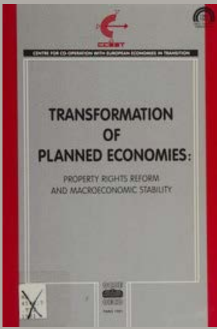

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Privatisation of Socialist Economies: General Issues and the Polish Case

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Summary

The current drive towards privatisation by transitional economies of central and eastern Europe is based on the same expectation as privatisation in Western countries, i.e. greater efficiency through changed and improved incentives. This expectation is not controversial in the centrally planned economies in transition, because it is believed that privatisation will inject life into the inert traditional system, de-politicise economic life and harden budget constraints. In addition, private property was never completely abolished and a limited régime of private property seems to be inherently unstable, given the strong logical arguments and actual pressures for its extension.

There are three main general issues raised by privatisation of the transitional economies of central and eastern Europe. First, in the early stages of economic reform and in order to free enterprise there is the danger of divesting central organs of their powers without transferring those powers to other agents. This raises on the one hand the problem of "re-subjectivisation" of ownership before privatisation, and on the other the problem of workers' self-management institutions. Next, there is the risk of unfair private appropriation – whether legal or "wild" – of state assets. Last, when should privatisation occur in the sequence of reform measures relative to stabilisation, demonopolisation, and partial financial and productive restructuring?

In Poland, privatisation has been facilitated by a long-standing tradition of private enterprise, but rendered difficult by the necessity to reconcile the sale of shares with the self-management institutions active in Polish enterprises (to be accomplished perhaps by reserving 20 per cent or so of shares to enterprise employees on privileged terms, or by a contractual package involving forms of profit sharing and "Mitbestimmung"). The debate in Poland has revolved primarily around the adverse distributional impact of privatisation, which sectors to begin with, the small size of the potential market, how to finance share purchases (free shares, credit or foreign capital), and the scope for debt-equity swaps. These issues reflect political struggle:

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the 15th version of the privatisation law was presented to Parliament in April 1990, and was met by a parliamentary counter-proposal. Although the law was finally approved in July 1990, it left open both the pace and modality of privatisation, further delaying progress towards privatisation.

Introduction

Today all the socialist economies of central and eastern Europe are restoring or expanding forms of private ownership and enterprise. The process involves all these "transitional" economies, regardless of the pace and achievements of their economic reform, including the Soviet Union and excluding only Albania; differences are only of speed, mode and degree. There is privatisation in a broad sense (the permission and encouragement of private enterprise and ownership), and in the narrow sense (the sale, gift or rental of state assets to private individuals and companies). This paper considers the general case for privatisation in the narrow sense (Section 2) and in the light of the system-specific characteristics of socialist economies (Section 3); additional reasons are offered for the resilience of private ownership in socialist economies and the mounting pressure for its extension (Sections 4-6). Some more general issues are considered in the current process of privatisation in the transitional economies of central and eastern Europe (Sections 7-9), with a more specific focus on the privatisation process in Poland (Sections 10-12).

The general case for privatisation

To a great extent the drive towards privatisation in central and eastern Europe has the same basis as a similar process also seen in the last ten years in Europe, North America, Japan and the Third World (see Hemming and Mansoor 1988; Vickers and Yarrow 1988). The strongest reason for this development is the expectation that privatisation can raise efficiency through changed incentives.

This expectation is found in the recent economic literature on principal-agent relations. Company managers, as agents of owners, are subject to contractual discipline enforced by shareholders; to take-over discipline enforced by potential bidders; and to bankruptcy discipline enforced by creditors. Managers of state enterprises are not subject to any such discipline, as they are subordinated to political authority and not to economically motivated shareholders; they are not subject to take-overs; and their losses are absorbed by automatic grants from the state budget (see Vickers and Yarrow 1988). Further arguments for privatisation have been the adoption of a deflationary fiscal stance less austere than it would be if implemented through fiscal means, and the promotion of diffused ownership patterns associated with the "property-owning democracy" model as an alternative to socialism.

These arguments for privatisation may have to be modified. Public enterprises sometimes can be more efficient than their private counterparts (in practice, see South Korean state steel; in theory, see Sappington and Stiglitz 1987, Stiglitz 1989). Privatisation of management might achieve the same effects as privatisation of ownership without divesting the state of its assets (i.e. the state could hold shares in private companies; see Meade 1989). In Western market economies, privatisation has not

been accompanied by significant progress towards property-owning democracy. In the case of transitional economies, however, privatisation not only raises the share of national assets held by private owners, it also extends the scope of ownership rights from absent or limited ownership to full-fledged private ownership. This qualitative aspect of privatisation in transitional economies provides additional system-specific, supportive arguments.

System-specific arguments for privatisation in socialist economies

First, there is a presumption that privatisation will inject life into the inert traditional system. With the benefit of hindsight the main drawback of central planning and state ownership has been its inability to respond to change (whether in technology, domestic demand, or world trade opportunities); the appropriation of the benefits that economic agents might obtain from faster response can only enhance the vitality and viability of those economies.

