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PRIVATIZATION IN POLAND: AN INTERVIEW WITH JEFFREY SACHS†

I. INTRODUCTION

Within the past few years, Poland has experienced more social, political, and economic change than had occurred in the past several decades. A sense of euphoria developed in 1989 when the Solidarity movement, forged by workers' unions, peacefully gained control of the government, held its first free elections and ousted communist leaders. Economic realism, however, quickly tempered this euphoria. Poland's economy was based on the Soviet model of state-owned industry and central control of production and trade.[1] After more than forty years of following the Soviet model, Polish citizens faced a bleak future: one had to stand in line for hours every day to buy food; markets ran out of food before noon; the zloty, the official currency, was not convertible into internationally traded currencies and was almost useless inside Poland;[2] and, inflation had been replaced with hyperinflation.[3]

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This interview was conducted in late 1991 by William Andrew Lichtenfels, J.D., Suffolk University Law School.

1. [Ed.] Bednarzik, *Helping Poland Cope With Unemployment*, MONTHLY LABOR REVIEW, Dec. 1990, at 25. The Soviet model enabled the Polish economy to recover after World War II, but led to shortages in production, decreased productivity, and low-quality production. *Id.* The Communist government attempted to reform the economy in the 1970s and 1980s in an effort to decentralize and to foster a more market-oriented economy. *Id. See also* Lipton & Sachs, *Creating a Market Economy in Eastern Europe: The Case in Poland*, Brookings Papers on Economic Activity 1 (1990).

2. [Ed.] The Communist government sought to quell the workers' unrest with frequent wage increases; the wage increases, however, were financed by simply printing more money. Weschler, *A Reporter at Large: Shock*, NEW YORKER, Dec. 10, 1990, at 86, 86; Brumberg, *What It Takes to Get From Here to There*, U.S. NEWS & WORLD REPORT, March 26, 1990, at 41, 41.

3. [Ed.] Monthly inflation rates at the end of 1989 were over projected to be

In the face of the economic crisis in late 1989 and the Communists' failure to reform the economy, Solidarity dismantled the centrally planned economy and adopted a free-market economy. The basic objective of the economic reform plan was to adopt the economic model of industrially developed countries, capitalism. The goal is to make this changeover into capitalism quickly and through radical steps in order to shorten the transitional stage and hardship to the people.

What has been termed as economic "shock therapy," instituted by the Polish government on January 1, 1990, included freezing salaries, lifting price controls, stabilizing the zloty, ending government subsidies to businesses, and privatizing state-run enterprises.[4] This "deep surgery" on the Polish economy quickly produced some expected hardships. In January, food prices increased by 70%, electricity and natural gas rose 400%, the cost of gasoline doubled, and coal prices rose by 600%.[5] Under the Communist government, there were no unemployed workers; by September 1990, however, over 900,000 Poles were without work,[6] industrial production dropped, and real wages decreased drastically.[7]

2,000%. Schares & Javetski, *The New Poland May Split Solidarity Apart*, BUSINESS WEEK, April 23, 1990, at 56, 56. Hyperinflation is defined as a rate of inflation that exceeds 50% per month. Norton, *The American Out to Save Poland*, FORTUNE, Jan. 29, 1990, at 129, 130.

4. [Ed.] Thomas & Wiecko, *Shock Therapy for Poland*, NEWSWEEK, Jan. 15, 1990, at 50, 50.

5. [Ed.] *See Global Wrapup: Poland*, BUSINESS WEEK, Feb. 5, 1990 (food and energy prices increased after abrupt switch to market economy); Brumberg, *supra* note 3, at 41 (country's economy is crumbling under austerity program); Thomas & Wiecko, *supra* note 4, at 50 (staggering price increases result of "new economic reality").

6. [Ed.] Bednarzik, *supra* note 1, at 27. *See also* Borrell, *Living with Shock Therapy*, TIME, June 11, 1990, 31, at 31 (discussing job losses in early 1990). Unemployment is a totally new experience to Polish workers because the Communist government guaranteed everyone a job, making unemployment illegal. "Half the people in Poland have jobs that would not exist in a normal economy." Sikorski, *Revolution Betrayed*, NATIONAL REVIEW, July 23, 1990, at 20, 21.

Poland has almost 18 million people in its labor force, out of a total population of 38 million. Bednarzik, *supra* note 1, at 27-29. The unemployment rate rose steadily from 0.3% to over 5% from January to September 1990. *Id.* at 29. By early 1992, unemployment had reached 11%. *Poland's Parliament Rejects Steps to Ease Impact of Move to Market*. N.Y. Times, March 6, 1992, at A6.

7. [Ed.] Schares & Javetski, *supra* note 3, at 56.

Proponents of economic shock therapy had forecast that immediate signs of strength and stabilization would result from the economic reforms and social sacrifices. Economic performance validated the proponents' arguments. Only a few months after the austerity program began, inflation fell to around 3% per month (from 30-50% per month in the second half of 1990),[8] the zloty stabilized at 9,500 to the American dollar,[9] and the endless lines for consumer goods disappeared since the markets had ample food supplies, though the prices are very expensive for the average Pole

Polish citizens, patient for two years, are beginning to question when the sacrifice will end. Shipyard and railroad workers have gone on strike for higher pay and better conditions.[10] Trade unions and farmers have also threatened to strike.[11] Average Polish citizens warn that if prices continue to rise, their patience will be strained beyond endurance.[12] Polish officials, however, remain determined to continue the economic reform. Prime Minister Jan Olszewski, who took office in December 1991, proposed a plan that would ease the sting of the free-market reforms.[13] The Sjem, or lower chamber of Parliament, rejected Olszewski's plan by a vote of 171 to 138 reflecting the division between those who feared the increased deficits and those who wanted still more state spending.[14] Subsequently, the Government submitted a tighter budget in

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8. [Ed.] *See id.*

9. [Ed.] *Global Wrapup: Poland*, BUSINESS WEEK, Feb. 5, 1990, at 43, 43. Prior to 1990, the "official" rate of zlotys was very much undervalued, to the point that the black market rate was a more accurate indicator of its worth. Weschler, *supra* note 2, at 86. The new government abandoned the fiction of an official rate and pegged all transactions to the rate prevailing on the black market. *Id.* While the zloty is still not completely convertible on the international market, the rate of exchange within Poland has been standardized and has stabilized. *Id.*

10. [Ed.] Borrell, *Living With Shock Therapy*, TIME, June 11, 1990, at 31, 31.

