Volume Title: Transition in Eastern Europe, Volume 2, The

Volume Author/Editor: Olivier Blanchard, Kenneth Froot, Jeffrey Sachs, eds.

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-05662-7

Volume URL: http://www.nber.org/books/blan94-3

Conference Date: February 26-29, 1992

Publication Date: January 1994

Chapter Title: The Logistics of Privatization in Poland

Chapter Author: Andrew Berg

Chapter URL: http://www.nber.org/chapters/c6725

Chapter pages in book: (p. 165 - 188)

13 The Logistics of Privatization in Poland

Andrew Berg

Privatization remains the most important outstanding item on the agenda of radical reform in Poland. The "big bang" reform program was designed to stabilize the hyperinflation, free prices, liberalize trade, and restructure the foundations of the economy toward a market system. An integral part of this restructuring was to be the rapid privatization of the state-owned enterprises (SOEs), which overwhelmingly dominated the nonagricultural economy.

In fact, little privatization of SOEs has taken place.[1] This is not due to a lack of ideas about how privatization should be accomplished; there has now developed a minor industry in which economists propose and discuss privatization programs.[2] Nor is it due to a lack of trying; the Polish government has attempted to implement several methods of privatization. This paper will supplement the discussion about privatization strategies with a review of the actual attempts to implement them. By doing so, it should become clearer why so little privatization has actually occurred.

Two themes emerge. First, although much of the debate has focused on opti-

The author thanks Kevin McDonald, Tony Levitas, his friends and colleagues at the Ministry of Finance, the Ministry of Privatization, and Jeffrey D. Sachs and Associates for many useful discussions, and especially Zanny Minton Beddoes for her invaluable help. He has also benefited from the remarks of conference participants. Mistakes and misjudgments remain his own.

1. In this paper, I do not address the dramatic success that has been achieved in the growth of the private sector, particularly in construction, trade and other services, and the transfer of shops to private hands. These developments have resulted in an increase of the share of the private sector in GDP to more than half by the middle of 1992. In industry, however, the share was still only about 19 percent. The vital topic of reform and privatization of the financial system is also not addressed here. For a fuller discussion of how privatization of state-owned enterprises fits into the general problem of economic transformation in Poland, see Berg and Blanchard (chap. 2 in vol. 1).

2. For discussions of Polish privatization, see, e.g., Dabrowski (1991), Dabrowski, Federowicz, and Levitas (1991), Gruszecki (1991), Kawalec (1992), Szomburg and Lewandowski (1990), and Winiecki (1992). For more general contexts, see Aslund (1990), Fischer (chap. 7 in vol. 1), Frydman and Rapaczynski (1992), Kornai (1991), and Stark (1990).

mal privatization schemes, in practice the issue has proved to be how to execute a minimally acceptable and feasible program. It is common to discuss privatization in terms of a set of goals, such as speed, effective ownership, equity, fiscal stability, avoidance of excess dependence on foreigners, and low cost. The problem, however, seems to be not how best to reconcile competing goals but rather how to accomplish anything at all. What is striking in Poland is that, more than two years into the radical "big bang" program, the vast majority of state enterprises have undergone no ownership transformation; instead, the highly unsatisfactory initial structure has been maintained: the workers control but do not own the enterprises.

If the current situation in the state-enterprise economy were satisfactory, this lack of action would be easier to understand. The current pattern of control of state enterprises, however, gives little cause for complacency. As economic theory would suggest, the evidence implies that these enterprises are generally performing poorly. And, despite the huge budget deficits, political pressure is growing to help these enterprises with subsidies, looser credit, and trade protection.[3]

The second theme is that the initial conditions and constraints have shaped what has been attempted and what has taken place. Section 9.1 isolates three constraints: the usual set of institutional weaknesses common to most LDCs, special problems associated with the revolutionary "rules of the game," and the existing pattern of ownership rights. Section 9.2 examines privatization efforts to date. Section 9.4 concludes.

13.1 The Constraints on Privatization

Poland shares with LDCs a set of well-known characteristics that make privatization difficult. They include a lack of well-developed capital markets and related institutions such as banks, insurance companies, a functioning judicial system to resolve civil disputes, and property registries; a shortage of skilled and experienced personnel; weak administrative capacity, including a shortage of infrastructure such as copy machines and telephones; a difficult macroeconomic environment; and state enterprises in generally poor financial condition. In addition, Poland's efforts to date have brought out a further set of problems whose influence is harder to appreciate but equally pervasive. This is the fact that the situation with regard to the rules of the game, in the broadest sense, is revolutionary. Laws are either new or newly enforced after decades of dormancy. Customs and traditions of behavior, especially the bureaucratic, are widely recognized as inappropriate to the new environment, while new practices have not yet developed. Two points should be emphasized here. First, I am not referring to some "socialist psychology" where individuals are no

3. For more discussion of these issues, see Berg and Blanchard (chap. 2 in vol. 1). For a discussion of restructuring problems in state enterprises, see McDonald (1992).

longer capable of responding to incentives.[4] Second, the problem is not predominantly that the laws themselves do not exist but that they have never been enforced. Most of the commercial code and bankruptcy law, for example, dates from the 1930s (see Gray 1991).

The problem lies rather in the lack of institutional development and in the complexity of the decisions involved in privatization. The habits and traditions that lower transaction costs by substituting for rigid rules do not exist.[5] As a result, where rules are broken, especially in privatization transactions, corruption is suspected.[6] Thus, each minor piece of a transaction, such as the publication of a request for tender offers, requires the signature of the head of a department, who may be criminally liable if there turn out to be mistakes in the advertisement. The result is that the Polish bureaucracy is in effect on a "work-to-rule" strike.[7]

The final and most important constraint on the privatization process is the initial structure of ownership rights. Understanding this requires a brief discussion of property rights in the state-owned enterprises. Polish state enterprises should not be confused with state-owned corporations in the West: they are not joint-stock corporations whose shares are controlled by agents of the state Treasury. They are also not administrative units of the bureaucracy. They are unique legal entities, subject to their own specific structures of ownership and control, with as much political legitimacy as almost any institution in Poland (see Breitkopf, Gorski, and Jaszczynski 1991; Dabrowski, Federowicz, and Levitas 1991; and Frydman and Wellisz 1991).

Poland began decentralizing decision making to the enterprise level in the 1950s, but the point of departure for the current situation is the 1981 State Enterprise Law, which in an emended form is still in effect. This law defined a state enterprise as "an autonomous, self-managed and self-financing unit, possessing personality at law," and gave to the self-management bodies, which are democratically elected workers' councils, the power to appoint the managing director, allocate profits, and plan production. The government kept only the power to create and liquidate enterprises, placing it in the hands of the branch ministry or "founding organ" responsible for the particular enterprise.

This legal self-management was strongly qualified in practice by the nature of the "shortage economy." The central administration and the management retained real independent power, partly through the fact that the shortage econ-

4. Where bureaucratic institutions are not involved, and where individual incentives are appropriate, such as in the small private sector, entrepreneurs are starting businesses in the hundreds of thousands.