Second, privatisation is bound to weaken the opportunity for political interference in economic life, especially in those economies still dominated by the Communist Party and its all-pervasive "nomenklatura". In principle it should be possible to cut the links between the centre and enterprises by inserting an intermediate layer of independent state holdings representing state interests. In this context privatisation may not be necessary, but it is an effective, well-tested institution and therefore more appealing than more controversial and less well-tried state holdings.

Third, privatisation of enterprises and commercial banks together is bound to harden the "soft" budget constraint of enterprises, which has been one of the main sources of the endemic excess demand typical of centrally planned economies everywhere. Again, it is conceivable that the budget of a state enterprise might be hardened as a result of a change in government policy, but in the light of experience there is little – if any – support for this expectation.

Whatever the validity and strength of the general justification, these three arguments strengthen the case for the privatisation now occurring in transitional economies. But there is more: privatisation appears also as the consequence of the resilience of private ownership in socialist economies, and there is a strong case for the further extension of the limited property rights which already have existed.

The resilience of private ownership

Private ownership seems to have a built-in resilience in the socialist economies, where it was never completely eradicated. Moreover, regimes of limited ownership seem to suffer from a certain institutional instability: whenever private ownership is even minimally present, the system tends naturally towards its further extension.

Let us consider what is the necessary and sufficient condition for complete abolition of private ownership. Imagine an economy where individuals have access to instant consumption of goods and services, whether freely (in unlimited amounts or within predetermined limits for each good and service) or subject to money prices and a maximum money budget per unit of time. In either case we stipulate that in this

economy individuals do not have any other access to consumption and are not able to transfer their consumption claims to others or over time, i.e. they cannot save in the sense of accumulating that part of their maximum consumption entitlement which they do not actually consume. This is the kind of partial or temporary arrangement familiar from expense accounts, communal kibbutz consumption or participation in academic conferences but – with the possible though unproven exception of Stone Age economies – such an arrangement has never been a basis for the lasting economic organisation of entire communities. Free unlimited consumption, the ultimate full communist model[1], belongs to this category but has never been implemented anywhere; "realised socialism" has never organised consumption on that basis.

The lack of a generalised system of consumption allocation of this kind is a necessary and sufficient condition for private property to arise. Namely, it is a necessary condition because otherwise property could not be transferred, rented or used without violating our stipulations. It is a sufficient condition because a possible private property right on consumption goods arises as soon as claims to consumption can be transferred to others (creating the possibility of future reciprocity, whether through market exchange or possibly through a deferred exchange of reciprocal gifts) or to oneself over time through production or through storage of either the goods or the claims.

It is interesting to note that money is a sufficient but not a necessary condition for private ownership to arise: even in a system without either money or voucher claims and with short-lived goods only (the least favourable set up for property rights to consumption to arise), a stock of consumption goods can be carried and owned within the constraints set by the rate of durability and by the storage space available, the actual stock being determined possibly as the result of an optimisation process leading to the equalisation of rates of time preference and expected rates of return on each consumption good accumulated[2]. Once there is money – at least in the limited role of a means of distributing consumption goods – and this money is non-perishable[3], the possibilities of amassing potential command over a stock of consumption goods become virtually unlimited even if all goods were perishable and no storage space were available. The actual stock of money held will be limited, though, by the same optimisation process, whereby the real rate of time preference is set equal to the real rate of return on money holdings, i.e. the percentage cost of money storage[4] minus the expected rate of money price increase, for all goods.

This reasoning presumes that "markets" clear, though it does not necessarily imply a supply schedule, only that given quantities of dated consumption goods are available and distributed at state-fixed prices. Market clearing is an inappropriate assumption for traditional socialist economies, which are inordinately prone to permanent excess demand due to the unreasonable overambition of planned targets, combined with an unsustainable commitment to stable prices. However, a claim to a stock of consumption goods can be held in real terms and (through money) even in conditions of persistent shortages except that the relevant prices are official money prices plus a premium for queuing or for random access to goods. Secondary retrading of shortage goods, whether it exists legally or illegally, will necessarily tend toward this relevant price level.

It follows from these reflections on theoretical consumption behaviour that, when we discuss private property under models of socialism other than the (unrealised) full communist model, we cannot bring into question the possibility of private property,

which is always there at least in the form of some property rights to a stock of consumption goods, nor the existence of a rate of return (negative though it may be in real terms) on that stock. We can only discuss the scope of those property rights and the way that rate of return is determined. Namely, we can discuss who can own what for what purpose, the unbundling of property into its constituent rights (as simultaneous *jus utendi, fruendi ac abutendi* in Roman law, with possible finer distinctions in modern times), their yield and their transferability to whom, and how the efficiency implications of private property respond to progressively increasing extensions of the scope of private property. We can also discuss the set of possible limitations or obligations which may be attached to property rights. Finally, we can discuss whether and to what extent the effects of private property might be simulated by alternative arrangements.

The case for extension of limited property rights

The presence of property rights to consumption goods is an apparently harmless consequence, of permitting individual choice of how to allocate consumption over time, an arrangement which is both efficient and – arguably – a basic freedom. However, once this limited scope of property rights is established there are very strong logical arguments on efficiency grounds, and in response to actual economic pressures, for their extension to a full-fledged capitalist regime of property rights – where anybody can own and trade anything except drugs and slaves, and rights can be unbundled and transferred at will[5].

