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POLAND

Economic Restructuring and Donor Assistance





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**National Security and
International Affairs Division**

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This report provides the results of our review of economic restructuring in Poland and the effectiveness of donor assistance in that country. The analysis in this report highlights a number of lessons learned from Poland's transition experience that merit consideration by countries such as Russia, Ukraine, and others not as far along the reform path as Poland. This information should be useful to your committees in their deliberations on the role of U.S. foreign assistance in the post-Cold War world.

We are sending copies of this report to the Secretary of State; the Secretary of the Treasury; the Administrator, U.S. Agency for International Development; and other interested congressional committees. Copies will also be made available to others on request.

If you or your staff have any questions concerning this report, I can be reached at (202) 512-4128. Major contributors to this report are listed in appendix V.

A handwritten signature in cursive script that reads "Harold J. Johnson".

Harold J. Johnson
Director, International Affairs Issues

B-261231

List of Congressional Committees

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The Honorable Sonny Callahan, Chairman
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Export Financing and Related Programs
Committee on Appropriations
House of Representatives

Executive Summary

Purpose

Since the reform process began in Central and Eastern Europe in 1989, Poland has undertaken some of the most dramatic economic reforms in the region. Although the United States now has assistance programs in a number of Central and East European countries, Poland has received the largest share of that assistance. GAO's objectives in examining U.S. and other donor assistance in Poland were to (1) assess the status and progress of the country's economic restructuring in the key areas of macroeconomic stabilization, foreign trade and investment, privatization, and banking; (2) describe impediments to these restructuring efforts; (3) discuss the role donors have played in the transformation process; and (4) identify lessons learned that could be useful to other transition countries.

Background

Between 1990 and 1994, the G-24¹ and international financial institutions² committed about \$36 billion in assistance to Poland. As of September 1994, the United States had obligated \$719 million in grant assistance to Poland. In addition, the United States has provided about \$700 million in Overseas Private Investment Corporation financing and insurance for U.S. businesses to facilitate their investment in Poland, \$355 million in Eximbank loan guarantees and investment credits, and about \$2.4 billion in official debt forgiveness.

A large part of the U.S. technical assistance has been provided under the Support for East European Democracy (SEED) Act of 1989 (P.L. 101-179), which authorized funding for Poland and other Central and East European countries for fiscal years 1990 through 1992. The SEED program was designed to assist Poland's transformation to a democracy and a market-oriented economy. Since fiscal year 1993, the assistance has been funded under both the SEED Act and the Foreign Assistance Act of 1961, as amended (P.L. 87-195). The U.S. Agency for International Development's assistance to Poland has primarily targeted private sector development, with less assistance being directed at quality of life and democratic institutions work.

¹The G-24 is composed of Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

²International financial institutions include the International Monetary Fund and multilateral development banks such as the World Bank.

Results in Brief

Poland has made substantial progress in stabilizing and restructuring its economy. For example, economic growth has resumed, and the country now has one of the fastest growing economies in Europe. However, Poland is still struggling to overcome relatively high rates of inflation and unemployment. The International Monetary Fund and other major donors played an important role in the early stages of the reform process by requiring Poland to adopt tough macroeconomic reforms in return for receiving substantial donor assistance. However, Poland's own efforts to implement tough reform measures and apply consistent macroeconomic policy over several years have been the critical factors in the country's economic recovery.

Poland has achieved significant increases in its exports to the West and a number of foreign companies have recently made significant investments in Poland. However, trade barriers hamper Poland's exports of certain products to the European Union, and a number of internal obstacles continue to impede foreign investment. Donor assistance has had only a marginal impact in facilitating trade and investment. Some of the most essential improvements in these areas require Polish government or donor actions beyond the confines of assistance programs, such as removing Poland's bureaucratic and tax obstacles to foreign investment and making markets more accessible to Polish exports.

Poland's progress toward privatizing its economy has been mixed. The country's economic reforms have resulted in a rapidly growing private sector, but significant portions of the Polish economy remain in the hands of the government. The United States and other donors are actively supporting Poland's efforts to restructure enterprises and implement its Mass Privatization Program; however, persistent delays threaten continued donor support.

Poland has fundamentally reformed its banking sector, but several major problems remain, including delays in bank privatizations, unclear policies regarding the licensing of foreign banks, and inadequate banking expertise and bank supervision skills. Donors provided key financial support for recapitalizing Poland's state-owned banks and restructuring their problem loan portfolios. Some early problems with donor technical assistance were encountered but have been resolved, and donors are now addressing some of the sector's most important remaining needs, such as the need for improved banker training and enhanced bank supervision.