11. [Ed.] Thomas & Wiecko, *supra* note 4, at 50.

12. [Ed.] Brumberg, *supra* note 2, at 41.

13. [Ed.] *Poland's Parliament Rejects Steps to Ease Impact of Move to Market*, N.Y. Times, March 6, 1992, at A6.

14. [Ed.] *Id.* The plan called for increased government spending and a gradual expansion of the money supply to encourage investment and exports, while keeping the deficit to under 5% of the gross domestic product, about $5 billion. *Id.*

conformity with conditions set down by the International Monetary Fund. That budget is still before the Parliament.

II. Interview with Jeffrey Sachs

The man behind the economic reform plan in Poland is Jeffrey Sachs, who visited Poland several times in 1989 as an adviser to Solidarity. In 1985, Sachs traveled to Bolivia and prescribed shock therapy to address the country's annual inflation rate of 24,000%.[15] The Bolivian government adopted his ideas and made immediate cuts in wages and state spending. After a collapse of world tin prices and increased State spending began to undermine the reforms, Sachs convinced the Bolivians to continue the austerity program and not yield to demands to ease the country's adjustment period. By 1987, the inflation rate in Bolivia leveled off at 15% and economic growth resumed. In early 1989, Warsaw called on Sachs.[16] Sachs has advised officials in Argentina, Brazil, Ecuador, and Peru as an adviser for the United Nations Development Program.[17] He has also advised the Phillipines, Yugoslavia,[18] Mongolia,[19] Istonia, and Slovenia. Sachs is currently leading a team of economic advisors to the Russian Government of Boris Yeltsin. This interview, conducted in late 1991, provides Sachs' thoughts on the economic and concurrent legal transformations in Poland.

Q: In your opinion, what economic method or system is the most successful?

A: The capitalist system of the advanced industrial countries

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15. [Ed.] Norton, *supra* note 3, at 130.

16. [Ed.] *Id.* Sachs refused to advise the Communist government, and it was not until Solidarity was legally recognized that he went to Poland. *Id.* at 131.

17. [Ed.] For a detailed description of privatization of selected enterprises in Argentina, Brazil, Chile, the Dominican Republic and Trinidad and Tobago, as well as Mexico, see International Center for Economic Growth, Privatization of Public Enterprises in Latin America (W. Glade, ed. 1990).

18. [Ed.] *See generally* Pechota, *Privatization and Foreign Investment in Czechoslovakia: The Legal Dimension*, 24 Vand. J. Transnat'l L. 305-34 (1991); Glick & Richter, *Legal Framework for Privatisation in Czechoslovakia*, 19 Int'l Bus. Lawyer 353-58 (1991).

19. [Ed.] *See* Gabor, *The Quest for Transformation to a Market Economy: Privatization and Foreign Investment in Hungary*, 24 Vand. J. Transnat'l L. 269-303 (1991).

is the system that works. I think there is a core of common elements in the economic systems of Western Europe, the United States, and Japan which should be adopted by all countries in reform.

Q: What are those elements?

A: First, a working monetary system where money can buy goods domestically, subject to normal supply and demand conditions, and where money can be freely used for international trade, making the currency convertible. The second element is the requirement that private ownership be the core of the economy. While there may be state ownership, it should play a minor role in the economy, not a dominant role. The dominant amount of production should be in private hands. The third element is a system of legal, financial, and administrative institutions to protect private property and make it possible to engage in the fundamentals of contracting, exchange of assets, trade and so forth. The last element is a social welfare system, a part of any modern economy. What is attractive about the advanced industrial countries is that these are mixed systems. There is a role for the state and there should be a social welfare system, but the core of the economy should be a private ownership market economy.

Q: Your third element required legal institutions to define property rights. The industrialized economies of the West employ sophisticated legal systems to support even the most basic economic transactions. But the economies of Eastern Europe and Russia under communism did not develop laws to regulate a market economy. What is current state of the law in these countries?

A: Well, that is a complex question and there is a complex answer to it. First, there is a difference among countries. Poland, Hungary, and Czechoslovakia actually share in the civil law tradition of Europe and have an extensive base of laws that were on the books in the pre-war period. Those laws were mostly thrown aside, or simply fell into disuse during the communist period, but there is a legal tradition. The legal tradition is not necessarily deep in that it has been neglected for decades, but it is around and available.

In Poland there is a whole legal scholarship. There are law

schools and, in fact, there are many practicing lawyers. There is a commercial code dating from 1934 that was taken back on the books and made operative in 1989. Bankruptcy law also exists in Poland. There is a German-style company law modeled after the 1871 German Company Act. Polish corporations look more like German companies with two levels of management, supervisory board and management boards, which are different from the unitary board system of the United States.

The point is that there is a legal tradition. It is very rusty and there are major gaps in the law; obviously there was a breakdown of proper training, debate, and use of these laws over the past 50 years. New theories about contract law or bankruptcy law or innovations in securities law and so forth have not yet been incorporated, in many cases, even on the books, much less into practice. There is a bankruptcy law in Poland, but nobody knows how to use it. There are a couple of first attempts right now, but the experienced liquidators that understand how to do a liquidation, or a financial workout, do not exist. The judges do not know how to do it and so there are very serious limitations in the legal knowledge.

Now, as you go east it becomes more and more problematic. Within Eastern Europe you have Bulgaria and Romania, for example, which were not in the Hapsburg Empire, so these countries did not follow the Germanic legal tradition, which had so much influence in Central Europe, including the Hapsburg part of Poland. Instead, Bulgaria and Romania were part of the Ottoman empire until the late nineteenth century. There you find a much shallower base for any of the legal structures that you would need and much less ability to just go back and pick up laws and make them operational again.