In fact, if I am allowed to save real consumption and retain its ownership at a real rate of interest implicit in storage conditions, obviously I should be given the opportunity to save instead in the form of cash and interest-yielding deposits and bonds at a nominal monetary rate of interest equivalent to the same real rate, thus releasing real resources for productive use. Indeed, if I am willing to save more and more at progressively higher interest rates, and there are correspondingly profitable productive uses for those resources, I should be given that opportunity for the sake of efficiency. This multiplies the possibility of accumulating private property by relaxing storage and perishability constraints and of receiving a rentier income.

Any investment in consumption goods has an element – albeit small – of risk-taking, depending on current conditions (should I invest in an umbrella or in sunglasses?) affecting the course of relative prices. Financial claims broaden the scope of potential exposure to risk and to its rewards or penalties; loans can be at fixed or variable interest rates; borrowers' creditworthiness will be reflected in their cost of finance. Even in the absence of risk-taking in financial markets, lotteries may and usually do exist in any socialist economy[6]. Moreover employment contracts even under socialism often carry performance-related bonuses, uncertain and lottery-like, broadening further the scope of risk-taking. But now, if I am allowed to draw an interest on financial claims and to expose myself to risk for the sake of a higher expected return, why should I be barred from owning a stake in the present value of an "enterprise" (defined broadly as a set of productive activities and contractual rights and obligations). In a world where there are interest rates and risk premia the introduction of private shares and capital markets does not involve a qualitative change. At first shares may be issued to workers of the same enterprise and may not

carry a vote; risk-spreading however suggests a reshuffling of stock across enterprises through generalised trade in a stock exchange, and managerial discipline requires the subjection of managers to the threat of an adverse majority vote (and the take-over threat of vote-acquiring bidders).

Finally, once I am allowed to hold an equity stake in an enterprise, and share in its success and failure, there is no qualitative change involved in my being allowed to directly found and run an enterprise and employ workers directly rather than through the mediation of managers[7]. Down the slippery slope of property rights, through small Pareto-improving steps, one may quickly revert to full-fledged traditional capitalism.

Over time, the case for privatisation mounts implacably with the accumulation of successive monetary gaps between income and expenditure, due to the excess demand systematically present in the socialist economy and the stubborn commitment to maintain stable prices in spite of it. The overhang takes the form of excess liquid assets and abnormally high levels of stocks, both by households and enterprises[8]. In the end the domestic overhang becomes so large as to suggest the selling of state assets to the population instead of alternatives which may be more unpalatable (currency confiscation, hyperinflation) or simply not available (additional domestic or international borrowing).

Ownership and entrepreneurship

An interesting question is whether there is a natural breaking point in this chain, i.e. where – if anywhere – do decreasing returns set in on the road to full capitalist ownership. According to Mises, private ownership of capital is a necessary precondition of capital markets and therefore of markets in general; without ownership markets cannot even be simulated (see Mises 1951; Hanson 1989). Mises was certainly right in that private appropriability (including potential transferability and use/abuse) of at least a share of enterprise profits and capital gains must be essential to the very existence of entrepreneurship[9]; however this does not necessarily imply the private ownership of any of the actual means of production. In fact one could imagine a state ownership system in which state assets are leased on competitive leasing markets to private entrepreneurs, who appropriate at least part of any residual income and who by selling their leases to others, can realise the present value of their entrepreneurial activities, without ever acquiring ownership of capital goods or, technically, of any enterprise. In such a system investment could remain a state function, whose efficiency would be monitored by comparing, *ex post,* the return on investment obtained from the rentals determined in competitive leasing markets, to the interest rates prevailing at the time of investing.

It is tempting to conjecture that there can be no markets without private property, nor economic planning with private property: however this conjecture, though not rejected by experience, is still unproven on theoretical grounds. Once entrepreneurial rewards are at least partly appropriable it is possible to conceive a replication of competitive capital markets with or without the participation of private individuals but without private ownership of capital assets as such (see Nuti 1988 and 1989). These kinds of arrangements (which could be actual markets and not just simulations), however, are not a case against private ownership but a case for economic reform; ideological obstacles against reform could be side-stepped, even if they

were not to disappear, as now seems the case. In practice leasings of state property (as in the Soviet "arenda" and the Polish "dzierzawa", and on an even larger scale in China) are one of the possible ways of implementing privatisation of state assets especially in special sectors such as agriculture, catering and small-scale production, but cannot represent a general exclusive alternative to the sale of assets and shares.

Another interesting question is whether entrepreneurship could be associated with forms of ownership other than state and private, such as municipal or co-operative. In the Soviet Union a great deal of emphasis has been placed on the growth of the co-operative sector, which in the 30 months since June 1987 has grown from 55 000 to 5.5 million employees (including members, full- and part-time dependent workers), and raised turnover from 29 million to 40 billion rubles. Soviet co-operatives are not subjected to the income and capital sharing restrictions typical of traditional co-operatives, and very often serve as shells for private enterprises. Therefore their growth is an indication of the potential role that might be played by ownership forms other than state or private under special conditions, but this growth cannot be taken at face value or simply extrapolated to other countries or periods. However it is conceivable that privatisation of state assets could help to transform dependent workers into partial entrepreneurs. This process seems to be making some progress in modern Western capitalism with the introduction of income and capital sharing and worker participation in enterprise decision-making (see Nuti 1990c).