5. On how ideology, customs, and tradition reduce transaction costs, see North (1981).

6. There is no direct evidence of actual corruption in privatization. However, there have been well-publicized scandals involving foreign debt management ("the FOZZ affair"), loopholes in certain import tariffs ("the alcohol affair") and large-scale check kiting and related bribery of government officials ("the Art-B affair"). These have served to heighten an already high sensitivity.

7. A type of industrial action, common in public unions prohibited from more overt strikes, whereby all rules and regulations are followed blindly and no actual work gets done.

omy made personal contacts in the government and with other firms critical for the functioning of the firm in order to obtain inputs, subsidies, tax relief, and so on (see Kawalec 1992; and McDonald 1992). The administration and the Party thus retained central roles in appointing and influencing management. In the late 1980s, as reform continued and central planning receded, the power of the workers' councils and managers vis à vis the state grew.

The critical point was reached in 1989 and 1990 with the collapse of the Communist regime. The financial relation between the state and the enterprise was clarified. The only remaining Treasury claim on profits was in the form of a proportional income tax and a "dividenda" payment based on the book value of capital in 1983. All remaining profits were left to the enterprise. The enterprise was still ultimately owned by the state, but most important aspects of ownership had by now been carefully and clearly allocated to the self-management bodies.

The final collapse of the old state structure at the end of 1989 and the beginning of 1990 led to a strong affirmation of the power of the workers' councils. New councils, elected in early 1990, proceeded to pass judgment on management in about half the firms, replacing some 40 percent of the managers reviewed.[8]

The growth in the stake of workers in the firm was more than a legal phenomenon. The shock troops of the Solidarity revolution were the industrial workers, and the front line in the confrontation between the state and the people was the shop floor. As a result, the sense of attachment of workers to their enterprise should not be underestimated. For example, 45 percent of workers surveyed in 1987 and 67 percent in 1989, and 63 and 77 percent of managers, respectively, were in favor of selling shares to workers, despite the fact that most workers did not "support private initiative" (CBOS 1989) in large state enterprises. Privatization of large enterprises to workers was also the most popular type of privatization among the entire population. For example, 80 percent of respondents to another survey agreed that "shares of privatized state enterprises should always be sold first to their workers" (CBOS 1990).

The upshot of this process is that workers are now the dominant force controlling the state-owned enterprise. Despite this power shift toward workers, however, management often maintains significant power because of information advantages or close contacts with suppliers, foreign partners, or even the government and because workers' councils may be passive or co-opted.[9] This granting of some sort of a stake in the firm to insiders has the advantage of creating a certain incentive for those who have the information to make efficient decisions.

8. Help-wanted advertisements can be observed in Polish newspapers in which workers' councils announce that they are looking for experienced, skilled managing directors.

9. There are often two, or even three, plant-level unions active in the enterprise, sometimes in conflict with the workers' council. As a result, the Polish press speaks of the firm being lost in the "Bermuda Triangle" of management, the workers' council, and the unions.

The situation is more complicated that the description given above implies. In addition to workers and management, the state retains significant power in the enterprise. While it has largely given up control of the enterprises, it has not relinquished the legal right to dispose of the assets of the enterprise. The need for ministerial approval of important transactions such as privatization or formation of a joint venture confers influence. The government also retains some of its traditional power through control over the banking system and the budget. Finally, many enterprises are in arrears on taxes, giving the state the power to force the firm into liquidation, as described below.

This confused control structure results in feeble decision making in the enterprise. The relative power of the various players (management, the workers' council, the unions, the government, and possibly creditors such as state banks) varies widely from enterprise to enterprise. In general, the end result, however, is that any one of the stakeholders can block change, while concerted action requires consensus. One implication is that, in smaller enterprises, the insiders are more likely to cooperate and actively carry out adjustments, whereas in large firms internal conflict and passivity are more common (see Dabrowski, Federowicz, and Levitas 1991; and McDonald 1992).

This peculiar ownership and control structure has unfortunate implications for privatization:

1. The current situation is extremely dangerous and probably unstable: real wages are rising, and profit rates have declined to the point where aggregate net profits were negative in the fourth quarter of 1991, with direct implications for the budget, both because of lower accrued taxes and because of enterprise arrears to the government. The budget deficit for 1991 was running at 4.5 percent of GDP, and arrears equaled 85 percent of this deficit. Taxes on wage increases in excess of government-established norms constituted the largest component of these unpaid liabilities. Prospects for the 1992 budget are worse.

2. The withdrawal of the state has left current insiders with a powerful informational advantage over the government as well as a strong incentive to try to preserve their current rights during privatization. One potential *positive* implication is that those who control the firm have the information and some of the incentives to behave efficiently. The looming threat of disenfranchisement through privatization weakens these incentives and encourages irresponsible behavior.

3. Insiders will resist disenfranchisement except where the firm is in financial distress. The government finds itself making promises of financial and other support in its effort actively to privatize firms.

The next section reviews the experience to date in the privatization of state-owned enterprises.

13.2 Privatization Efforts to Date

13.2.1 Spontaneous Privatization

Given the constraints outlined above, it is not surprising that the first occurrence of privatization was instigated and controlled by insiders. With the relaxation of government control over the enterprise in the late 1980s, and as the end of the Communist era appeared, management found opportunities to privatize profits through so-called *nomenklatura* privatizations. In a typical transaction, the management and perhaps ministry officials would participate in a new private company that would enter into a joint venture with the state enterprise. Transfer pricing and other terms of the joint venture would ensure that profits would be transferred to the private company.

Condemnation of these sorts of deals was widespread, and one of the Solidarity government's first reforms in late 1989 made liquidation of a state enterprise mandatory in the event that "over half of the enterprise's assets are composed of shares, other equity in joint-stock companies, or bonds, or have been transferred in usufruct to other parties on the basis of civil contracts" (Breitkopf, Gorski, and Jaszczynski1991). The increased power of the workers' councils and unions also resulted in a curbing of *nomenklatura* privatizations.

As the power in the firm has shifted from the *nomenklatura* to the stakeholders described above, a related form of spontaneous privatization has developed. In this case, assets are transferred to private hands with the agreement of all interested parties, which would normally include workers and managers. For example, one wholesale distribution enterprise, with several hundred employees, was largely dismantled and began to operate in private hands, probably without any transaction registered as *privatization.* The gas station was leased to employees, the trucks were sold, and a private company was using the parking lot and some of the office space. The arrangements may or may not have been legal, but probably no one with any power to interfere was unhappy. In another case, a warehouse that was part of a state farm was being used by a local farmer to store animals prior to export, as part of a major private operation. The state employee in charge of the warehouse was also an employee of the private company.

