III

## Experiments with Privatization

THE SOLIDARITY GOVERNMENT began in 1990 to privatize the massive state enterprise sector in an atmosphere of uncertainty. The reformers were unsure of how to proceed or of what results to expect. No communist country had undergone such a transformation and even the IMF could not accurately predict the consequences of its prescriptions. Although small businesses could be privatized by direct sales and leasing, large SOEs would have to be privatized primarily through the transfer of property to the enterprise's employees, or managers, or through public offerings and sales to foreign investors.[8] Furthermore, the introduction of "mass privatization" was expected to accelerate the pace of property transfers. As it turned out, the government tried to use all of these methods, as will be described below.

**Restitution and Reprivatization.** One of the first issues the Solidarity government had to deal with before privatization could proceed was a clarification of property ownership rights and the settlement of ownership claims of people whose property had been confiscated or nationalized under the Communist regime. Poland's reprivatization plan would return assets confiscated by the government from 1944 to 1962.[9] Compensation could take the form of capital bonds, cash, or the return of assets. Reprivatization was limited to those activities that would not obstruct the overall privatization process, become a burden for a large part of the society, or violate existing laws and social norms. By 1991, however, more than 70,000 claims had been filed for confirmation of property ownership. These claims placed huge burdens on the state budget and jeopardized the outcome of the restitution plan. Some estimates placed the number of potential restitution claims at 200,000 to 500,000 and the cost at $18 billion to $23 billion, which was equal to nearly 50 percent of Poland's foreign debt.[10]

**State-Administered Privatization.** A limited form of privatization actually began in Poland a few years before the collapse of the Communist regime. Legislation passed in 1987 and 1988 allowed SOEs to transform themselves into joint-stock companies.[11] This resulted in so-called "spontaneous privatization," a process that was initiated by the enterprise itself without effective control by the government. Consequently, a majority of buyouts were by state enterprise managers who took advantage of their insider status. In most cases, insiders seized the most attractive parts of a joint-stock company, while the less successful activities were left as burdens on the state treasury.

Criticism of the unregulated nature of spontaneous privatization resulted in 1990 in new legislation governing transfers of state property to private ownership. In addition to forming the Ministry of Ownership Changes to supervise privatization of Poland's SOEs, this legislation also provided a framework for the public offering of stock and the creation of a stock exchange in Warsaw. In November 1990, shares of the first five state enterprises were offered for sale. A total of 4.3 million shares were valued at 300 billion *zloty* ($32 million). To encourage Poles who knew little about even the most basic concepts of a stock market to invest, the government decided to sell the best companies first. In addition, the government was careful not to overvalue the enterprises because it feared that an immediate decline in share prices would result in a loss of investor confidence. In order to prevent excessive dispersion of ownership, the state treasury retained from 17.5 percent to 30 percent of the shares in three of the enterprises. It could then offer these shares to larger investors who would be willing to take an active role in managing the companies.[12] Foreigners could purchase between 25 percent and 40 percent of the shares of any single enterprise. The results of the public offering were disappointing. Only 14 companies were trading on the Warsaw Stock Exchange by mid-1992. The poor performance of the shares of these former SOEs further dampened public enthusiasm for this form of privatization. The decline in stock prices was particularly discouraging because these enterprises were Poland's best.

The failure of other methods of privatizing large SOEs led to a controversial plan for "mass privatization," which initially proposed to distribute state-owned property to Polish citizens at no cost. Although the implementation of the plan was delayed, mass privatization appeared to be the only potentially effective means of rapid restructuring. Advocates of this approach argued that it would privatize SOEs more rapidly than other alternatives because it would eliminate the need for the state to determine their market value. It would also encourage the concentration of ownership rights instead of spreading them over 28 million Polish citizens. The government could avoid making difficult decisions about of how to allocate the companies among different groups eligible to buy shares. Western experts could advise the NIFs without generating charges of selling out to foreigners. Finally, distribution of low-cost shares would overcome the problems of inadequate domestic savings and capital.[13]