General issues: subjectivisation

In the current privatisation experience of central and eastern European economies three general issues have arisen. The first is the danger that, in the early steps towards economic reform, decentralisation of decision-making from central bodies to enterprises might divest the state of its assets without transferring ownership rights to other subjects. In that case it is as if state ownership became *"res nullius"*, and before privatisation can take place it is necessary to undertake and complete a process of "re-subjectivisation", re-uniting property rights under the same public holder before actually privatising. This is what happened in Hungary with the 1984-85 legislation on state enterprises, which *de facto* acquired most of the rights associated with ownership on the unprecedented and nonsensical theory that "enterprises belong to themselves" (as officially stated by the Ministry of Justice). This unusual state was not remedied by the first attempts at privatisation (Act VI 1988; Act XIII 1989; see Hare 1990).

A similar problem arises in those countries where workers have gained a measure of self-management: some of the new shares may have to be sold or granted to enterprise employees, in order to trade off their full management rights (incompatible with shareholders' rights) with fuller ownership rights on a smaller scale (therefore embodying a smaller voice in enterprise management). Regardless of this argument, or beyond the limits of this kind of "conversion", shares may be sold to workers in order to strengthen popular support and to promote a property-owning democracy as an alternative system. Forms of workers' ownership abound in a capitalist economy: Employee Stock Ownership Plans (ESOPs, where workers acquire shares held collectively before they are distributed after a period or at retirement or departure) or Trusts (ESOTs, where workers are temporary co-owners and only enjoy a share of the

revenue while they are employed), Personal Equity Plans (for regular savers, attracting tax exemption up to a maximum limit), Equity Holding Cooperatives, additional Pension Funds, Swedish-type collective investors, and so forth (see Uvalic 1990).

The new shares can be partly managed by state holdings and new pension funds. State holdings – as noted above – are often regarded with suspicion, as bearers of central interests dependent on and ultimately answering to the centre. There is however no reason why they should not respond to a policy commitment to make profits instead of being responsible for the achievement of government targets (the Italian state holding IRI, for instance, has responded to policy changes and has rapidly turned from an endemic loss maker into a profit-oriented and profit-making entity, presiding over privatisation). Pension funds (new, for there are none in Eastern European economies) are also credible collective investors, but they should only be given as much stock as they can reasonably need to take over pension liabilities; there is no justification in profits funding the consumption of pensioner rentiers, instead of being channelled to self-financed investment.

It is conceivable that the banking system might exercise control over companies through direct and indirect (namely on behalf of clients) shareholdings and the associated voting rights. Such a role is typical of the German-Japanese model of financial markets and has been advocated for Poland by Gomulka (1989). However, banks in that model rely on a full-fledged stock exchange and do not replace it. Thus the ability of the banking system to hold and administer state ownership should not be overestimated[10].

Private appropriation of state property

A phenomenon often practised and sometimes advocated in our "transitional" economies is the private appropriation of state property, either as a public policy of free distribution or as the result of spontaneous, "wild" auto-appropriation (in Polish *"samouwlaszczenie")*.

It has been suggested (for instance by Attila Soos in Hungary, Dusan Triska in Czechoslovakia, Jan Szomburg and Janusz Lewandowski in Poland) that shares in state enterprises or holdings may be given away freely to all citizens, directly or in the form of vouchers. This policy seems to have the advantage of creating an instant capital market, as well as the political advantage of generating instant capitalism and popular support for it. The needs of budgetary balance and monetary discipline, however, should strictly limit any privileged access to shares, as well as their free distribution (apart from the need of "converting" self-management rights into ownership stakes, discussed in the previous section). Free distribution of shares would be costly [as it was in the only known case to date, in British Columbia in 1979][11]. It would add a wealth effect to consumption demand, worsening inflationary pressure whether open or repressed. It would have an urban bias (of a kind that would not be present in case of free distribution of the profits of state enterprises as citizens' income): peasants in remote rural areas would be unlikely to benefit as much as the inhabitants of the capital city. As soon as potential limits to disposal lapsed, free distribution would also likely lead to rapid retrading and concentration of assets in the hands of a few better-informed people with access to liquid means (if this is not a

preoccupation, perhaps a lottery with large bundles of shares would be preferable and cheaper to administer). The state is not withering away in the course of transition and will continue to tax: "Daddy state... is alive and well", as Kornai (1990, p. 82) graphically puts it; privatisation revenues could replace taxes, thereby avoiding their distortionary effects on economic efficiency (Newbery 1990).

Free share issues are often advocated on grounds of lack of sufficient domestic capital. However – depending on the policy towards debt-equity swaps – domestic credit may be granted on a large scale for the population to take part in privatisation; as long as this credit is sterilised and is not recycled to government expenditure, it can create a useful buffer against possible subsequent loss of macroeconomic control, when the government might sell its credits rather than raise additional taxes. In a country like Poland, state revenue from privatisation could be used to retire hard currency credits of enterprises and households via the state banking system, which are not backed by hard currency reserves and therefore limit central control over the money supply. Finally, the free gift of state assets seems an out-of-place largess on the part of governments heavily indebted to international creditors, who would be justified in asserting a prior claim to those assets[12].