When you go to the Soviet Union there are also differences. The Baltic Republics had less rudimentary market systems in the inter-war period. They were independent states. Estonia's living standards were similar to Finland's in the inter-war period. The Baltic states had market economies which they remember and from which there is a legal tradition. If you look

even farther back in history, the Baltic states were part of the Germanic trading system even before German unification as a part of the Hanseatic League between the Fourteenth and Seventeenth centuries. So, there you have some possibility of resurrection of a European civil law tradition.

When you go to Russia, you are starting from a society which has never been a society with a legal order in the sense that we would recognize it because the czar, in principle, owned everything and had the power over everything. Of course, there were legal codes in Czarist Russia and there were commercial bases for transactions, but protection of property rights was always extremely weak. A fascinating, specific instance was a Russian company law in the nineteenth century which failed to incorporate the advances made in the legal theory of the corporation in Western Europe. Limited liability was adopted very late in the nineteenth century, and then, what was really remarkable, was that automatic registration of corporations was never permitted under czarist rule.

Until 1917, you needed the czar's signature and permission to establish a corporation. This is an example that enables you to realize why, even while there were some market structures in Russia, they were never like the liberal market structures that European civil law made possible. There were never truly independent, self-standing legal persons, free of the czar and free of czarist and bureaucratic wishes. So, even if you could go back to 1917, you wouldn't find a very satisfactory legal basis from which to draw.

Nothing was done in the last sixty or seventy years to do much for legal understanding of private market institutions. Obviously, quite the contrary. The legal base in Russia is incredibly weak and I think it has to be a fundamental part of an economic reform program to have a wholesale effort, a very deep and rich effort, to create a commercial code for Russia as rapidly as possible. Even with a newly formed commercial code, the market reforms do not work well at the outset.

Q: You mentioned that the reforms do not work well at the beginning, could you describe your theory on these reforms?

A: My theory of all this is that institutions can be transmit-

ted across national borders, but you cannot expect miracles at the beginning. You try to put the framework in place and then hope that the society grows into it and learns to live with it. One should also appreciate that in the end, even if you put in totally American or Western European concepts, what is going to come out will be a Russian economic system. Japan is our best example of that. In order to start Japanese reconstruction after World War II, the United States occupation authorities put in place a considerable amount of United States economic law on the corporation, antitrust, labor relations, and so forth. These laws have not produced American results, but rather distinctly Japanese results; even when the framework is almost identical to United States law. This result is not to be shunned, in fact, it's a great merit. It means that there is a possibility of transmitting institutions without killing local culture, without leading to a total importation from the outside.

I also believe that effective legal institutions are, in some sense, like a new industrial technology. When a new drug is invented in Japan or the United States, it can be used anywhere, without the need to reinvent it. If a fax machine is developed by American or Japanese technology, it can be used in Western Europe or Eastern Europe without the need to reinvent it.

I view the law quite the same way. I am not trying to oversimplify the analogy, but what I mean is that capitalism took 200-300 years to develop but I do not think it means that you have to go through 200-300 years to use it. What capitalism represents, in part, is a set of institutions which are truly breathtaking in their ingenuity. For example, the modern corporation is just an astoundingly effective innovation with the concepts of limited liability, tradeable shares, and corporate governance. These fundamental concepts are hard-won, hard-learned innovations. We don't think of them as such, but when you see how the modern corporation was put together, starting from 1650 when the first idea of joint stock companies came around under royal charter, up through automatic registration with the limited liability, to modern innovations of se-

curities laws to prevent insider trading or provide free public information and so forth, these are innovations that are brilliant in their result. I believe that Eastern Europe and Russia should not have to relearn all of this through 200 painful years, but should be able to put a Western-style company law on the books, and begin to learn to manage with it.

Obviously, the law is not like a pill or fax machine, in that the law is also a fundamental part of society. Aside from focusing on the breathtakingly clever legal institutions that have developed to enhance efficiency and high living standards, we should also recognize the deep social context to the law.

For example, a market economy means uncertainty. It means that individuals must have flexibility since they may not have their job in five years. It may mean moving somewhere else. We know that modernization has created great social tensions because traditional societies are not only societies without modern legal structures, but they are societies in which the nature of daily life and the rhythms are different. Modern Poland has certain rhythms of a quite detrimental sort because they were the rhythms imposed for fifty years by a military occupation, in effect, by a foreign occupying power.

What makes it possible to believe that you can change to a market economy is, first, there is a tradition to go back to that is important. Second, there are examples, of which Japan is clearly the best, of a rapid importation of institutions which take hold even when they are of a rather foreign character to the prior tradition. And third, Poland has a very deep sense of being a central part of Europe, not just a part of Central Europe. Therefore, there is the intention to become like the rest of Europe and to work hard, to take the shocks, dislocations, and the uncertainties that will come when Poland becomes a normal working part of Western European social, political, and economic institutions.

On the economic level, I think the reform, per se, in Poland is going forward with great success, but with one major caveat. The society is in a tumult right now, not because of the reforms, but mainly because of the complete and incredibly rapid collapse of the old communist order. There is great so-

cial confusion, anxiety, and divisiveness in the Polish society and economic reforms probably add to that, but all that tension and anxiety would be there whether you are reforming or not. You cannot find a place that is happy and calm right now in all of the old socialist world because the death of the old system has meant a period of great tumult no matter what you do.

I'll just refer you to the greatest risks in Poland: populism and confusion of property rights. Political power in the parliament could leave the government unable to take the last decisive reform steps. This risk is heightened by the fact that Poland has adopted extreme proportional representation as the basis for parliamentary representation. This voting system surely increases the likelihood of numerous weak political parties and a government that is dependent on fragile multi-party coalitions. Twenty-seven political parties are putting forward nationwide slates. No less than sixty-two parties are fielding at least one candidate in the parliamentary elections. I have been warning the Polish government for two years that they have the wrong election framework.