The program, announced in June 1991, proposed to privatize 400 of the largest state enterprises through the establishment of National Investment Funds (NIFs). These 400 firms produced about 25 percent of all state enterprise outputs and accounted for 12 percent of industrial employment in Poland. Initial projections envisioned that 50 percent to 80 percent of these companies would be privately owned by the end of 1994.[14] However, a series of political setbacks in Parliament delayed the initiation of the program until 1993, when it was revised to place 600 companies under private ownership. The NIFs were scheduled to begin operating in mid-1994 but the mass privatization program was further delayed until 1995.[15]

**Management and Employee Buyouts.** Poland, like other Central European countries, also experimented with management and employee buyouts. Reformers saw as the advantages of this approach the potential for increasing managers' or employees' motivation to make SOEs more profitable, and for mobilizing support within the companies for privatization. Selling, leasing, or renting SOEs would also help to develop small enterprise in Poland. For example, cooperatives could be been taken over by their employees with government-assisted financing. Because banks were usually reluctant to provide financing to new ventures, in 1990 the government allocated 250 billion *zloty* ($26 million) from the Fund for the Restructuring of the Economy to alleviate capital shortages. Although the allocation was insufficient to meet demand, it provided guarantees to the banks for approximately 2 trillion *zloty* ($211 million) of loans for employee buyouts.[16] The Polish law on privatization passed in July 1990 required that up to 20 percent of the shares of privatized companies be reserved for workers of the enterprise at a 50 percent discount of the issue price. Workers could not, however, obtain total discounts that exceeded their salary for the previous six months. The law sought to create four million small investors among SOE employees.[17]

Critics argued that these buyouts were socially undesirable on several grounds. They did not increase a company's managerial or employment skills, essential conditions for improving productivity and competitiveness. The assets of the company were usually undervalued; and since the companies were operated by essentially the same management and labor force, it was difficult to obtain external capital investment and credit from commercial lenders.[18]

**Direct Sales.** The government of Poland also permitted direct sales of state companies. Individual or groups of investors could purchase all or part of a state enterprise through direct acquisition. Advocates of direct sales argued that there were few other alternatives until Poland developed strong equity markets. Other means were far slower and less promising ways of selling financially ailing companies. In order to encourage foreign investment, Parliament passed a law allowing repatriation of 100 percent of net profit and invested capital, beginning in July 1991. Parliament also passed laws providing foreign investors with compensation guarantees for nationalization, preferential income tax rates, and tax holidays, and abolished required central government approvals for joint ventures in all but a few strategic industries.

Following unsuccessful public offerings in 1990, twenty companies were offered to one or two large, primarily foreign, investment groups. For example, Unilever acquired an 80 percent stake in the detergents producer Pollena Bydgoszcz; Philips took over the lighting manufacturer Polam Pila; and Thomson Consumer Electronics formed a majority-owned joint venture with the television tube producer Polkolor. Generally, however, sales to foreigners initially met with little success. Only about 25 large and medium-sized companies found foreign buyers. The reluctance of foreign investors to take over existing enterprises was understandable because they could easily avoid such problems as labor disputes or mass layoffs by building new factories.

**Asset Privatization through Liquidation.** Finally, Poland pursued privatization through the sale of liquidated company assets. This became one of the most common and most successful approaches for hundreds of large- and medium-sized SOEs. Using liquidation proceedings, the state sold physical assets belonging to SOEs that were beyond restructuring and for which shares in the company could not be sold. In spite of its name, this method did not necessarily lead to bankruptcy. It was generally used to free SOEs of their debts prior to privatization. This was followed by selling or leasing all or part of an enterprise's assets to the managers and workers.