The other form of private appropriation – spontaneous, or "wild" auto-appropriation – is worse because it is selective: privatisation without publicity and competition may result at least partially in divestiture, rather than sale, and in the parallel appropriation of state property by a few well-informed people in positions of power. In the early stages of privatisation in Hungary and Poland (Hare 1990, Grosfeld 1990, Chilosi 1990), then elsewhere, managers and party officials often converted their position into a share of state capital, through semi-legal or outright illegal transactions tolerated because of their large scale and the offenders' positions. This type of transaction includes: subcontracting of profitable activities, reciprocal disposals between state enterprise managers to their personal advantage, personal deals in joint ventures with foreign partners, artificial liquidation of viable activities transferred to internal bidders, etc.[13]. There is no conceivable justification for condoning these practices, which are equivalent to the worst cases of insider trading in western markets.

Privatisation in the reform sequence

A crucial general question is the position of privatisation in the sequence of reform measures, i.e. whether it should occur during or after stabilisation, before or after de-monopolisation, and financial and productive restructuring.

It seems most inappropriate to sell off shares in state enterprises before stabilisation and fiscal reform. Here stabilisation is understood as domestic market equilibrium in non-hyperinflationary or excessively inflationary conditions, at uniform prices; fiscal reform is understood as the termination of *ex-post, ad hoc,* enterprise-specific taxes and subsidies levelling profitability throughout the economy. Without these prior achievements, trends in product and input prices and therefore enterprise profitability would be impossible to assess, and as a result assets would be underpriced and yet unattractive in conditions of uncertainty. Thus privatisation cannot really contribute directly to the stabilisation process (see Nuti 1990a and 1990b). An exception can be the privatisation of housing (where the stream of future services is directly con-

sumed by the owner), small plots of land and small scale services (where future benefits are more strictly dependent on the owner-worker's effort supply). This kind of "small" privatisation can contribute to stabilisation.

The very announcement of a firm decision to proceed with privatisation on a clearly predetermined schedule and procedure can itself make a contribution to stabilisation (the opposite happened in the USSR announcement of future price increases destabilised domestic markets and aggravated shortages). The announcement can be particularly effective if it is followed by the issue of special bonds, at low or zero nominal interest but carrying an option to purchase without restriction any state asset which will be privatised subsequently – pending the determination of asset prices. In Poland in November 1989 this instrument was used but bonds redeemable through privatisation were indexed and the timing and pattern of privatisation were not specified; thus the bonds cost the government much more than other forms of bond financing and even so, in the uncertainty about privatisation terms, were not very attractive to the public at the time of issue[14].

De-monopolisation is also a necessary precondition of privatisation: without it asset prices would include a capitalisation of monopoly power, which would be either unduly validated or – from the viewpoint of buyers – unfairly removed later on. A firm commitment to subsequent de-monopolisation still leaves a strong element of uncertainty; foreign trade liberalisation may alleviate the problem by raising the degree of competition.

The transformation of state enterprises into joint stock companies presupposes the valuation of their net assets and their recapitalisation (as the Czechs put it, "the bride has to be endowed before being given away..."). Or, if necessary, excess liquid resources may be drained away before privatisation; at least some rationalisation of output structure and input outlays (including labour employment) must take place. To proceed otherwise implies the likely underselling of state assets. If, before privatisation, an active capital market has been organised, valuation and financial restructuring can be left to competitive mechanisms; otherwise some competitive redeployment of assets has to be stimulated among state enterprises. In any case it seems important that labour redundancies and redeployments should be handled before, rather than after, privatisation, both to ensure fair compensation of workers and to make assets more attractive to potential alternative users.

The Polish economic framework

In the ten years preceding 1990 Poland experienced stagnation in real output, while consumption levels fell by 10 per cent over the ten years to end-1989). Polish external debt reached $42 billion (of which $28 billion was owed to other governments), too large an amount to be fully serviced in spite of recurring trade surpluses (about $1 billion per year in 1985-89). Shortages were endemic and inflation accelerated reaching the yearly rate of 740 per cent in 1989, when output declined by 1.7 per cent (see Kolodko 1989).

The economic framework of the 1990 drive towards privatisation is that of a drastic stabilisation programme, launched by the new Mazowiecki Government on 1 January 1990, aimed at restoring market equilibrium, introducing resident converti-

bility for current transactions, and promoting net exports, while at the same time making progress towards reform and restructuring (see Kolodko 1990, Frydman-Kolodko-Wellisz 1990, Nuti 1990c).

The stabilisation package envisaged the abolition of subsidies and the reduction of the budget deficit to 1 per cent of GNP (down from 8 per cent in the previous year); monetary discipline and an increase in real interest rates to positive levels (the interest rate was raised also on old contracts, amounting to a tax); almost complete price liberalisation (except for energy, pharmaceuticals and fertilisers, whose price increases were diluted in subsequent months); very mild wage indexation of wage guidelines (at 30 per cent of inflation in January, 20 per cent in February to April, 60 per cent in May to December except for July when indexation was 100 per cent to compensate for energy price increases) and penal taxation over that level; trade liberalisation; 32 per cent devaluation of the zloty, made convertible and held at 9 500 zlotys per dollar, with the backing of external assistance provided by international agencies and the Group of 24 (a $700 million International Monetary Fund (IMF) stand-by credit, a $1 billion stabilisation fund, $300 million from the World Bank, EC-coordinated assistance under the PHARE programme, and credits and gifts by individual countries) and the rescheduling of debt service.