By its nature, this sort of privatization is hard to observe, much less measure. It is probably economically efficient. If it is significant, it represents an important qualifier both to the claim that little privatization has taken place and to the statistical evidence on the decline in employment and output in the state sector. Informal estimates from recent surveys suggest that perhaps one-third of enterprises have engaged in some sort of partial asset transfer to the private sector and that virtually all the assets from the burgeoning private sector come from the state sector.[10]

10. I am indebted to Tony Levitas for sharing preliminary results from current work in Poland. I rely heavily on his information both here and later, when I discuss outcomes in liquidated enter-

It is not clear that this sort of privatization can form an important part of the overall process. It appears to be difficult to arrange in the larger state enterprises. The privatization of an asset in such an enterprise requires an arrangement within the company for distribution of the gains. If the asset is well defined (a pig farm belonging to a shoe factory, e.g.), it may be a natural outcome for those working with the asset to appropriate it. For integral parts of the factory, however, the internal coalition may be difficult to form. In one case, a private company in Gdansk leased workshops and hired workers from one of the large state-owned shipyards at much higher (presumably efficiency) wages. This arrangement was halted by the workers in the state enterprise, who apparently objected on grounds of equity.

13.2.2 The Law on Privatization of State-Owned Enterprises

The alternative to spontaneous privatization is active government intervention to privatize. The government gained the legal power to begin privatizing state enterprises with the passage of the Law on Privatization of State Enterprises on 1 August 1990 (see Center for Privatization 1990), and this continues to define the context for privatization in Poland.[11]

This law was the culmination of a long and acrimonious debate. Initially, at the end of 1989, the government envisaged universal *commercialization* of state enterprises (Polish terminology for the legal conversion of state-owned enterprises into joint-stock companies owned by the state Treasury and subject to the commercial code). The government hoped to privatize these commercialized firms rapidly, primarily through initial public offerings. There were several justifications for this approach: the desire to generate widespread share ownership for sociological and political reasons; a strong attachment to Anglo-Saxon-type capital markets, itself partly due to the influence of aid-financed investment bankers and financial market specialists; and, more generally, the feeling that the valuation and sale of assets was the only "civilized" approach. The government's intentions to commercialize "from above," without workers' council approval, generated strong resistance, and the plan was abandoned. This was partly simple interest-group politics in the Sejm (the lower house of Parliament) and partly a widespread fear of nationalization, based on concerns that the state would run the enterprises no better than it had in the past and that Solidarity might take on characteristics of the former regime if given power over the enterprises.[12]

prises. For further discussion of measurement of the private sector and some estimates of biases in the measurement of output and consumption during transition, see Berg (1992).

11. For a useful description of privatization mechanisms in Poland, see Madigan (1992).

12. The main alternatives to the government plan in the Sejm were variations on the idea of worker self-management. Gruszecki (1991) argues that, while there was some real attraction for the worker-management/employee-stock-option-type plan, a dissatisfaction with the government approach of selling enterprises generated much of the resistance. In the end, and after some twenty-four versions, the final draft still assumed the case-by-case commercialization and sale of enterprises.

The law envisages two possible paths for the privatization of an enterprise. The first, *capital privatization,* was intended in general for large enterprises. The second, *liquidation,* was intended for smaller enterprises and will be discussed below. The first step in capital privatization is commercialization. This step normally requires the approval of the workers' council, the management, and an assembly of employees.[13] With commercialization, a board of directors is appointed by the representative of the Treasury (now the minister of privatization). The workers appoint one-third of the board. The 1981 State Enterprise Law no longer applies to commercialized enterprises. In particular, the workers' council loses its powers, and the management is responsible to the board.[14] After commercialization, the Ministry of Privatization (MOP) is responsible for privatization of the enterprise. The workers are given the right, however, to buy up to 20 percent of shares at half price, subject to a limit on the total discount equal to one years' wage.

The second major path of privatization envisaged in the law is liquidation.[15] Here, the basic idea is that the enterprise decides to privatize, the branch ministry responsible for the enterprise agrees, the MOP concurs, and the liquidation is implemented by the branch ministry. The state enterprise ends its legal existence, and there are three possible outcomes for the assets: (1) The assets are sold piece by piece by the responsible ministry. (2) A new company is created between the Treasury and a private investor. (3) The management and employees create a private firm and lease the assets (and the liabilities) of the enterprise from the Treasury.[16]

13.2.3 Implementation of the Privatization Law

Commercialization

Commercialization is the necessary first step to capital privatization. Table 13.1 gives the number of firms commercialized by size facts and table 13.2 a sectoral breakdown. Some 244 enterprises have been commercialized since the law was passed (as of the end of 1991). These represent about 10 percent of employment in the national economy. The government strategy has been to associate commercialization directly with privatization, so, while the con-

13. The law did provide that a majority of the Council of Ministers and the prime minister could compel an enterprise to commercialize without workers' council approval. This power has not been exercised to date. For explanations of this aspect of the law, see *Prywatyzacja* (Ministry of Privatization), nos. 1, 4 (1991).

14. A later addition to the law allows the loosening of wage controls in an effort to encourage commercialization.

15. Confusingly, the State Enterprise Law of 1981 also envisages "liquidation" of state enterprises that are delinquent on certain tax payments. This distinct type of liquidation will be discussed separately below.

16. The new private company must be created according to the commercial code, with a paid-in capital equal to at least 20 percent of the book value of the state enterprise. The law also defines some of the terms of the lease. For legal commentaries on this aspect of the law, see Prywatyzacja, nos. 2, 3 (1991). For further explanation, see esp. Madigan (1992).

Table 13.1 **Number of State Enterprises Commercialized and in Liquidation as of 31 December 1991**

	Liquidations via 1981 State Enterprise Law				Liquidations via 1990 Privatization Law					
No. of employees	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)	Commercialized	Total
Total	442	5	2	534	24	15	338	416	244	1194
<200	324	4	0	371	15	8	159	190	8	569
200–500	75	0	1	99	6	4	117	144	52	295
>500	43	1	1	64	3	3	62	82	184	330

Source: Ministry of Privatization, Warsaw.

Note: Means of liquidation: (1) via sale of property; (2) via contribution into company; (3) via leasing; (4) total.

Table 13.2 **Number of State Enterprises Commercialized or in Liquidation by Industrial Sector as of 31 December 1991**

		Enterprises Transformed					
	Total No. of Remaining State Enterprises	Liquidated		Commercialized		Total	
Sector		No.	%	No.	%	No.	%
Industry	3,009	255	8.5	201	6.7	456	15.2
Construction	1,367	271	19.8	30	2.2	301	22.0
Agriculture	1,833	174	9.5	1	.1	175	9.5
Forestry	51	1	2.0	2	3.9	3	5.9
Transportation	529	62	11.7	7	1.3	69	13.0
Communication	5	1	20.0	0	.0	1	20.0
Trade	608	126	20.7	1	.2	127	20.9
Other	826	60	7.3	2	.2	62	7.5
Total economy	8,228	950	11.5	244	3.0	1,194	14.5

Source: Ministry of Privatization, Warsaw.