My point is that the collapse of the old system has meant tremendous anxiety and an inevitable amount of pain in parts of the Polish society and that this unstable situation was destined to develop, with or without reform. The Soviet Union is not reformed but the pain is great. If you do not put these kinds of reforms in place quickly, in my view, the likelihood is not less pain, but chaos. I do not believe that there is a tradeoff, as is often portrayed, of fast reforms with more social cost, or slower reforms, at less social cost.

The real tradeoff in my view is to do it quickly and have a chance at a coherent system, to which society will take time to adapt, but this will not produce chaos; or, try to do it slowly and end up with incoherence, financial catastrophe, and social disorganization. There will be a deep crisis in any event because when an old system collapses, whether it is the Hapsburgs, the Russian empire in 1917, or the communist empire today, there is great dislocation and unhappiness. A market economy probably heightens the anxiety levels because a cen-

tral part of the philosophy is to take care of yourself and you are telling that to people in the midst of great uncertainty. They ask, "What do you mean take care of ourselves? How can we take care of ourselves when we do not understand anything that's happening to us?"

One final thought — if into that complexity you throw the kind of election law that Poland has adopted, an almost perfect proportional representation system which favors small parties in voting, you will get the result Poland has. In my view, Poland does not have a serious electoral system. That is a harsh judgment, but they have made a dreadful choice. This is a country that did not take care of itself and it could and should have done better. It has been a deep part of their history, from the inter-war period and even from the eighteenth century, to favor small splintered groups. In doing so, they weaken their capacity to act. They have done it again and it is sad.

Q: But aren't the Polish people existing in a revolutionary period? And, if so, there are bound to be terrible growing pains. How do you think economic and legal institutions will help cohere the fragments?

A: Well, first of all, what you are aiming for is a working model. What I believe Poland should be aiming for, and what it is and what it professes to be aiming for, is to be an integrated part of Europe. This means adopting several thousand codes and regulations of the European Community and membership in particular political institutions and so forth. Now, this does not mean that it is an easy path from here to there.

In practical terms, you have factory towns that are going under, and agriculture is being hit hard. Change is occurring at a very rapid rate as a result of two things. First, you cannot stand still at this moment because a lot is collapsing, no matter what you do; and second, change was held up for forty-five years so that there is a backlog of necessary changes which are going to come faster now than if they have been stretched over the whole post-war period.

Q: Should we transfer economic institutions first, or transfer

more broadly-based social concepts, such as the law and legal institutions, in order to achieve economic goals?

A: Well, I think it is important not to get too abstract on this because this is not a blank slate on which we are writing. Both the society and the economy are pre-existing, it is not as if we can say we are starting on page one and we are going to write everything from scratch. What we can do is help Poland take the practical steps to get where they want to get. They want to be part of the European Community within a decade. That means fundamental legal, political, and institutional changes. But, the order in which one tries to make those changes depends on the real economics that you confront. For instance, in the fall of 1989 there was hyperinflation. There was no luxury to say why not sit back and spend two years teaching them about markets and then they could make some fine distinctions between point A and point B. There was hyperinflation, chaos, and fear — fear of hunger in the winter of 1990, which thankfully did not emerge, partly as a result of the reforms that were carried out.

So, very practical steps had to be taken and, in my view, Poland went the right way by freeing prices, introducing a new foreign exchange law which allowed for free international trade, adding various kinds of banking and financial regulations to allow for the rapid integration of Polish enterprises with western markets, and so forth. Of course, there is a very broad range of areas where you would like to work, but the order in which you could do it is partly dictated by what the greatest emergency is at the moment and partly by the simple logic that if you want to have a market economy, first you need money that can facilitate market transactions; second, you need free prices; and third, you need freedom of entry and exit of enterprises and protection of property rights.

I think there is a certain logical order of how these reforms can be done. And, again, I would say that what is happening in Eastern Europe is in some ways similar to many, many reform experiences that have occurred in Latin America in the past twenty years and, even before that, in Germany and Japan after World War II.

Q: Let's talk about property rights. You said that confusion of property rights plays a role in retarding the acceptance and effect of your economic reforms. How can countries, without developed patent laws, corporate laws, or any significant history of modern regulatory experience, comprehend and adopt these ideas before the opportunity for your reform has politically expired?

A: A very good example is that one of the most important messages that the United States Government has been giving to the Polish Government in recent months is that if Poland is expecting foreign investment to bring in new high technologies, they are going to have to strengthen very considerably the protection of intellectual property rights and all of the other legal protections necessary to attract firms that must have the confidence to bring in these proprietary technologies. This has been a very strong message from the Commerce Department. I am sure that Poland is hearing a similar message from the European Community ("EC"). Thus, one of the ways that law will develop is pressure from the outside, not just the models that they choose to follow. Also, the fact is that Poland is being told, "if you want to play the game, this is how the game is played right now." In the Association Agreement that Poland is now negotiating with the EC, Poland will come under the competition codes of the EC, including the restrictions on state aid to enterprises. There will be a vast body of regulations and law regarding competition and state involvement that Poland will simply incorporate.

Q: How will the country handle that?

A: No doubt, partly with trial and error and partly with a lot of political unhappiness in some sectors. I hope they are making a basic bargain that they are going to learn to live within these strictures relatively quickly as the counterpart of being accepted relatively quickly within a community of nations that has long-established rules. If they want to be members, they have to learn to live within those rules.

Now, what is also true is that while I presume there is a social consensus in Poland towards quick membership to the EC, it's also very clear that there are particular interest groups opposed to the EC rules of the game, that express themselves

more and more in the political process. There are parts of the public that oppose the Association Agreement with the EC. I regard the Association Agreement as absolutely the pivotal part of this whole strategy. If it is not politically accepted in Poland, it would call into question, I think, the whole basis of the reform. I still have the confidence that it will be accepted, but there is a contentious political element to it.

Q: You had mentioned corporate property. One of the significant statements that you made in a past article is that the British IPO Model would not work in Eastern Europe and that there should be something structured more along the lines of a stock giveaway.[20] *Why do you see this method as significant for Eastern Europe?*

A: First, your question presumes that there already are corporations. There are enterprises and there are factories with workers in them with capital, but they are not yet in corporate form so they do not have the legal structure of corporations, in most cases. Also, they do not yet come under the commercial law. They are still bureaucratic creatures of the state and their ownership is much more muddled than to say that they are owned by the state, because when you get down to the actual exercise of property rights, there is a tremendous confusion among managers, workers, bureaucrats, politician, and the general public.