The programme was successful in establishing domestic market equilibrium: net exports rose to $1.7 billion over the first seven months; inflation exploded going up to the monthly (point-to-point) rate of 105 per cent in January 1990 then settled down to 4-6 per cent per month, which is still much too high on a yearly basis; and the exchange rate was held at the target rate, in spite of hyperinflation and continued inflation differentials with hard currency countries (which just goes to show how grossly undervalued it must have been in January 1990). However, the real purchasing power of wages (formerly overestimated by statistics because of permanent shortages) fell by a third; output in mid-year stagnated after a fall of over one-third; and unemployment, around 10 000 at the end of 1989, grew fast and at the end of July 1990 had reached 700 000, rising at a rate of over 25 000 per week – government forecasts expect 1.3 million unemployed by the end of 1990.

In brief, the stabilisation programme has overshot its output, employment and real wages targets, and yet there is hardly a sign of "supply response". Against this background the advantages expected of privatisation – demand deflation, efficiency, entrepreneurship – become particularly important.

Polish privatisation: debates and practice

In Poland there is a long standing tradition of private enterprise both in agriculture (following the de-collectivisation of 1956, with about 4 million employees today) and outside agriculture as well, especially in the last six years (private manufacturing, transport and other services, including joint ventures, with over 1 million employees). This makes up almost one-third of the labour force, and grew in 1988 at 11 per cent while state employment was falling at 1-2 per cent; these trends have accelerated in 1989-90. By early 1990 there were 845 677 private enterprises (though mostly of very small size) attracting the best employees away from the public sector (Chilosi 1990). Official forecasts for 1990 expect state industrial output to fall by 28 per cent and

private output to grow by 5 per cent, bringing the relative shares of the two sectors in industry from 92 to 87-88 per cent and from 8 to 12-13 per cent, respectively.

The privatisation of Polish state assets and the setting up of a stock exchange where they could be sold and retraded were already under consideration by the last communist-dominated Polish Government, and naturally were revamped by the Mazowiecki-led coalition (see Grosfeld 1990). Finance Minister Leszek Balcerowicz, speaking at the IMF assembly in Washington in October 1989, stated that:"The Government of Poland intends to transform the Polish economy to a market economy. This process is to be accompanied by a gradual change in the pattern of ownership towards that which prevails in countries with advanced economies."

Privatisation has been generally regarded as a deflationary instrument to avoid or reduce hyperinflation, a guarantee of enterprise independence from central organs and, most importantly, a way of enhancing productivity and entrepreneurship.

The main difficulty faced by both the former and the present government has been the reconciliation of privatisation schemes with the self-management institutions set up in Polish enterprises by the legislation of September 1981 (see Nuti 1981 for a comparison of the legislation with the more militant draft law submitted by Solidarity at that time). This legislation gave workers collectively some, indeed most, of the rights usually exercised by shareholders (such as managerial appointments and dismissals, verification of current performance, distribution of profit, and investment plans). Therefore the transformation of state enterprises into joint stock companies to be sold off to the public implies the cancellation or substantial dilution of those rights which, especially at times of drastic reductions in real wages, has to be compensated and negotiated. But there were also other difficulties, in part indirectly related to the modification of self-management.

The starting position of workers before privatisation is that of part entrepreneurs – not having ownership rights but having extensive decision-making rights and some profit-related benefits – for 100 per cent of the enterprise. An obvious trade off is that of giving workers the position of full entrepreneurs – i.e. 100 per cent owners, decision-makers and residual claimants – as shareholders in the enterprise with a much smaller stake. But how much smaller? And should it not be an equal absolute stake in all enterprises rather than a percentage which would unduly favour capital-intensive sectors? But then how are shares to be valued, before a capital stock is set up? Should one start with the ailing enterprises or with the viable ones? And why limit the share-out to workers in state enterprises, excluding for instance workers in government services, or the unemployed; should everybody not have an equal share of state assets financed by past consumption sacrifices on the part of the whole population? Current savings could not afford to buy more than a small fraction of the whole national capital anyway. Why not give everybody a free share in all state enterprises, or rather in a number of state holding companies, thus solving at a stroke problems of capital valuation, equality and small size of the market? Or perhaps free equal vouchers should be offered to the whole adult population to convert into a portfolio of their choice as privatisation proceeds. But then, why dilapidate state assets when the state budget deficit must be eliminated and there are pressing welfare needs, not to speak of the burden of external debt? Should sales and debt-equity swaps not be explored first? Could workers in state enterprises be satisfied by a combination of lesser involvement in decision-making and stronger participation in enterprise profit, instead of having to be paid off with a capital stake?

These questions were hotly debated in Poland and arguments somewhat impeded the progress of privatisation.