Note: The percentages indicate the ratio of number of transformed enterprises to the number of remaining state enterprises.

straints discussed above have influenced this process as well, I will not focus on them, except to summarize some tentative conclusions.

First, it was not difficult to find board members. A training program developed within the MOP has succeeded in producing enough candidates. There is no direct evidence, however, that boards intervene actively. MOP officials complain that important decisions require their direct intervention. It appears that boards tend to become advocates for the enterprise instead of agents of the owner (the Treasury).[17] Second, the enterprise and the government tend to

17. For this reason, the placing of representatives of creditors, such as banks and other enterprises, on the boards of commercialized companies is being considered.

feel that the state is newly responsible for the enterprise. This is a logical result of the increased ownership rights of the government and an outgrowth of the implicit or explicit promises that the government makes to enterprises in its efforts to get them to commercialize.

Third, some evidence points to an increased passivity in the enterprise. There is apparently a fear on the part of the management that, since the government is now responsible for finding buyers, foreign partners, and so on, it is not a good idea to risk strikes or other disruptions that might be caused by restructuring. The fact that the MOP will actively structure any eventual privatization means that the management has much less chance of benefiting from, for example, a joint venture than if it could negotiate and conclude the deal itself.

The First Five IPOs

In the year after the passage of the privatization law, the government focused its energies on the preparation of companies for initial public offering (IPO). The idea was to make the first privatizations so successful that the process would "snowball" and up to 100–200 enterprises could be processed and sold every year. However, the experience with the first five IPOs convinced almost everyone that additional methods of privatization were necessary.

The selection of companies was a long and politically difficult venture, in which a list of twenty companies in January 1990 was winnowed down a final five. These companies, with 23,000 total employees, were chosen as the best candidates by Western and Polish consultants, on criteria of quality of management, financial soundness, ability to export, and so on. They were offered to the public in November 1990. The five enterprises were successfully sold, although the subscription period had to be lengthened and a state-owned bank allowed to purchase shares in order to avoid undersubscription in some issues. Ultimately, 130,000 shareholders bought shares worth $31 million. The offering of five large companies simultaneously has to be considered a success considering the environment, but these transactions were expensive and, more important, required tremendous allocation of government human resources.

The achievement of actually privatizing five companies in the Polish situation and, in the process, creating some of the institutions of a capital market was remarkable. But the success has been mixed. Since the initial offering, at least two of the five have got into in serious difficulty, as real appreciation of the zloty and the elimination of CMEA (Council for Mutual Economic Assistance) trade have hit them hard. Share prices have fallen below the offering price in four of the five companies. The boards do seem to function reasonably well. But these boards have a high concentration of scarce talent, such as the president of a new development bank and department directors from the MOP. The companies still appeal to the MOP for help when in trouble as well, cashing in on implicit or explicit promises of support.

In a larger sense, the failure of the IPO approach was clear and acute. While certain technical details could be better worked out in the future, nothing suggested that there would be a "snowball" acceleration of IPOs; the next round would clearly be as hard as the first. While some capacity had been built, the transaction cost was unsustainable, and public enthusiasm had fallen in response to the poor stock market performance. After all, only five had been done. Nonetheless, the government continued to carry out public offerings, and, since 1990, there have been another five full or partial public offers, in which some $33 million worth of shares have been sold. (For a list of all firms privatized through capital privatization, see app. table 13A.1.) In addition, there have been another sixteen enterprises privatized through auctions and tender offers. As table 13A.1 shows, the total value of shares sold in these sixteen enterprises was about $142 million, with the companies valued at $228 million. The largest of these were sold at least in part to foreign investors.

The IPO approach has thus proved to be extremely slow. Advocates of alternative approaches had already provided the reasons why the program could not be the primary vehicle for privatization. Until the end of 1990, however, there were always those who argued that the process was about to accelerate drastically. It is thus instructive briefly to look at the reasons for the slow pace of public offers.

The novelty and risk of the procedure compelled the government to promise good returns to investors and health and success to the companies involved. This made doing due diligence (verifying the health of the company, checking the balance sheet, etc.) even more arduous than the difficult environment would imply. The fact that afterward there would be diffuse ownership, together with the political exposure of the project, made it necessary to carry out any restructuring prior to privatization. The "snowball" concept exacerbated these problems by raising the stakes enormously.

In addition to the need to value the firm, all sorts of details slowed the process down. For example, the legal determination of all the land-ownership claims and tax liabilities of the enterprises was a necessary prerequisite for privatization and required close cooperation from a large number of government bureaucrats unaccustomed to making legal statements. In addition, in some cases, complex "unofficial" claims against the enterprise needed to be unraveled prior to privatization. For example, an enterprise might have been providing free central heating to the local town for many years. The future of this relation would have to be negotiated prior to privatization.

Sales to foreign investors illustrate many of the same problems as IPOs. In particular, they highlight the different agendas and relative bargaining power of insiders and the MOP. Managers are often the best equipped to locate and negotiate with foreigners. They know their own business and often the industry and may have long-term relationships with the foreign partners. They are generally interested in preserving and strengthening their company, perhaps under workers' council pressure. They may also be looking for some sort of "golden parachute" from the investor. The typical large direct foreign investment in the late 1980s, the joint venture, was thus often a sort of *nomenklatura* privatization.

The MOP recognized the inherent conflict of interest involved when managers negotiate deals for state enterprises and called for major foreign investments to take place through capital privatization, with the Ministry of Privatization taking an active role in the negotiations and making the final agreement. This did not prove effective. Managers have the incentive to negotiate quick and cheap deals, but ministry bureaucrats do not. Given the sums of money involved, the difficulties in valuation, and the fact that the need to sell to highly risk-averse foreign investors lowers the price, very few bureaucrats are willing to take the responsibility for deciding to accept an offer. Moreover, they face steep obstacles in overcoming the insider power of managers to conduct legitimate tender procedures.[18]

As a result of these problems, many more deals have been announced than negotiated, and the big transactions have by and large not yet happened.

The Sectoral Approach

As a result of the difficulties with IPOs and the resultant demand for alternatives, and because of the difficulties the MOP had in coping with potential foreign investors, the "sectoral privatization" approach gained favor in 1991. This was intended to speed up the process and deal efficiently with the many problems with the IPOs and individual trade sales. The idea of sectoral privatization was simply to process capital privatizations, especially trade sales to foreign investors, one industry at a time instead of one firm at a time. Thus, one financial adviser could be used for a sector instead of a firm (see Hermann 1990). There were five factors encouraging this approach:

1. A simple economy of consulting and ministerial resources was possible. Handling a sector would be only slightly more difficult than handling one firm. The economies of scale come in several forms: (*a*) Marketing of companies to potential investors is more efficient. Industrial trade shows can be visited, advertisements in trade journals can be combined, and so on. (*b*) Industry studies, both domestic and foreign, are a necessary part of a serious single-company analysis. (*c*) Someone must oversee each consultant contract within the MOP. It helps to have one contract for several companies. As discussed above, the difficulty in finding a person able and willing to accept responsibility for a deal cannot be overestimated. The sector approach was to provide structure and help for MOP officials.