Managers can do a lot on their own without having to go to a supervisory board, or a board of directors as we would call it, because such a thing doesn't exist. It is the workers who legally have the right to oversee the daily management of the enterprises through workers' councils, up to, in most cases, the ability to appoint and fire managers. So, the workers right now, to some extent, undertake the role of owners. That is obviously a serious conflict situation because the workers are not real owners, as the state is supposed to be the owner. But the state is also represented in a variety of ways: the privatiza-

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20. [Ed.] J. SACHS, THE ECONOMIC TRANSFORMATION OF EASTERN EUROPE: THE CASE OF POLAND, 10 (September 1991) (prepared for the Frank E. Seidman Award in Political Economy) (available at the Suffolk Transnational Law Journal office).

tion ministry; the foreign investment agency, if there is a potential foreign partner involved; and the minister of industry, which is the so-called founding organ of many of these enterprises and, therefore, has some rights over direction and management.

Not only are the property rights not held solely by the state, but they are also poorly defined. There is no solid legal structure that commands anyone to do anything to represent the interests of the assets of the firm. You get managers and workers trying to bleed the enterprises of assets or income while the state remains the nominal owner and the political punching bag for those who want to get subsidies or debt write-offs for the firm. Given all of this, I am a very strong advocate of trying to define the property rights quickly for these enterprises.

The message of this year's Nobel Prize winner, Ronald Coase, is that what you need for a market economy to operate decently is a clear definition of property rights,[21] and that is what Poland lacks right now with the state industrial sector. From a pure efficiency point of view, it is not that important who in the private sector gets the property rights in the first instance because property rights can be traded in markets. Even if you allocate the property rights in a particular way initially, they will be juggled over time so that those who can best manage the assets have a shot of getting them through

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21. [Ed.] Coase's concepts were first published in his 1937 paper entitled *The Nature of the Firm*. Michael Mandel, *Plain Speaking Takes the Nobel Laurels*, BUSINESS WEEK, Oct. 28, 1991, at 38, 38. *See also* RONALD COASE, THE FIRM, THE MARKET, AND THE LAW (1988); Ronald Coase, *The Problem of Social Cost*, JOURNAL OF LAW AND ECONOMICS, Oct. 2, 1960.

His main thesis was that legal entitlements, such as property rights, can be bought and sold, and that the outcome of a transaction will be the same no matter who is assigned the property right in question. *Schools Brief: Of Bees and Lighthouses*, ECONOMIST, Feb. 23, 1991, at 72, 73. The initial allocation will only affect the distribution of income in the sense that the person who has the property right is better off than the person who doesn't own it; but the market will bring about efficient allocations no matter who originally owned it since it is freely transferrable. *Id*.

Coase argues that no form of government action is necessary to deal with negative externalities or public goods; the market will provide the optimum allocation as long as transaction costs, such as gathering information and negotiating agreements are not prohibitively high. *Id*.

takeovers or through buying shares. I remain a great, if frustrated, believer in massive privatization based at least in part on simply assigning the property rights of these enterprises to the private sector in a variety of ways. I would like enterprise shares, for example, just to be given to the workers within the firm. They would receive some fraction of the shares (as individual shareholders, not as a collective body of shareholders) and those shares could subsequently be traded. I do not think that much time should be wasted on trying to define a purchase price for the workers, or still worse, auctioning such shares; I would simply give twenty or thirty percent of the enterprise shares straight away to the workers in the firm. Let them trade them later on or not, as they see fit.

I would like to see another tranche of the shares of these enterprises given to the general public, not just to the workers in the firm. When you think about how to give away shares to the public, it is not that easy, as there are twenty-seven million adult citizens of Poland, and you want to devise a way that has even a rudimentary sense of fairness.

The way that I have been trying to explore with the Polish Government is to deposit enterprise shares owned by the government into newly constructed private mutual funds, the shares of which will be freely distributed to Polish adult citizens so that at some point, each would become an owner of a mutual fund share. The new owner could end up trading it or keeping it, investing more in the mutual fund and so forth, but at least right from the beginning you would assign proper ownership claims for about thirty percent of the shares of the enterprises through these new mutual funds.

My basic idea would be to partially privatize almost all of the enterprises right at the beginning by giving about twenty percent to workers and thirty percent or more to the public via mutual funds. In addition the government would probably maintain a block of shares, maybe thirty or forty percent of each of these enterprises. The government could do a variety of things with these shares: it could sell them to a foreign investor, auction them in a public offering, or give them away by further endowments of mutual funds or by creating pen-

sion funds or other mechanisms. Right from the beginning you would create a legal corporate structure in these enterprises and at least partial private ownership of the shares of the enterprises. The alternative, which remains a favorite among many of the experts in Eastern Europe, is to follow the tried and true path of privatization used in Britain. For example, during the 1980s, Britain sold the shares of enterprises to the public in public offerings as the predominate vehicle for privatization.[22]

Q: Why do you reject that method?

A: I reject it because if there is one thing that is known about it is that it takes a great deal of time. It is simply impossible for administrative, political, and financial reasons to do more than a handful of public offerings every few months.

Q: But aren't you more aware and more clear about the property rights in that situation, rather than depositing the shares in mutual funds?

A: No, I do not think that there is any ambiguity of property rights if you go through mutual funds, pension funds, and direct distribution of shares to workers. All of those claims can be precisely defined. The idea that financial intermediaries own shares of stock should not surprise Americans because more than half of the equities on our stock exchanges are owned by financial intermediaries, by mutual funds, pension funds, life insurance companies, and the like. This is a normal, well-defined way to establish ownership.