Liquidation was popular because a privatized company no longer paid the excessive wages tax or dividends to the Ministry of Finance Thus, employees acquiring an enterprise could do so with the hope of greater after-tax profits and salaries. Whereas privatization by liquidation allowed an outright sale of assets, the majority of these transactions entailed inflation-indexed "lease-purchase" agreements with the Treasury. This method not only attempted to create capitalism without capital but, given the poor health of the companies, also raised the possibility of mass failures among those firms.[19]

From 1990 until early 1993, more than 600 state enterprises with a work force of nearly 200,000 were liquidated so that management, employees, and investors could buy their assets. Most of the liquidated companies—primarily in construction, communications, transport, agriculture, or manufacturing—were small units with low capital investment requirements.[20]

## IV

### Problems of Implementing Privatization Policies

ALTHOUGH CHANGES IN POLICY transformed Poland's economy from a socialist to a market-oriented system, the implementation of privatization lagged behind other economic reforms. Polish reformers hoped to have more than half of the SOEs in private ownership by 1994. But by late 1993 only 28 percent were privatized, generating only about $473 million in sales.[21] The Ministry of Ownership Transformation reported that of the 8,443 state-owned companies only 617 had been liquidated, 59 had completed the process of capital privatization, and 792 had been transformed into joint-stock companies owned by the State Treasury by mid-1993.[22] In 1994 there were still 6,500 companies in state ownership. In the previous three years there had been only a dozen public flotations, 99 direct sales of SOEs to investors and 693 employee buyouts.[23]

The delays in privatizing state enterprises were attributable to macroeconomic, political, bureaucratic, and structural problems. In the initial stages rapid privatization was hampered by the economic uncertainty that accompanied the demise of the Communist regime in 1989 and by the adjustment shocks inherent in the rapid transformation to a market system. Recession created adverse conditions for the privatization of financially weak SOEs and for entrepreneurs trying to start new businesses. Many companies that financed their privatization with fluctuating rate loans were threatened with bankruptcy because of a sharp increase in interest rates.

The social traumas of rapid economic change also created political ambivalence about and substantial resistance to privatization. The public initially evaluated economic reform policies very critically.[24] Opinion polls taken in 1991 showed that only 53 percent of Poles believed that reforms were going in the right direction.[25] In this continuing atmosphere of doubt, the September 1993 elections brought to power a coalition of the Democratic Left Alliance (SLD), the successor to the former communist party and its rural ally, the Polish Peasant Party (PSL). Both parties appealed to those groups of people who felt most threatened by the economic reforms—farmers, SOE workers, people on low fixed-income pensions, unskilled laborers, and the unemployed. The SLD and PSL campaigned on promises to slow down the reforms, reverse some of the Solidarity decisions, and provide a stronger "safety net" for those adversely affected by privatization. They promised to increase workers' wages, raise pensions for public sector employees, reduce taxes on state firms, reverse plans for increases in the value-added tax and in energy rates, provide better assistance to the unemployed, increase farmers' subsidies, protect domestic markets from foreign competition, and make cheaper credit available.[26] PSL leader Waldemar Pawlak became prime minister in October 1993, replacing Hanna Suchocka's Solidarity-dominated coalition. Although the SLD-PSL government did not reverse economic reforms, it slowed down and modified some Solidarity programs, including plans for mass privatization.

Disagreements raged over the potential inflationary effects of mass privatization because in the initial proposal the public would receive shares at no cost. Critics argued that as soon as share trading was allowed, low-income people would sell their holdings to wealthy investors for cash and increase their spending on consumer goods, further fueling inflation. In addition, there was a danger that the ownership of shares would be concentrated in the hands of a few investors, creating a strong political backlash. Furthermore, critics of the NIFs claimed that they would eventually become monopolies. Because of their large size and small number, the Funds could gain control of entire sectors of the economy. Such a concentration of ownership would undermine the development of a competitive market. It would be politically dangerous to declare bankruptcy of any insolvent NIF because it could lead to the closing of several large enterprises and the layoff of thousands of workers. Thus, without the option of bankruptcy, the NIFs would not differ from the old, state-owned conglomerates.[27]