The new Polish law on privatisation (July 1990)

The office of the Government Plenipotentiary for questions of Property Transformations – a new ministerial post in the new government, held by Krzystof Lis – prepared a number of successive versions of draft laws on "The Privatisation of State Enterprises" and on "The Council of National Capital and the Agency for Ownership Transformations" (Biuro 1990a and 1990b). In April 1990 the 15th version was presented to the Polish Parliament, with a counter-draft law being submitted by a group of Trade Union deputies close to Andrzej Milkowski of OKP (Solidarity's Citizen Parliamentary Committee; see OKP 1990). The government project, somewhat modified to take into account suggested amendments, was approved in July 1990 by impressive majorities (328 votes to two with 39 abstentions in the lower house; 60 votes to seven with two abstentions in the Senate), but it left many issues still unresolved.

The Law establishes a Ministry of Property Transformation, to oversee the transformation of state enterprises into share companies initially held by the Treasury as single shareholder, followed within two years by the sale of shares to domestic and foreign investors, mostly by public offer at a prefixed price. The initiative to privatise a given enterprise can be taken by management, workers or the "founding organs" (i.e. the central body or bodies exercising authority on the enterprise to date) and is subject to governmental authorisation.

Up to 20 per cent of shares are reserved for workers of the privatised enterprise at a 50 per cent discount on the price of issue; the discount however cannot exceed half of the buyer's salary over the last six months. This is an ingenious constraint which broadly equalises access to capital by employees in enterprises characterised by different amounts of capital per person.

This reserve creates a potential class of 4 million small investors but excludes from the discount the other 13 million working in state agencies other than enterprises and in the private sector; however a portion (expected to be 10-20 per cent) of the shares of companies undertaking privatisation is to be distributed freely and equally to the general public. Moreover, access to capital ownership is facilitated by the fact that shares can be purchased on credit, if so decided by the Minister of Property Transformation and the Minister of Finance. In order to limit *nomenklatura* acquisitions only individuals can acquire shares at the time of privatisation. As long as an enterprise is in state hands, one-third of the board of directors is to be elected by workers.

Foreign investors can freely purchase state company shares subject to an overall ceiling of 10 per cent, which can be raised by the Agency for Foreign Investments (transferred to the Ministry of Property Transformations from the Foreign Trade Ministry). Dividends and the proceeds of subsequent share sales may be repatriated abroad without special permits.

An alternative form of ownership transformation is through liquidation, i.e. selling or leasing all or part of the enterprise assets to employees or external

entrepreneurial groups, preferably at public auction, with a view to facilitate the creation of new private enterprises.

Several hundred enterprises are expected to close in the next year, and their assets will be sold or leased. Privatisation of some companies (out of over 7 000 potential candidates) started in September 1990; some leading enterprises will be included, e.g. the Kielce construction conglomerate Exbud and a cable factory in Czechowice. Foreign assistance is providing funds to pay the fees of Western consultants and banks involved in this operation.

Opposition to earlier government plans had been voiced primarily on the grounds of infringement of workers' self-management rights, neglect of workers' ownership schemes and excessive concentration of power in the hands of the CNC President. The proposed counter-project left greater scope for ESOP-type schemes of employee ownership and for access to finance by domestic investors, and envisaged greater social control over privatisation, at the risk however of bureaucratising the process. The Law approved in July 1990 made some concessions in this direction, introducing some free shares and the possibility of purchases on credit.

A central question remains: what role foreign capital might play in Polish privatisation, and therefore the weight of implicit or explicit "debt-equity swaps". Capital inflows to date have been fairly small (a cumulative amount of $200 million to March 1990 for joint ventures – over one-third from West Germany – compared with a Soviet total of $600 million). On the one hand foreign participants are needed to secure competition, to provide know how and fresh hard currency capital; on the other hand Poland has little incentive to repay the extant debt ($41.4 billion at end-1989, or 4.8 times total Polish yearly exports) out of national capital assets, other than as part of an international exercise in debt relief or at a discount comparable to that at which Polish commercial debt retrades today in secondary markets (over 80 per cent). In any case, the result of any privatisation targeted to foreign buyers is indeterminate without stipulating the associated credit policy (determining the zloty credit available to domestic buyers for the purchase of state assets) and exchange rate policy (determining the domestic value of foreign bids).

The Law leaves to governmental discretion the scale and time schedule of privatisation; Parliament is to set only "basic directions" for privatisation once a year and decides on the uses to which sales revenues are to be put. The law also leaves to future governmental decisions the scale of free distribution, the scale of credit sales and the size of foreign acquisitions; it also leaves to subsequent legislation the institution and regulation of financial markets – a step which is obviously out of sequence. Until these questions are resolved, the progress of privatisation is bound to continue to be controversial and to be delayed.