The public offering is attractive to the Eastern Europeans because it seems so clear and well-defined. Also, it is a lot of fun, you get an investment bank, you do a careful evaluation of the enterprise, you try to price the shares, and you float them on the new stock exchange. It is all very exciting. The problem is that maybe you can do a few each year. There are 3,000 state-owned industrial enterprises in Poland, so you are

22. [Ed.] *See generally* Beaumont, *Privatization, Contracting-out and Public Sector Industrial Relations: The Thatcher Years in Britain*, 20 J. COLLECTIVE NEGOTIATIONS IN PUBLIC SECTOR 89 (1991); Gambel, *Privatization, Thatcherism, and the British State*, 24 J. LAW & SOCIETY 1 (1989).

talking about decades if not longer, to privatize if you try to go that way.

My great concern is what happens in the meantime? In the meantime, you have terrible and quite fundamental problems of misgovernance of all of society's assets that remain in state hands because you do not have clear ownership rights. You do not have a clear, long-term perspective. You have incentives for very socially destructive, short-term behavior.

If we were starting from a blank slate and had fifty years to prepare for implementation, then naturally, almost any careful way of privatization might be more attractive. But, the fact is, we are operating in "real times" as the scientists would say, and things are going forward while the enterprise sector is not properly governed. It is being subjected to terrible shocks which are blowing it off-course and into widespread bankruptcy in many cases. You need real owners and real managers and you cannot get them quickly if you use the traditional methods of privatization.

Q: What do you foresee as the immediate legal problems for these financial intermediaries coming in and offering to manage the brand new mutual funds?

A: I do not see any great problems actually. I am not sure whether this program is going to get off the ground in the end because it has its share of critics; but, the Polish government has been working towards doing at least some privatizations this way and there are about 220 companies or enterprises which are being converted to corporations and whose shares will now be distributed to funds. It seems pretty clear that at least for that restricted subset of firms, the suggestion to distribute shares to a variety of funds will go forward, perhaps as an experiment. The Polish government has been interviewing dozens of potential management firms which would be on contract with the mutual funds and pension funds to help manage the assets. Some of the biggest names in the world in asset management are quite eager to get a foothold into this market, so there is no shortage of interest in terms of getting experienced management help. After all, the United States financial services industry and the financial services industry in

London are not doing so well that they can afford to turn down business like this. Second, the privatization ministry has been working very closely with international law firms and with Polish law firms to extend the company law to include various forms of financial intermediaries. It is all very professional work, extending the basic concepts of holding companies, mutual funds, pension funds, and so forth, into the Polish legal system. I think that is going forward satisfactorily.

Q: One of the most interesting things about your plan is that it seems to be very much a top-down method of privatization, rather than a grass roots development. What you're imposing is first, a method, then a market, and then a medium in order to effect these changes. As the law progresses in tandem with these markets, what will be the effect on the average Polish citizen who is going to be introduced to this over the television and through the newspapers?

A: Well, first let me say the distinction you make of top-down and bottom-up is a very good one. One kind of bbottom-up privatization is the establishment of brand new enterprises. In Poland, there are hundreds of thousands of new private firms, mostly very small, that have started up since the beginning of the reforms. There are also five or six methods, at least, that are actively in use for privatizing existing state enterprises in Poland and the rest of Eastern Europe. Most of the methods are of the bottom-up character. First, there have been almost 800 cases of what Polish law terms liquidation. It is essentially winding up the state enterprise and then leasing all of the assets back to the work force and the management. By this method, hundreds of firms have been transferred to the workers and management in the kind of lease buy-back arrangement and that is very much a bottom-up process where a group of management and workers make a proposal to the ministry to take over the assets.

Q: Why not just say, "You people sitting in the corner offices are the bosses and those of you down in the factory, you're the workers and these are your rules and obligations. From now on, instead of getting a paycheck you can get a paycheck plus stock and we're also going to sell off the majority interest in this firm

to the Board of Directors or to the public at large." That seems to be the bottom-up kind of thing. What you're saying is to establish markets, and then work our way into the boardroom, then into the factory floor, and then into the households.

A: There are several considerations when you think about how to privatize. One is administrative ease, the second is fairness, and the third is the likely efficiency of the management of the assets. Now, the kind of method that you just described is certainly administratively easy and, in fact, it is happening for small and medium size firms. The government is not the one organizing the effort that way. Instead, the management in the firm is coming to the government and saying, "We have a plan to buy back the firm over time." The government has established a lease buy-back mechanism which, as I said, is called liquidation in the Polish law. But, hundreds of enterprises are being organized in that very way. Managers end up being the managers and the stockowners, which are predominantly the managers, and the workers will elect the first Board of Directors and so forth. Then, over time, presumably shares will start trading off market, maybe the managers will pick up more of the shares or what not. In any event, that kind of thing is happening.

There was a great concern that procedure described above could not be a generalized process for large industrial enterprises. One reason was that anything remotely approaching a reasonable market value for these enterprises, would be beyond the financial reach of the workers and the management within the firm. On the other hand, if you simply give the enterprises to the insiders, there is a sense that such an approach would be unfair to the rest of society. That does not happen to work in the state industrial sector. After all, there are only about 3.5 million people working in what could be considered the state industrial sector out of a labor force of 18 million and a total population of 38 million people. So, giving the firms only to the insiders, especially for the large enterprises, was deemed politically untenable.

In my view, the government went too far the other way because I would still like to see a fraction of the shares of even

the large enterprises given exactly the way you described. Assign the shares to the management and the workers to improve incentives, to reflect what is, in fact, a partial existing ownership claim that workers and management have on their firms after being there for decades. I hope that the government comes back to being somewhat more generous with this insider privatization.

Another idea that I mentioned was the likely effectiveness of the management. It is useful to have outside shareholders helping to govern the enterprise. This is a consideration that I think can be exaggerated, but there was a feeling that establishing these financial intermediaries to help them be partial owners of the enterprises would be useful in achieving effective corporate governance. I would like to see not only mutual funds and pension funds be owners of shares, but also the banks in Poland. The idea is that you will get better results than having predominant insider ownership. So that was another consideration. The fact is that there are sufficient political and administrative complexities that the only way this job is going to get done is by trying a little bit of everything.