The implementation of privatization was also slowed by the weaknesses of SOEs targeted for privatization. The poor financial condition of the majority of the SOEs quickly become a serious obstacle to privatization. For example, one of the main reasons why the original "mass privatization" program was delayed was that nearly half of the targeted firms were found to be close to bankruptcy and, therefore, deemed unsuitable for privatization. In 1991 about one-third of Poland's SOEs reported losses.[28] Most large SOEs were burdened with enormous debts. At the end of May 1992, total indebtedness of state enterprises reached

323 trillion *zloty* ($24 billion), a sum equal to the size of Poland's state budget.[29] Yet, despite their poor financial health, insolvent enterprises continued to operate by liquidating their assets or by obtaining loans from other state enterprises.[30]

Moreover, many managers and workers were ill-prepared psychologically to deal with real competition. In Poland, socialist leaders required state enterprises to create jobs for everyone who was willing to work and made it difficult for SOEs to terminate employment. As a result, managers had little incentive to use workers efficiently or effectively. At the same time, employees were not motivated to be productive: their jobs were secure; their pay was low; and a large portion of their consumption came from state subsidies for housing, transportation, medical care, housing, and education.[31] Legislation enacted in 1981 granted workers powers that in a market system are usually reserved for directors and shareholders: managerial appointments and dismissals, verification of performance, distribution of profits, and investment decisions. Because privatization of an enterprise represented a threat to those rights, it was often opposed by workers. Furthermore, workers' councils were responsible for blocking several acquisition proposals out of the fear that privatization would lead to mass layoffs.[32]

Although new legislation reduced the influence of the workers' councils by giving the government more authority over SOEs, the first signs of the weakening of workers' bargaining power came during the wave of strikes in summer 1992. Until then the government had routinely given in to striking workers' demands for higher wages. This time, however, the government refused to participate in negotiations with the workers; and for the first time since the fall of the Communist regime in 1989, strikers received dismissal notices. The government risked a collapse of Fiat's $2 billion takeover of the FSM-car plant in its determination to depoliticize labor issues.[33] But the resolve of the SLD-PSL government and of future regimes to maintain this strong position remains uncertain.

Because of the potentially adverse effects of privatization on employment and despite their commitment to eliminating subsidies for SOEs, the government had to bail out some inefficient companies to limit unemployment and prevent the demise of large producers.[34] The Solidarity government decided, for example, to prevent the bankruptcy or liquidation of the giant Ursus tractor plant in Warsaw despite the fact that the company had accumulated more than $30 million in debt by 1991 and had monthly operating losses of $35 million. The company's demise would have adversely affected the company's 24,000 employees as well as 10,000 employees in cooperating plants and 80,000 workers in the 300 companies that were supplying tractor parts to Ursus. Because of the serious unemployment implications and the likely protests and demonstrations by labor unions, the government chose to try to restructure the company gradually, despite its continuing losses, rather than allow it to be liquidated.[35]

Valuation of SOEs was also a major hurdle in privatization. There was a widespread perception in Poland that the government sold SOEs at minimum prices. It was common during the early stages of privatization for former Communist-installed managers to lead buyouts of their companies. The accuracy of the valuations of these firms was questioned because the value assigned to them by consulting firms was often completely arbitrary and determined by a potential investor in that firm. In many cases, the company's management was responsible for hiring an appraiser who could be offered a stake in the buyout. Given the peculiar nature of accounting principles used under the communist system, determination of the value of assets and liabilities was nearly impossible.[36]

The government's inability to attract large amounts of foreign investment also slowed privatization. Foreign firms were not prepared to put capital into Polish enterprises unless they had management control. From 1989 to 1992, foreign investment in Poland totaled only $700 million.[37] Despite the introduction of more liberal joint-venture legislation, foreign investment remained low because less than half of registered joint ventures were operational. Even guarantees for full profit repatriation failed to spark interest. Approximately 80 percent of foreign companies had a founding capital below $100,000. Furthermore, the role of foreigners was restricted in some forms of privatization.[38]