2. The bargaining position vis à vis the foreign investor was seen to be

18. For example, at one point, the MOP wanted to conduct a competitive tender for an important enterprise with two interested foreign buyers, one Japanese and one British. After a long and disastrous meeting between ministry representatives and the management, on the one hand, and the Japanese potential investors, on the other, the Japanese went home for good. Only then did the ministry officials notice that the management team was wearing the company ties of the British firm.

stronger. The investor could no longer go from company to company seeking the best deal.

3. The bargaining position vis-à-vis the company would be stronger. The MOP is equipped with perhaps more information than the managers themselves and can explain why the firm needs to be a part of the privatization. The ability to sit down with representatives of the entire industry and threaten them that if they do not get on board, they will lose out to their colleagues and competitors has turned out to be effective in getting firms to volunteer.

4. Sectoral studies could in principle help inform industrial policy.

5. Certain policies that affect all the firms in an industry could in principle be carefully formulated and applied, such as treatment of environmental liability.

Sectoral studies are under way in some twenty sectors. One, in the detergents sector, has been more or less completed. This project was initiated because of foreign expressions of interest in particular companies. After some nine months, the result has been that most of the firms involved in the study have been dealt with in some fashion. The best three were sold for what ministry officials perceived to be much better prices than would otherwise have been obtained. Other sectoral projects have resulted in studies with little other action so far, although perhaps forty transactions are in some stage of preparation. Five transactions have been carried out as of the end of 1991, all trade sales to foreign investors.

In general, however, the goals of the sectoral approach have yet to be realized. Heavy reliance on foreigners and consultants may have caused a public backlash against selling companies "too cheaply" to foreigners. More generally, it remains a question whether much can be done except to sell good companies to foreigners, something that Western investment banks do know how to do. On balance, while the sectoral approach seems to be a sensible way to conduct some foreign trade sales and can provide some useful information to the ministry, it is not in itself going to accelerate greatly the overall privatization process.

Privatization through Liquidation

Liquidation is the second main path of privatization envisaged in the 1 August 1990 Privatization Law. It was designed to facilitate a decentralized and "bottom-up" process, whereby interested enterprises could take the initiative to privatize themselves,subject to certain constraints, but with the possibility of lease financing from the Treasury.

This type of privatization has been by far the most common, despite receiving much less attention in the public (and especially foreign-language) debate, and although the MOP resources devoted to this path have been relatively minimal.[19] Although the law allows for three mechanisms for liquidation, in prac-

19. This is in part because small firms, typically the ones that undergo this sort privatization, represent a relatively small part of Polish industry. For example, the largest 413 enterprises employed in 1989 account for 45 percent of all workers in industry.

tice 81 percent of transactions have followed the leasing method: the creation of a new private company whose shareholders are the workers and managers and that leases the assets of the state enterprise. This follows from the "bottom-up" nature of the process: insiders try this, in general, only if they want to own their firm. (Tables 13.1 and 13.2 above present the size and sectoral breakdown for liquidated enterprises.)

In a typical transaction, the management and workers of a small and promising firm decide to privatize. They hire a consultant, approved by the MOP, who does a valuation of the company. The legal status of the assets and liabilities of the state enterprise is determined (land ownership etc.). When the responsible branch ministry and finally the MOP agree, the liquidation begins. The workers and managers form a new company and put in the start-up capital as required by the law. Often a "rich uncle," perhaps a foreign investor, helps provide the money. If no one objects, such as rival claimants for the assets or the local government, the MOP is likely to approve the liquidation. These transactions require months of strenuous effort, although, unlike capital privatizations, most of the work is done by the enterprise or the consultants it hires.

An important uncertainty exists as to how many of these deals have actually been completed. Some 416 liquidations have achieved final ministerial approval. However, only 154 have reached the final step, in which the state enterprise is crossed off the books. It appears that a variety of problems can arise to complicate the final closure of the deal. First, property claims turn out to be multiple and conflicting, or at least difficult to disentangle.[20] Second, the new private company, which may already be operating and benefiting from the state-enterprise assets by the time the ministerial agreement is given, may try to renegotiate the terms of its lease.

There are some potential problems with these liquidation privatizations. The companies may be overleveraged if the initial valuations were too high. The companies may be betting that the government will not want to reclaim the assets or that they will be able to appropriate the assets before this happens. The anecdotal evidence of excessively burdensome leases may, of course, reflect managerial attempts to force renegotiation of terms. The ministry has been worried, however, that the enterprises would be so burdened by debt payments that they would not be able to invest.

Important early evidence suggests that firms that undergo this type of privatization engage in active and positive restructuring. They change pay scales, reduce the work force, find partners, and so on. This seems to happen through-

20. An example of the kind of tangled property claims that can cause problems may illustrate the point. A private-sector supplier of plumbing (the "toilet king") during the late 1980s gained control over the parking lot to a major hotel outside a major town. He apparently made a deal according to which he supplied fixtures to the hotel in return for some sort of concession to the (only available) parking lot. He is currently charging a few dollars to each hotel guest to park there. This hotel could not be liquidated without first clarifying the legal status of this contract.

out the process, not only at the end, implying a confidence that the assets will eventually be privatized.

There are few signs of social or political resistance to these transactions, perhaps as a result of its "bottom-up" nature, although some people in the MOP are bothered by the idea that insiders are appropriating state assets too cheaply. In conclusion, this is a privatization method that seems to accommodate itself to existing stakeholders. With the caveats mentioned above, it seems to be proceeding fairly rapidly, without enormous ministerial effort.[21]

Bankruptcy

The second most common path to the transformation of a state enterprise, after liquidation and worker/management buyout, is liquidation according to the State Enterprise Law of 1981, a form of bankruptcy. This method is intended for firms that are in arrears to the government, which thereby gains the legal right to appoint a liquidator to sell off the assets and pay off creditors. A liquidator has begun work on some 534 mostly small firms, with an average employment of about 250, since the passage of the privatization law in 1990. Only a few of these liquidations have been completed.[22]

There is also a German-style bankruptcy law that gives creditors or the firm the option to begin bankruptcy proceedings in court. Given the general macroeconomic climate and financial outcomes in state enterprises, one would expect a large number of these bankruptcies. It is outside the scope of this paper to discuss why, in practice, virtually none have occurred, but the logistical and institutional difficulties involved in applying long-dormant laws are overwhelming.

Mass Privatization

The inclusion of a discussion of mass privatization in a paper concerned with the experience of privatization is somewhat premature, as no companies have actually been privatized through this method. The constraints discussed in this paper have, however, shaped the ongoing preparation of the program.[23]

21. One attractive alternative to the worker/management leasing approach for small companies would be simply to hold an auction. A desire to avoid excessive leverage, to find active outside owners, and to get better prices led the ministry to try this approach in 1991. Very few auction transactions have been carried out. Often, only one bidder has emerged, and this sole bidder may turn out to be a manager from the firm or a partner in the consulting company that handled the valuation. Examples like this help explain why some in the ministry consider that the most appropriate firms for auctions are the ones that come to the ministry begging for help, desiring only to avoid bankruptcy: these are the firms that the insiders do not much want and that therefore will not take care of themselves.