Q: Do you think the divestment of the partial interests that managers and workers presently enjoy will create a significant stumbling block to the implementation of a fair market for the use of all the players?

A: Well, the reason I want to see quick corporatization and partial distribution of shares is precisely so that you clearly define who really owns the property rights and you get them under one well-defined roof. I do not believe that the worker's council, at this point in time, or any longer in the future, should be dictating who is the owner of the enterprise. It is a confusion that is a holdover from the socialist system; it does not work. You need owners that really own the capital of the enterprises. One of the things that corporatization does is to remove the legal right of the worker's council over the day-to-day management of the enterprise and the appointment of the manager. Once the enterprise is corporatized, these functions are clearly to be performed by a supervisory board, even if it is a treasury-owned supervisory board, at least there is a well-

defined supervisory board that reflects the interest of real owners, rather than the workers that happen to be there.

Q: How feasible is that type of turnover?

A: I think that you make a deal. You point out that when everyone has a semblance of power, we end up with very poorly managed enterprises and everybody ends up poor. If we can define the property rights, everybody stands to benefit. To compensate the workers for diffuse, ill-defined, and fairly harmful property rights right now, the workers should get twenty or thirty percent of the shares. Workers can do what they want with the shares, and there will be proper legal institutions and a proper legal framework for the management of this enterprise. I would compensate for this partial ownership, but it is not a zero-sum game. It is not a fixed pie to be divided. The whole theory of this is that if we can better define the property rights, the enterprise is going to be managed better and there is going to be a pure gain shared among all of the interest that had been formerly diffused.

Q: What do you recommend to attorneys to going over to Poland to advise on these issues and assist in putting together these deals?

A: Well, there are a lot of lawyers there, so the first thing I would say is to get over there fast because the market is filling up. There is definitely a rapidly growing international legal community in Warsaw, Prague, and Budapest, reflecting the fact that lawyers are needed and their skills are remunerated and it is very interesting work right now. It is basically legal work in defining property rights and getting the deals done.

Exactly who to turn to and how to do a deal remains a pretty complicated story for the reason that the property rights still remain confused. You spend time at the enterprise level, at the foreign investment agency, at the ministry of privatization, at the ministry of industry, and increasingly, you spend time with private Polish-based consulting firms that know a lot about the local market.

There is, of course, a legal procedure of how to actually bring about a full privatization and there are dozens that are being done. But, the fact remains that, even aside from the

legal process, it remains a fairly complex bureaucratic process as well because there are so many players that still have a piece of partial ownership. You have to touch a lot of a bases to get the deals done.[23]

III. POLAND'S 1990 PRIVATIZATION LAW

On July 13, 1990, the Polish Parliament passed the *Law on Privatisation of State-owned Enterprises* ("Privatization Law").[24] The privatization law, together with the Law on the Establishment of Ministry for Ownership Transformation, governs the privatization of state-owned enterprises.[25] Several of Jeffrey Sachs' suggestions have been adopted in the Privatization Law.[26] The privatization process will be achieved through a two-step process: first, all state-owned enterprises are transformed into corporations;[27] next, the shares of the corporations are transferred to third parties.[28]

The Office of the Minister of Ownership Transformation will direct privatization policy.[29] The Council of Ministers will form a list of enterprises "especially important" for the national economy; any privatization of these enterprises requires a permit from the Council of Ministers.[30] There are

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23. [Ed.] *See generally* Berenson, *Legal Considerations and the Role of Lawyers in the Privatization Process: An Overview*, 27 FED. BAR NEWS & J. 159-65 (1990).

24. [Ed.] 29 I.L.M. 1226 (1990). The official Polish translation of the law is contained in *Dziennik Ustaw*, No. 51, item 298 (1990). The I.L.M. contains an unofficial English translation. *Id.*

25. The Banking Law governs the change in ownership form for publicly-owned banks. Slupinski, *Polish Privatisation Law of 1990*, 18 INT'L BUS. LAWYER, Nov. 1990, at 458.

26. [Ed.] Under article 24 of the Privatisation Law, employees of state-owned enterprises have the right to purchase 20% of the shares owned by the State Treasury at a discounted price. Law on Privatization of State-owned Enterprises, art. 42, *reprinted in* 26 I.L.M. 1226, 1237 (1990). Another provision provides that privatization vouchers, which can be exchanged for shares in state-owned enterprises, will be distributed to all Polish citizens free of charge. *Id.* at art. 25, *reprinted in* 26 I.L.M. 1226, 1238 (1990).

27. [Ed.] *See generally* Law on Privatization of State-owned Enterprises, ch. II, arts. 5-17, *reprinted in* 26 I.L.M. 1226, 1231-34.

28. [Ed.] *See generally* Law on Privatization of State-owned Enterprises, ch. III, arts. 18-36, *reprinted in* 26 I.L.M. 1226, 1235-40 (1990).

29. [Ed.] Law on Privatization of State-owned Enterprises, *reprinted in* 26 I.L.M. 1226, 1226 (introductory note by Zbigniew Slupinski).

30. [Ed.] Law on Privatization of State-owned Enterprises, art. 2, *reprinted in* 26

three ways to bring about privatization of a state-owned enterprise.[31] The Polish Prime Minister, upon the request of the Minister of Transformation, has the authority to order privatization.[32] The Minister of Transformation may transform a state-owned enterprise upon the joint request of the executive director of the enterprise and the employees council,[33] or upon the request of the enterprise's founding body as long as the director and employees council consents.[34] The Minister of Transformation can deny a request for transformation, but must provide guidance on what conditions the enterprise must meet before it can be transformed.[35]

Corporations created by the transformation of state-owned enterprises are governed by the Commercial Code,[36] and the corporation is wholly owned by the State Treasury until its shares are transferred to third parties.[37] The corporations created by the transformation of state-owned enterprises acquire all rights and liabilities of the enterprise,[38] including any claims by former owners and heirs whose property was appropriated by the Communist regime.[39]

When a corporation's articles of incorporation are prepared, the corporation is entered on the Commercial Register and the state-owned enterprise is deleted from the Register of

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I.L.M. 1226, 1231 (1990). The purpose of article 2 is to ensure that the government must give final approval in the privatization of important public service enterprises such as airlines, radio, railroads, television, and some military sector enterprises. *Id.* at 1226 (introductory note by Zbigniew Slupinski).