V

## Conclusions

ALTHOUGH REFORMERS IN POLAND faced serious challenges in implementing privatization policies during the early transition period between 1989 and 1994, they did make progress in transforming the socialist command economy to a market-oriented system. By 1995, Poland had adopted and implemented comprehensive macroeconomic reforms that helped to stabilize and restructure its economy. The government also adopted the basic legislative and policy changes needed to create market-oriented institutions and experimented with and began to implement privatization.[39] Inflation declined from 585 percent in 1989 to 43 percent in 1992 and retail prices increased by less than 36 percent in 1993. Monetary subsidies were reduced; virtually all price controls were lifted; and strict tax policies maintaining compensation increases (at the SOEs only) below the rate of inflation were introduced. Gross domestic product grew by one percent in 1992 for the first time since the reforms were initiated in 1989 and increase by 4 percent in 1993 and 1994. Gross fixed investment increased by 5 percent.

Clearly, however, it was private sector expansion rather than SOE privatization that fueled economic growth in Poland. From 1990 to 1993, the private sector created 3.5 million new jobs. Private firms employed about 45 percent of the nonagricultural labor force in Poland in 1993. In retail trade, the private sector employed more than 90 percent of workers and in construction more than 75 percent. Private companies were responsible for more than 80 percent of domestic turnover. By 1994 about 60 percent of the economy was estimated to be in private ownership.[40]

The transformation of Poland's economy thus far owes much more to the development of small- and medium-sized enterprises than to the privatization of large state enterprises. In contrast to other communist countries, small-scale enterprises were allowed to operate in Poland during the socialist era, although not without difficulties. The first step in transferring the ownership of small businesses to private hands involved developing existing small businesses by removing barriers that had previously blocked their growth. In January 1989, the government passed the Law on Economic Activity that allowed large numbers of people to set up their own businesses either as sole proprietorships or as limited liability or joint-stock companies. All Polish citizens were granted the right to establish their own businesses without restrictions on the number of employees or the amount of property they could own. Within a year of the law's passage, more than 800,000 people had established sole proprietorships. Between 1989 and 1991, the number of unincorporated sole proprietorships increased from 813,000 to 1.4 million. The number of incorporated private firms increased from nearly 11,700 to a little over 45,000.[41] One of the immediate outcomes of those reforms was the growth of street trade. Entrepreneurs sold their goods in the streets at relatively low prices and, thus, forced stores to become more competitive. Eventually, these successful entrepreneurs opened their own retail stores or wholesale firms.

Another means of privatizing those small businesses that could not be reclaimed through restitution was to auction them to the public. The arguments used for small-scale privatization in Poland and throughout Eastern Europe were that it could be accomplished rapidly, it would involve large groups of people lacking substantial amounts of savings or capital, and it would generate revenues for local and national governments. Small-scale privatization would demonstrate quickly the benefits of involving large numbers of small shopkeepers in the process and would improve the efficiency of service enterprises by removing them from state control. The open and transparent auction process allowed market prices rather than political privilege to guide the allocation of state assets.[42] Under Poland's plan, only Polish investors were allowed to participate; buyers had to make a 40 percent down payment and pay the balance within four years. To help finance the purchases, the government made available preferential credit with interest rates not higher than three quarters of the prevailing bank rate.[43]

Thus, the greatest contributions to Poland's economic transformation may well have been those reforms that simply allowed entrepreneurs to take over state-controlled small businesses or to create their own small- and medium-scale enterprises without undue restrictions and controls. More than 1.7 million private firms had been registered by early 1993, most of them operated by individuals using their own savings. In addition, 61,437 private domestic companies were registered as legal corporations along with 11,473 joint ventures.[44]

The lessons of Poland's experience during the early 1990s suggest that much more attention must be given by the International Monetary Fund, international assistance organizations, government and the private sector to creating an economic climate conducive to small business expansion. Although policies encouraging small business development in Poland have been quite successful, more remains to be done. A World Bank survey of small manufacturing enterprises in Poland found that entrepreneurs continue to be hampered by three major problems: 1) constrained demand for their goods domestically because of slow economic growth and the introduction of domestic and foreign competition; 2) financial problems created by exorbitant interest rates for loans from banks and informal sources, slow payment for goods by state firms, and lack of working capital; and 3) rapidly changing government regulations that keep them in a state of uncertainty about how they must operate.[45] The poor state of physical infrastructure in much of Poland also raises costs for entrepreneurs and lowers their efficiency.