Notes

1. According to Strumilin, a sufficient condition of full communism is that free consumption should be the larger share. However in order to measure the relative shares of free and non-free goods – unless all goods are subject to a two-tier (free and non-free) regime – it is necessary to use a set of weights, i.e. actual or shadow prices. Yet it is not clear from where the necessary price system would come. In principle prices could come from a system of marginal valuations with reference to a central body, were it not for the fact that under full communism presumably central bodies "wither away" with the state.
2. If I consume a quantity c(i) of good i per unit of time and that good has durability T(i), I can carry a revolving stock of c(i)*T(i); if v(i) is the storage volume required per unit of of consumption good i and I have a maximum storage space V, then I will have a maximum command on a stock of consumption goods given by a vector c with elements c(i)*T(i) subject to the scalar product of c and v (the corresponding vector of storage requirements per unit of consumption) being equal to or less than V. Here "durability" means 100 per cent conservation for a period of time T(i), which is equivalent to a zero real own rate of return on storage; this already gives rise to an optimisation problem, in that the rational consumer, given his expected future claims to consumption c(i, t) will equate his real rate of time preference, implicit in his rate of intertemporal substitution, to the zero own rate of return on storage. As a result of this maximisation problem actual stocks of goods C(i, t) may well be lower than the maximum allowed by storage space and durability characteristics. In practice the consumption goods stored have a rate of decay d(i) which is a function of storage time, i.e. d(i)=d[i, T(i)], giving rise to a more complex optimisation problem, simultaneously determining d(i) and T(i) as well as C(i, t); now there can be different real rates of time preferences for each good, being equated to the rate of decay which is an implicit negative rate of (own) real interest.
3. Even paper money could be made perishable if an early enough date were fixed by which it had to be spent, or its liquidity could be reduced if its validity as legal tender were subject to some inconvenient procedure of official validation. Keynes (1936), for instance, suggested that cash should be stamped at frequent intervals; for a history of the idea of money "melting" or "reabsorbing", see Morley-Fletcher (1980-81).
4. This cost is virtually equal to zero, or a small amount taken with a negative sign; if interest-earning liquid deposits are possible, they are treated here as financial assets different from money.
5. Except for contracts involving the delivery of future labour services, which would not be capitalistic but feudal, as they would imply the compulsory subjection of individuals to other individuals or firms.
6. China appears to have been an exception, at least until recently.
7. The March 1990 Soviet legislation on property prohibits one-man-owned enterprises employing wage labour, but allows joint-stock companies, somehow regarded as "collective" forms of ownership. This is an absurd distinction, co-ownership being no less private than one-man ownership of a whole asset. Soviet legislators literally are preventing

"exploitation of man" by one other man but allow it when it is done by several men together.

8. In the Soviet economy in 1990 excess liquid assets in the hands of the population are estimated, to be of the order of an average four months' wage bill; enterprises' inventories were 82 per cent of national income in 1985, compared with 31 per cent in the United States (Shmelev and Popov 1989, p. 305).
9. In this respect my own views have radically altered with respect to Nuti (1974), where the possibility of group entrepreneurship in the traditional socialist model was considered with excessive optimism.
10. Gomulka envisages a special role for banks in the privatisation process: public shareholdings in state enterprises would be entrusted to the management of banks, which would earn a share of dividends and realised capital gains; Gomulka regards privatisation of those banks as equivalent to the privatisation of the public assets entrusted to them but this is a misconception: if I buy shares in Merrill Lynch I do not acquire a stake in the portfolio of their clients. Moreover, emphasis on realised capital gains rather than on the increase of portfolio evaluation is bound to unduly inflate turnover (by encouraging a special case of so-called "bed and breakfast" transactions, i.e. sales followed by quick repurchases).
11. In early 1979 the provincial government of British Columbia set up a new Crown Corporation, the British Columbia Resources Investment Corporation, with $151.5 million in assets, and distributed five free shares to any citizen who asked for them, plus additional shares at $6 each; 170 000 persons were involved. However the new company made some bad investments and soon incurred substantial losses; the operation is not judged to have been a success (see Stanbury 1989, pp. 282-283).
12. The loss of potential collateral on the part of creditors may be thought to be overcompensated by the greater potential productivity which could derive from privatisation and the further impulse to economic reform. Certainly no international creditor has publicly argued against free distribution of state assets in debtor countries.
13. The auto-appropriation of state assets by the nomenklatura has been facilitated in Poland by the extraordinary growth of joint stock and limited liability companies founded in Poland, which were almost 30 000 in 1989. Some transactions, in which managers appeared on both sides as sellers on behalf of their state enterprises and as buyers for their own companies or even joint ventures – naturally have been declared void by the Supreme Court, but the bulk of this kind of transaction are unlikely to be challenged especially when foreign buyers are also involved (Chilosi 1990).

    A famous case is that of Igloopol, the largest Polish agro-industrial complex, valued at 145 billion zlotys and artificially liquidated and transferred for 55 billion zlotys to a joint stock company with the same board of directors, whose shares - transferable at their discretion -were sold mostly to Party organisations and activists. The Ministry of Agriculture (of which the Igloopol Managing Director was Deputy Minister) approved the liquidation procedure in spite of a Ministry of Finance report which declared it illegal and economically unjustified (Grosfeld 1990). A recent decree of the Mazowiecki Government has now made illegal the participation of state enterprise managers and workers' councils in the companies founded by their own enterprise (Chilosi 1990).
14. Kolodko (1990) reports that a million zlotys invested in these bonds at the end of 1989 were worth by the end of the first quarter of 1990 2.5 million zlotys, compared with 1.3 million zlotys if invested in three-month deposits at the National Savings Bank (PKO) and 1.06 million zlotys if invested in dollar-denominated deposits. This is an indication of the lack of credibility of government policies.

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