31. [Ed.] *See* Law on Privatization of State-owned Enterprises, arts. 5-6, *reprinted in* 26 I.L.M. 1226, 1231-32 (1990) (article 5 provides two methods of causing Minister of Transformation to privatize, article 6 contains another method).

32. [Ed.] *Id.* at art. 6, *reprinted in* 26 I.L.M. 1226, 1232.

33. [Ed.] *Id.* at art. 5, para. 1(1), *reprinted in* 26 I.L.M. 1226, 1231-32.

34. [Ed.] *Id.* at art. 5, para. 1(2), *reprinted in* 26 I.L.M. 1226, 1232.

35. [Ed.] *Id.* at art. 5, paras. 3-4, *reprinted in* 26 I.L.M. 1226, 1232.

36. [Ed.] Law on Privatization of State-owned Enterprises, art. 7, *reprinted in* 26 I.L.M. 1226, 1232 (1990).

37. [Ed.] *Id.* at art. 8, *reprinted in* 26 I.L.M. 1232-33 (1990).

38. [Ed.] *Id.*

39. [Ed.] Law of Privatization of State-owned Enterprises, *reprinted in* 26 I.L.M. 1226, 1228 (1990) (introductory note prepared by Zbigniew Slupinski). *See also id.* at art. 20, para. 3, *reprinted in* 26 I.L.M. 1226, 1235 (1990) (Minister of Ownership Transformation may order legal analysis regarding claims against corporation's assets).

State-owned Enterprises.[40] Alienation of all shares must be accomplished within two years of the date the corporation is registered in the Commercial Register unless the Council of Ministers extends the deadline.[41] Under the Privatization Law, foreign parties cannot acquire more than 10% of a corporation's shares without a permit from the Foreign Investment Agency.[42]

Shares of the corporation owned by the State treasury can transferred at an auction, through a public offering, or through negotiations following public invitation.[43] Employees of state-owned enterprises have the right to purchase 20% of shares owned by the State Treasury at a 50% discount.[44] Privatization vouchers will be issued free of charge by the Sjem to all Polish citizens living in Poland.[45] These vouchers can be used to acquire shares in corporations transformed from state-owned enterprises, rights in mutual funds holding shares issued upon transformation of state-owned enterprises, or portions of liquidated state enterprises.[46] Any shares not acquired by third parties within three months from the date they are offered will be transferred to and held by banks or other financial institutions.[47] State-owned enterprises can also be privatized through liquidation, whereby the entire enterprise or organized parts of it are sold or leased to third parties.[48]

The final chapter of the law, Chapter V, addresses a variety of other issues, including the fees which notaries may charge for services connected to converting a state-owned enterprise into a corporation.[49] In addition, an article in Chapter V al-

40. [Ed.] *Id.* at art. 12, *reprinted in* 26 I.L.M. 1226, 1233 (1990).
41. [Ed.] *Id.* at art. 19, *reprinted in* 26 I.L.M. 1226, 1235 (1990).
42. [Ed.] *Id.* at art. 19, para. 2, *reprinted in* 26 I.L.M. 1226, 1235 (1990).
43. [Ed.] Law on Privatization of State-owned Enterprises, art. 23, para. 1(1)-(3), *reprinted in* 26 I.L.M. 1226, 1236 (1990).
44. [Ed.] *Id.* at art. 24. paras. 1-3, *reprinted in* 26 I.L.M. 1226, 1237 (1990).
45. [Ed.] *Id.* at art. 25, *reprinted in* 26 I.L.M. 1226, 1238 (1990).
46. [Ed.] *Id.*
47. [Ed.] *Id.* at art. 28, *reprinted in* 26 I.L.M. 1226, 1238 (1990).
48. [Ed.] *See* Law on Privatization of State-Owned Enterprises arts. 37-43, *reprinted in* 26 I.L.M. 1240-42 (1990).
49. [Ed.] *Id.* at arts. 44-50, *reprinted in* 26 I.L.M. 1226, 1242-43 (1990).

lows the Minister of Finance to grant a three-year suspension of corporate income taxes and taxes on wage increases for corporations in which foreign persons have aquired shares.[50] This exemption can be made by the Minister of Finance in situations where "an important interest of the national economy is involved."[51] If the corporation is dissolved within the term of the three-year tax suspension, the corporation must pay the tax accrued during the suspension.[52]

Based on the framework of the law, the Polish government has been developing a Mass Privatization Program (MPP) along the lines described by Professor Sachs in the interview.[53] More than 200 large state-owned enterprises are being converted into joint-stock companies. Under the MPP proposal, ten percent of the shares of each of the enterprises will be distributed free-of-charge to the employees. Another sixty percent of the shares will be distributed into ten private mutual funds that will be licensed as part of the MPP program. In turn, the mutual fund shares will be distributed to the general public, either for free, or for a low cost to cover the expenses of distribution.[54]

Under current plans, one fund will be designated as the "lead" fund for each enterprise, and the lead fund will receive thirty-three percent of the shares of the firm, while the other nine funds each receive three percent of the shares.[55] Each fund will play the role as "lead" fund for about twenty of the two hundred enterprises. The lead fund will have the principal role in corporate governance, while the other funds will have a smaller role.[56]

The MPP has won the support of the previous and current Polish governments, but it still requires Parliamentary approval for implementation. The requisite draft legislation will

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50. [Ed.] *See id.* at art. 46, *reprinted in* 26 I.L.M. 1226, 1243.
51. [Ed.] *See id.*
52. [Ed.] *See id.*
53. Telephone interview with Jeffrey Sachs (Apr. 13th, 1992).
54. *Id.*
55. *Id.*
56. *Id.*

be considered by the Polish Sejm in the spring of 1992.[57] If the program is accepted, the mutual funds will begin operating in the fall of 1992.[58]

57. *Id.*
58. *Id.*