In sum, the lesson to be learned by governments in other transitional countries is that Poland's transformation to a market economy has been driven far more by private sector expansion than by privatization of SOEs. Although the latter is a necessary condition for economic progress, it is far from sufficient. If market economies are to emerge in former socialist countries, new institutional structures must be created early in the reform process to provide domestic entrepreneurs and foreign investors with the legislative and regulatory framework, capital, and skills necessary for expanding small- and medium-scale enterprise.

## Notes

1. Organization for Economic Cooperation and Development, *Reforming the Economies of Central and Eastern Europe* (Paris: OECD, 1992).

2. The most concise statement of the case is found in International Finance Corporation, *Small Scale Privatization in Russia: The Nizhny Novgorod Model—Guiding Principles* (Washington, DC: IFC, 1992).

3. Center for International Private Enterprise and the Futures Group, "Poland Case Study," *Economic Reform Today*, Vol. 1, No. 1 (1991): 9–15.

4. See G. Helleiner, "Stabilization, Adjustment and the Poor," *World Development*, Vol. 15, No. 12 (1987): 1499–1513; Branco Milanovic, "The Cost of Transition," *Transition*, Vol. 5, No. 8 (1994): 1–4.

5. See International Monetary Fund, *World Economic Outlook*, Washington: IMF, 1993; and Slovoj Czesany, "Stabilizing Aspects of the Economic Reforms and the Macroeconomic Developments in Hungary, Poland, the USSR and Czechoslovakia," in S. P. Prasad and R. B. Peterson (eds.) *Advances in International Comparative Management*, Vol. 7, (Greenwich, CT: JAI Press Inc., 1992), 157–168.

6. Jedzejczak and Sterniczuk, "Privatization in Poland—1991," 45–60.

7. Anna Sabbat-Swidlicka, "The Legacy of Poland's Solidarity Governments," *RFE/RL Research Report*, Vol. 2, No. 44 (5 Nov. 1993): 19–22.

8. For a more detailed description of these methods in Poland and in other Central European countries, see Dennis A. Rondinelli (ed.) *Privatization and Economic Reform in Central Europe: The Changing Business Climate*, Westport, CT: Quorum Books, 1994.

9. For a summary of restitution laws see Michael S. Fischer, "New Laws in Eastern Europe Set Terms for Restitution," *Business International* 38, no. 31 (Aug. 5, 1991): 261–262, 268.

10. See Unsigned article, "Bids to Reclaim Property Increasing; Total Bill Could Reach $23 Billion," *BNA's Eastern Europe Reporter*, Vol. 1, No. 3 (Nov. 25, 1991): 113; and Ben Slay, "Poland: An Overview," *RFE/RL Research Report*, Vol. 1, No. 17 (Apr. 24, 1992): 15–21.

11. Ben Slay, "Poland: An Overview," *RFE/RL Research Report* Vol. 1, No. 17 (Apr. 24, 1992): 15–23.

12. Zbigniew M. Fallenbuchl, "Polish Privatization Policy," *Comparative Economic Studies*, Vol. 33, No. 2 (1991): 53–69.