22. Tables 13.1 and 13.2 above present the size and sectoral breakdown for enterprises liquidated through the 1981 State Enterprise Law.

23. Discussion of the design of large-scale free giveaway privatization programs has a fairly long history, however. Among the many papers on free giveaways in Poland are Szomburg and

Therefore, the following briefly outlines the program as it appears to be developing, reviews some of the choices that have been made, addresses unresolved questions, and then asks why it has taken so long to implement.[24]

1. The program aims to involve some 200–600 companies, at least initially. A plausible estimate would be that these companies will average about 1,000 employees per company, so even this first tranche could amount to more than 10 percent of employment in industry. These companies will be commercialized over the next few months (some 150 have already been completed). Thirty-seven Polish consulting companies coordinated by a major international accounting firm are preparing informational packets on each enterprise to be involved in the program.

2. Ten to twenty financial intermediaries ("funds") are to be created. The funds will be joint-stock companies under the Polish commercial code, similar in some respects to American closed-end mutual funds. Their shares will be distributed to the Polish population, the ultimate owners. Their initial board will be appointed by the MOP. The first shareholder's meeting will be held and the board subject to reelection perhaps after the 1992 books are audited, in 1993.

3. The funds will choose and sign contracts with fund management companies, with the assistance of the MOP. The fund managers will have responsibility for all day-to-day management of the fund and its portfolio. The management contracts will contain strong incentive clauses to minimize dependence on initial valuations.

4. Each fund will be the lead shareholder in some ten to twenty companies, holding a 33 percent stake, and will hold much smaller pieces, say 2–3 percent, of many more enterprises. The method of distributing the companies to the funds has not been made clear. It may involve some sort of auction (for "bidding points," not real money) or a random allocation.

5. Workers in the enterprises involved will receive free of charge 10 percent of the shares in their firm (up to a limit of one year's wage worth of equity at book value).

6. The funds will be able to buy and sell shares in their portfolios soon after they begin operation, subject to approval of the Anti-Monopoly Commission. They will be responsible for appointment and oversight of board members for the companies in their portfolio. They will be given special responsibility for the companies in which they are the lead shareholder.

7. The mechanisms for the transfer of the shares of the funds to the population are still under active discussion and investigation. One plausible option

Lewandowski (1990), Lipton and Sachs (1991), and Frydman and Rapaczynski (1992). Implementation had been prepared in earnest since S. G. Warburg was appointed adviser on mass privatization to the MOP.

24. At the time of writing, the timing for the program was still uncertain, as the enabling legislation was before Parliament.

involves the creation of a single "program share" that would represent one share in each fund in the program. These shares would be distributed to the population (or sold for a small fee) and would be tradable over the counter. When a large number (for example, twenty) of the shares are taken to a licensed broker, they would be registered and "broken out" into the individual fund shares, which would be traded on the stock exchange. Dividends would not be distributed and proxy voting disallowed until the shares had been broken out. This potential solution has the advantage that it significantly reduces transaction costs associated with trading, payment of dividends, shareholder relations, and so on in the initial period.[25] Shares in the funds may be distributed somehow as an alternative to wage or pension payments for public-sector employees.

This brief description suggests that a large number of issues remain undecided. Among the more important questions are how to guarantee sufficient autonomy of management companies, how to manage trading of the large number of shares and, possibly, dividend payments, and how to handle the incentive contract if the fund decides to terminate the current fund management contract prematurely.

Many important questions appear to have been settled, however. I will concentrate on one: the "top-down" versus "bottom-up" creation of the funds. A central question faced early in the design of the program involved whether the funds should be created by the government or whether they should be allowed to develop spontaneously. Approaches similar to the current Czechoslovak approach were actively discussed in Poland. In this type of plan, vouchers are distributed to the population, who then are encouraged to choose an intermediary institution in which to invest the voucher. The intermediary, competing with other intermediaries for the voucher, can choose the enterprise of its choice for the initial investment.

The decision to reject this idea in Poland was made to minimize complexity. It was decided that the construction of a system that could reliably and in a reasonably fraud-free way distribute and redeem vouchers would be costly and risky, and perhaps impossible. The benefits of a more spontaneous creation of intermediaries by individuals were not considered to be worth the risk of large-scale confusion, chaos, and fraud. The ministry decided that relying on tested and reputable fund-management companies in the early stages would be more reliable than trusting the uninformed choice of voucherholders. In this model, shareholders would exercise choice later, as their share in the funds became tradable.

A potentially unfortunate upshot of this choice, however, and perhaps the major reason for the cautious approach taken so far toward mass privatization plans, is the risk of excess "centralization" perceived by some (such as, e.g.,

25. Of course, if it were politically acceptable randomly to allocate each citizen to one specific fund, this would further simplify the process.

Frydman and Rapaczynski 1992).[26] The government essentially creates the funds at first and by default must appoint the first board of directors, who are subject only to the indirect discipline of diffuse shareownership and legal obligations. It was judged that this would be an effective way of leveraging scarce government energies and that it would be possible to create a small number of quality boards.

Related to the "top-down" nature of fund creation is the need to decide on the structure of the intermediaries. If voucherholders simply decided with whom to invest, the government could avoid deciding whether the funds should more closely resemble holding companies, mutual funds, venture capital funds, or whatever. In the event, the proportion of shares going to the funds as outlined above was judged to provide a sufficiently active owner while avoiding some of the risks of excessive concentration of power.

Most of the other outstanding implementation issues can be worked out through pragmatic and careful analysis of options and discussion with potential fund managers. Three, however, are arguably more serious. Until now, the ministry has not used its powers to force the commercialization of state enterprises. Instead, it has relied on enterprises to volunteer for commercialization and specifically for mass privatization. Given the above discussion about incentives for insiders to attempt to preserve current rents where they exist, a concern about negative self-selection is logical.

It is not entirely clear that all the difficulties associated with capital privatizations have been resolved for mass privatization. One of the goals of mass privatization is to avoid having to construct each privatization separately, but some firm-specific issues may have to be addressed. For example, it may be necessary to unravel unclear property claims and decide on the disposition of social assets currently controlled by the enterprise. Another example is provided by the problem of environmental liability. Blanket indemnification for past damages usually requires an environmental audit at the time of transfer of assets, a time-consuming process. On the other hand, the absence of indemnification may expose the funds to excessive future risk.