13. Ben Slay, "The Mass Privatization Program Unravels," *Report on Eastern Europe*, No. 44 (Nov. 1, 1991): 13–18.

14. Economist Intelligence Unit, *Poland: Country Report*, No 3 (London: EIU, 1991): 1–21.

15. The first step in the mass privatization process was to "commercialize" the enterprises by transforming them into joint-stock companies fully owned by the state treasury. Next, about 20 National Investment Funds would be created. These NIFs would then receive 60 percent of the stock in the commercialized enterprises while the state treasury retained 30 percent. Managers and employees would receive 10 percent of the shares free of charge. Shares in the NIFs were to be sold at a nominal price to Poland's 28 million adults, but securities trading would not begin until one or two years later. To secure the commitment of these funds to the success of enterprises in their portfolio, 33 percent of each company's shares would be assigned to only one NIF. The remaining 27 percent was to be distributed among the others. Thus, each enterprise would have one of the NIFs as a major stockholder. Such an arrangement would aid in maintaining the stability of the securities market and prevent excessive dispersion of share ownership. Postponing the marketing of shares would prevent the shareholders from dumping securities and would give privatized companies time to reorganize.

16. Fallenbuchl, "Polish Privatization Policy," 53–69.

17. Mario Nuti, "Privatization of Socialist Economies: General Issues and the Polish Case," in Hans Blommestein and Michael Marrese (eds.) *Transformation of Planned Economies: Property Rights Reform and Macroeconomic Stability*, (Paris: OECD, 1991), 51–63.

18. Even when employee or management buyouts were not the principal instrument for privatization, the government made provisions for employee shareholding in their negotiations with many private investors in SOEs. It encouraged foreign investors to give employees and managers preferential treatment or protection. The Polish government negotiated special treatment for employees and suppliers, such as in the American Gerber Products Company's bid to purchase

the Polish Alima Baby Food and Juice Company. The approval of Gerber's bid hinged on guarantees to maintain existing employment levels in the company for at least 18 months after the acquisition was completed. The 1,000 employees and 4,500 agricultural suppliers of Alima were also allowed to buy up to 40 percent of the shares in the company at a 50 percent discount on their issue price.

19. Martin Wolf, "The Giant Leap to a Capitalist System," *Financial Times* (May 3, 1991).

20. Christopher Bobinski, "Poland: Much Lost Time Has to be Made Up," *Financial Times*, Special Supplement (July 3, 1992): 4; and Unsigned article, "Government Reports Accelerated Privatization Process in 1992," *BNAs Eastern Europe Reporter*, Vol. 2, No. 7 (Mar. 30, 1992): 243.

21. Unsigned article, "Poland Tallies its Sell-Offs," *The Wall Street Journal* (Oct. 21, 1993): A15.

22. Louisa Vinton, "Privatization in Poland: A Statistical Picture," *RFE/RL Research Report*, Vol. 2, No. 32 (13 Aug. 1993): 58-62.

23. Economist Intelligence Unit, *Country Report: Poland*, 1st Quarter, (London: EIU, 1994): 12–13.

24. 24.Penn and Shoen Associates Inc., *Democracy, Economic Reform and Western Assistance in Czechoslovakia, Hungary and Poland: A Comparative Public Opinion Survey* New York: Freedom House and the American Jewish Committee, 1991.

25. In the same surveys, only 12 percent said that their personal economic situations were better one year after the collapse of the Communist regime, and most believed that their situations would not improve in the immediate future. More than two-thirds of those surveyed believed that their families' standard of living would drop markedly in the future, and more than a majority feared that the economic reforms would fail. Only about 30 percent of those surveyed in Poland stated that they would prefer to work for a state-owned company, but one-quarter of the respondents said that only small businesses should be privatized.

26. Louisa Vinton, "Poland's New Government: Continuity or Reversal?" *RFERL Research Report*, Vol. 2, No. 46 (Nov. 19, 1993): 1–7.

27. Slay, "The Mass Privatization Program Unravels," 13–18.

28. Judy Dempsey, "OECD Raps Poland's Knuckles," *Financial Times* (July 3, 1992): 2.

29. Louisa Vinton,"Polish Government Proposes Pact on State Firms," *RFE/RL Research Report* Vol. 1, No. 42 (Oct. 2, 1992): 10–18.

30. Jeffrey D. Sachs, "Accelerating Privatization in Eastern Europe: The Case of Poland," in World Bank, *Proceedings of the World Bank Annual Conference on Development Economics* (Washington: World Bank, 1991): 15–30.