The final question concerns the political acceptance of foreign involvement and of the program in general. Recent events, and some survey results, suggest that understanding and acceptance have grown and that the new Sejm is seriously addressing itself to remaining questions. Furthermore, the difficult situation for state enterprises has muted objections to temporary "centralization" of control and has perhaps focused debate on how to improve the situation for the state enterprises. On the other hand, the recent elections have witnessed some

26. The current, somewhat decentralized control structure has some advantages that could be threatened by a strengthening of direct government responsibility for the firm. There is the risk that the firms become even more passive than they currently are as workers and managers wait for the government to "save" them. Finally, the budget might come under even greater pressure if the government were less able to claim that it had no responsibility for wage setting in a given state enterprise.

resurgence of nationalism and doubts about foreign involvement in the economy. At the time of writing, mass privatization seems to have renewed political momentum and a good chance of going forward.

Why, then, is mass privatization taking so long to set in motion? On the one hand, the program has numerous potential advantages in light of the constraints mentioned above. It avoids some of the problems of valuation, finds owners for a huge number of firms, includes free distribution to insiders, but also prevents them from taking all the assets. It should mobilize resources in a decentralized way to restructure large numbers of enterprises, leveraging ministry energy through the funds. On the other hand, it is both a novel and a complex operation, involving to date some four foreign advisery firms, tens of Polish consulting companies, and much technical and political effort. Legal, economic, and political issues have to be carefully coordinated. Many decision makers felt a strong disinclination to increase government involvement in the enterprises, after years of struggling for decentralization. Difficult choices have presented themselves at each step in the design of the program. The alternative of taking a little more time to reflect and gather information has always been attractive. The lack of examples has been decisive in encouraging this extra care.[27] The program also has an important all-or-nothing feature: the critical mass of companies included needs to be large enough that the value of the fund shares is not ridiculous. Finally, such a complex plan requires the several ministries, political leaders, and the population to mobilize behind a basically confusing agenda.

13.3 Conclusion

Two years after the "big bang," 11 percent of Polish state enterprises have been commercialized or privatized. This paper has reviewed attempts at implementing privatization in Poland. In doing so, it has highlighted how difficult the process is and explained some of the reasons for this difficulty. The overthrow of the Communist regime, marketization of the economy, and legal and political revolution have changed all the "rules of the game," and in this environment the complexity of the privatization task overwhelms administrative capacity. Moreover, privatization requires a widespread rearranging of ambiguous property rights. It is not clear who owns the firm, who is responsible for liabilities, and in particular what power remains with the state. The result has been a confused political debate, a paralyzed bureaucracy, and enterprises whose workers and managers control the enterprise without any certain long-term stake in the firm.

We can characterize privatization strategies into three broad categories. The first, followed by Poland in 1990, stresses the careful creation of capital mar-

27. Stabilization programs are also complex and risky to implement. However, the existence of various worked-out examples simplifies the design of a new program.

kets and case-by-case "top-down" privatization of state enterprises. This has essentially failed. The second emphasizes the organic growth of the private sector, perhaps augmented with spontaneous privatization (see Kornai 1991). It may indeed be that the Polish economy will evolve over decades into a market economy without privatization of the large state enterprises. Indeed, the private sector is growing at a phenomenal rate, and liquidations of small enterprises seem to be proceeding fairly rapidly. The deep risks of this strategy are now evident, however. The deteriorating financial situation of state enterprises is leading to large and growing budget deficits. A macroeconomic relapse would endanger the growing private sector just as it threatens to move into manufacturing.

The third broad strategy is exemplified by the mass privatization program and emphasizes large-scale and widespread free distribution of equity through intermediary institutions. Much preparatory work has now been done, and implementation should soon begin, although parliamentary support has not yet been forthcoming. It is possible that this novel approach, designed with East European constraints in mind, may succeed where traditional methods have failed.

In retrospect, excess caution has been exercised in choosing the best possible scheme for mass privatization. It is difficult to imagine a plan whose implementation would have left the situation in the state enterprises worse than it is now. It may have been possible early on to act decisively and avoid much of the fragility of the current economic and political situation. A window of opportunity may have closed: the political honeymoon of the post-Communist era is over, and the financial predicament of the state sector continues to worsen. It is possible that the political system will manage to provide an environment that allows the private sector to continue to grow steadily. Unless mass privatization takes place, however, the risk of continued economic and political stability will be great.

Appendix

Table 13A.1 Individual Enterprises Privatized through Capital Privatization as of 31 December 1991

Name of Enterprise	Value (billion Zl)	Method of Sale	Value of Shares Sold (billion Zl)
Exbud S. A.	112.00	IPO	50.40
		Public tender	34.00
Slaska F-K	70.00	IPO	58.10
Kablis S. A.			
Prochnik S. A.	75.00	IPO	60.00
Tonsil S. A.	120.00	IPO	60.00
Krosno S. A.	132.00	IPO	66.00

Table 13A.1 (continued)

Name of Enterprise	Value (billion Zl)	Method of Sale	Value of Shares Sold (billion Zl)
Fampa S. A.	87.50	Public tender	77.00
Zminowroc	30.00	Leveraged buyout	30.00
Budokor Sp. Zoo.	52.80	Leveraged buyout	42.20
Norblin S. A.	40.00	Public tender	32.00
Polam Pila S. A.	223.03	Public tender	178.42
Pollena	330.00	Public tender	220.00
Wolczanka S. A.	75.00	Contract, IPO, Public tender	48.00
Swarzedz S. A.	100.00	IPO	70.00
Huta Szkla	54.00	IPO	3.90
Zywiec S. A.	200.00	IPO	154.00
Ekomel Sp. Zoo.	5.73	IPO	4.60
E. Wedel S. A.	687.50	Public tender	275.00
		IPO	83.20
Mostostal S. A.	99.75	Auction	69.82
Famet S. A.	35.00	Auction	25.00
Pol-Baf S. A.	40.00	Public tender	38.50
Techma Sp. Zoo	7.00	Public tender	3.60
Krakbud Sp. Zoo.	10.60	Public tender	8.50
Kaprinz Sp. Zoo.	4.5	Public tender	2.40
Pollena	165.82	Public tender	119.97
Pollena S. A.	71.60	Public tender	57.28
Alima S. A.	209.18	Public tender	125.51

Source: Ministry of Privatization, Warsaw.

Note: IPO = initial public offering; public tender = public tender of enterprise or portion thereof (this normally refers to a "trade sale" to foreign investors).

References

Aslund, A. 1990. How to privatize. Stockholm Institute of East European Economics. Mimeo.

Berg, A. 1992. The radical transformation of a social economy: Poland, 1989–1991. Ph.D. diss., Massachusetts Institute of Technology, Department of Economics.

Breitkopf, M., M. Gorski, and D. Jaszczynski. 1991. *Privatization in Poland.* Warsaw: Friedrich Ebert Foundation.

Center for Privatization. 1990. Act on the privatization of state-owned enterprises. Warsaw.

Centrum Badan Oponii Spoleczne (CBOS). 1989. Propozycje przeksztalcen stosunkow wlasnosci w opinii robotnikow i kadry kierowniczej prezedsiebiorstw (Proposals to transform ownership in the opinion of workers and managers in enterprises). Warsaw, June.

———. 1990. Jak prywatyzowac polska gospodarke (How to privatize the Polish economy). Warsaw, June.
Dabrowski, M. 1991. Privatization in Poland. *Communist Economies and Economic Transformation* 3, no. 3:317–25.
Dabrowski, J., M. Federowicz, and A. Levitas. 1991. Polish state enterprises and the properties of performance: Stabilization, marketization, privatization. *Politics and Society* 19, no. 4:403–37.
Frydman, R., and A. Rapaczynski. 1992. Privatization and corporate governance in Eastern Europe: Can a market economy be designed? In *Central and Eastern Europe: Roads to* growth, ed. G. Winckler. Washington, D.C.: International Monetary Fund and Austrian National Bank.
Frydman, R., and S. Wellisz. 1991. The ownership control structure and the behavior of Polish firms during the 1990 reforms: Macroeconomic measures and microeconomic responses. In *Reforming Central and Eastern European economies: Initial results and challenges*, ed. Vittorio Corbo, Fabrizio Coricelli, and Jan Bossak. Washington, D.C.: World Bank.
Gray, C. 1991. The legal framework for private sector development in a transitional economy: The case of Poland. Working Paper WPS no. 900. Washington, D.C.: World Bank.
Gruszecki, T. 1991. Privatization. Warsaw: Stefan Batory Foundation.
Hermann, K. 1990. Sectoral privatization. Warsaw: Ministry of Privatization. Mimeo.
Kawalec, S. 1992. The dictatorial supplier. In *The unplanned society*, ed. J. Wedel. New York: Columbia University Press.
Kornai, J. 1991. The principles of privatization in Eastern Europe. Harvard Institute of Economic Research Discussion Paper no. 1567. September.
Lipton, D. and J. Sachs. 1991. Privatization in Eastern Europe: The case of Poland. *Brookings Papers on Economic Activity*, no. 2:293–333.
McDonald, K. 1992. The tap-dancing rhinoceros: Transformation of the Polish economy at the enterprise level. ITCA Europe. Warsaw: Mimeo.
Madigan, J. 1992. Privatization methods and strategy. Warsaw: International Privatization Group. Mimeo.
North, D. C. 1981. *Structure and change in economic history*. New York: Norton.
Stark, D. 1990. Privatization in Hungary: From plan to market or from plan to clan. *East European Politics and Society* 4, no. 3:351–92.
Szomburg, J., and J. Lewandowski. 1990. Property reform as a basis for social and economic reform. *Communist Economies* 1, no. 3:257–68.
Winiecki, J. 1992. Privatization in East-Central Europe: Avoiding major mistakes. In *The emergence of market economies in Eastern Europe*, ed. C. Clague and G. Rausser. Oxford: Blackwell.

Discussion Summary

Tom Kolaja discussed many of the practical problems that have handicapped the privatization process in Poland. First, he noted that the Ministry of Privatization has had difficulty attracting qualified personnel because of large wage differentials between the private and the public sectors. Kolaja said that private consultants earn ten to twenty times as much as equally qualified state employees. Second, Kolaja noted that many of the high-ranking officials in the ministries have come from the reform movement and hence have limited professional experience as politicians or bureaucrats. Third, he said that civil servants are criminally liable for any mistake they make during the privatization process. This explains why many decisions are avoided or delayed by being passed up the ministerial hierarchy. Finally, Kolaja observed that costly uncertainty has been generated by a lack of coordination among the myriad Polish regulatory agencies.

Kolaja also discussed the proposed program of mass privatization. He supports this approach, but he noted two potential hurdles that it will face. First, the Polish ministries must clarify whether and how environmental liabilities will be carried over from old to new firms. Second, the ministries must establish how much control the new owners will have. For example, he wondered whether the new owners will be able to carry out mass layoffs.

Jacek Rostowski noted that commercialization is often initially perceived by managers as a means by which firms can acquire additional government support instead of as an intermediate step to privatization. He cited examples in which newly commercialized firms had requested favors from the government officials who were serving on their boards. Rostowski warned that it usually takes at least two years before the boards of these commercialized companies start functioning in ways that correspond to the boards of Western firms.

Simon Johnson contrasted the Polish and Czechoslovak privatization experiences. First, he noted that the Czechoslovak voucher program had provided a much more successful "packaging of capitalism" than had been achieved by the various Polish privatization programs. Second, Johnson said that, in Czechoslovakia, all managers had been forced to submit privatization plans, thereby giving the privatization process a strong start.

Kalman Mizsei noted that delays in the privatization process in Czechoslovakia, Hungary, and Poland have been very costly to the governments because the market value of enterprises has fallen significantly during the last three years. He added that privatization programs should include an aggressive effort to attract foreign capital, as is currently being done in Hungary. He also praised Hungary's support for "self-privatization," a program in which privatization of small- to mid-sized firms is achieved with minimal interference by the State Property Agency.

Mark Schaffer suggested that the Kornai strategy for privatization—organic growth of the private sector without active efforts to privatize state-owned firms—might be a more successful strategy than the proposed plan of mass privatization. Schaffer warned that mass privatization may not solve the problem of growing demands for government subsidies and bailouts; newly privatized state firms will still generate such demands. Moreover, Schaffer stressed that the program of mass privatization will be fairly complicated, time consuming, and costly.

Stanley Fischer wondered whether the paper had taken a view that was overly pessimistic. He suggested that potential changes in the commercialization laws, of the type proposed in the paper by Andrei Shleifer and Robert Vishny (chap. 12 in this volume), would improve the prospects for commercialization. *Geoffrey Carliner* wondered whether Kolaja's comments were also too pessimistic. He asked if Kolaja's description of the difficulties plaguing the Ministry of Privatization was intended to suggest that privatization company by company has been a total failure.

Jeffrey Sachs argued in favor of privatization programs that work more quickly than the company-by-company approach that Poland has used so far. Sachs pointed out that the failure of the Polish approach was predicted. There were not enough skilled people in the privatization ministries to privatize each of the 3,000 industrial firms in Poland on a case-by-case basis. Sachs argued that the Poles need a privatization system that will operate more quickly, even if this leads to a less controlled and careful privatization process. He emphasized that case-by-case privatization is politically painful and extraordinarily time consuming and that it leads to charges of corruption with every deal. By contrast, a more aggressive program in which firms are turned over to insiders would operate quickly through a relatively decentralized mechanism and would align the interests of workers with the privatization process.

Andrew Berg responded to Schaffer's criticism of mass privatization. Berg conceded that there are unresolved questions about whether the new investment funds will insulate the government from demands for subsidies from newly privatized firms. However, Berg emphasized that the newly privatized firms will have the right allocative incentives with regard to whatever resources they end up controlling. Berg argued that it is much better to give resources/subsidies to an enterprise that is using them efficiently than it is to use subsidies to preserve structures that really should die.