31. See Byron Brown, "Transforming Postcommunist Labor Markets: The Polish Case," *RFE/RL Research Report* Vol.1, No. 32 (14 Aug. 1992): 50–56.

32. Nuti, "Privatization of Socialist Economies," 51–68.

33. Christopher Bobinsky and Anthony Robinson, "Poland's Hero Strikers Fall from Grace," *Financial Times* (Sept. 22, 1992): 7.

34. Leslie Colitt and Anthony Robinson, "Heavy Going Slows the Pace of Race to Reform Czechoslovakia's Economy," *Financial Times* (Mar. 26, 1991): 2.

35. Unsigned article, "Government Trying to Save Troubled Ursus Tractor Plant," *BNA's Eastern Europe Reporter* Vol.1, No. 1 (October 28, 1991): 13–14.

36. Some argued that the best way to appraise an enterprise was by determining its market value, but this method was not very useful when there was only one buyer. Despite a considerable book value, an enterprise could have a zero or even negative market value after the dismantling or restructuring costs were included. Even as late as 1994, critics of the Polish government contended that its concern with selling SOEs rapidly led state agencies to undervalue them.

They pointed to the sale of stock in Bank Slaski in 1994 for an initial offering price of $23—only to see the buying price of the stock increase to $313 a share the following day—as one of many examples of the deliberate undervaluing of SOEs that deprived Poland's Treasury of needed revenues. See unsigned article, "Poland Faulted on Sell-Off," *The Wall Street Journal* (Jan. 27, 1994): A10.

37. Unsigned article, "Poland's Investment Climate," *The Wall Street Journal* (Oct. 27, 1992): A12.

38. For example, in "mass privatization" foreign investors would be allowed to purchase companies' shares only if the National Investment Funds decided to sell the shares privately or on the open market. Obtaining a majority stake in one company would be nearly impossible. Domestic savings were inadequate to absorb more than a small fraction of the companies that would be available for privatization, and many of those who did have savings either retained them as a hedge against an uncertain economic future or used them to start small businesses.

39. See Jan Vanous, "Polish Economic Monitor," *PlanEcon Report*, Vol. IX, Nos. 28–29 (1993): 1–34.

40. Anthony Robinson, "Expectations Continue to Soar," *Financial Times*, Poland Survey (Mar. 19, 1994): 2.

41. See Leila Webster, "Private Sector Manufacturing in Poland: A Survey of Firms," Industry Series Paper No. 66 (Washington: World Bank, 1992): 1–11.

42. See International Finance Corporation, *Small Scale Privatization in Russia*, 5–6.

43. Economist Intelligence Unit, *Poland: Country Report*: 1–21.

44. Louisa Vinton, "Privatization in Poland: A Statistical Picture," *RFERL Research Report*, Vol. 2, No. 32 (Aug. 13, 1993): 58–62.

45. See Webster, "Private Sector Manufacturing in Poland," pp. 1–5.

**Editorial Note.** The Editors of this *Journal* note with sadness the passing of John A. Gronouski on Jan. 10, 1996. Dr. Gronouski was the former American Ambassador to Poland, former member of the Cabinet as Postmaster General, and the first Dean of the Lyndon B. Johnson School of Public Affairs at the University of Texas in Austin. He served as a referee for this article.

## *People: From Impoverishment to Empowerment*

PEOPLE: FROM IMPOVERISHMENT TO EMPOWERMENT (New York and London: New York University Press, 1995 ) is, in the words of James Gustave Speth, Administrator of the United Nations Development Programme, the result of a collaborative international effort of more than fifty global citizens of different backgrounds committed to improving the state of humanity. The papers were presented at the third Round Table Conference on global "Change: Social Conflict or Harmony?" held at Stockholm, Sweden in 1994 under the auspices of the UNDP Development Study Programme (The first Round Table was held at Antalya, Turkey in 1990 and the second at Bucharest, Romania in 1992. The product of the Bucharest conference was reviewed in this *Journal* under the title *A World Fit for People*, April, 1995).