While the situations of other transition countries vary greatly, Poland's transition experience offers a number of lessons that merit consideration by countries such as Russia, Ukraine, and others not as far along the reform path as Poland. These lessons suggest that while donor assistance can be important in supporting economic restructuring efforts in certain key areas, the ultimate success or failure of such efforts is far more dependent upon the actions of the transition country than it is upon those of outside participants.

Principal Findings

Early Stabilization Efforts Have Been Successful

In late 1989, Poland began a major stabilization program that became the foundation for Poland's current economic recovery and continuing restructuring. These stabilization efforts included tightening fiscal and monetary policy, liberalizing prices, devaluing the currency, and controlling the growth of debt. Western donors provided substantial financial support for Polish stabilization, including a \$1 billion Polish Stabilization Fund, debt restructuring and forgiveness as part of the Paris Club³ agreement, and International Monetary Fund standby arrangements.

Poland's stabilization measures resulted in substantial declines in output during the early years of transition. However, after maintaining consistent macroeconomic policy over several years, Poland now has one of the fastest growing economies in Europe. The country's official gross domestic product grew by an estimated 5 percent in 1994 and is projected to grow by another 6 percent in 1995. However, Poland still has inflation and unemployment problems. The estimated rates for 1994 were 31 percent and 15.9 percent, respectively.

Overcoming Trade and Investment Obstacles Is an Essential Task for Poland

Since the reform process began, Poland's trade with the West, and the European Union in particular, has grown significantly. For example, in 1988, about 30 percent of Poland's exports and 27 percent of its imports consisted of trade with the European Union. By 1994, these figures had grown to 53 percent and 54 percent, respectively. However, Poland

³The Paris Club is the mechanism the United States and other official creditors use to reschedule debt from foreign countries that are unable to meet their external debt obligations. Paris Club meetings are organized by the French Finance Ministry. Traditional participants of the Paris Club are the industrial country members of the Organization for Economic Cooperation and Development. Membership varies and depends on which countries were official lenders to a specific debtor country. The Department of State represents the U.S. government in Paris Club negotiations.

continues to run a large trade deficit, and while a preferential trade agreement exists between the European Union and Poland, European Union protective measures limit Poland's access to that market for certain products, such as some steel and agricultural products.

Poland has made progress in removing some obstacles to foreign direct investment, and the country's 1991 Foreign Investment Law is generally regarded as a satisfactory legal foundation for foreign investment. According to the Polish Agency for Foreign Investment, the value of foreign direct investment in Poland exceeded \$5 billion and another \$5.1 billion had been committed as of March 1995. Nevertheless, a number of bureaucratic, tax, and other obstacles continue to impede such investment.

Donor assistance has had only marginal impact in facilitating foreign trade and investment. For example, donors rejected Polish requests for capital to fund an export credit insurance agency and instead responded with little more than numerous consultant studies. In another case, the U.S.-funded American Business Center in Warsaw lost money and was closed when comparable services quickly became available through the private sector. Some of the most persistent impediments to foreign investment, such as bureaucratic and tax uncertainties, demand the attention of the Polish government rather than donors. On the other hand, further reducing European Union trade barriers could help Poland increase its exports, diminish its trade deficit with the European Union, and earn additional foreign exchange for further restructuring.

Poland's Progress Toward Privatization Has Been Mixed

Poland's economic reforms have resulted in a growing private sector. Many new businesses have emerged and a large number of existing small- and medium-sized retail businesses have been privatized. Poland's private sector is now the primary source of the country's economic growth and a substantial base of Polish employment. However, the pace of privatization for larger state-owned enterprises has been slower than expected, and significant portions of Polish productive capacity and employment remain in the hands of the government. Privatization has been delayed because of indecision brought about by changes in the government, the reluctance of employees and managers at large state-owned enterprises to privatize, and the poor financial position of many of these enterprises. Many donors have questioned whether the Polish government is fully committed to the privatization process.

Donors have demonstrated active support for Poland's Mass Privatization Program and continue to commit capital and technical assistance for the program, despite waning public and governmental support. However, donors are concerned about continued delays in implementing the program. If the Polish government fails to follow through on its promise to move forward on the program in 1995, donor support may erode.

Reforms in Poland's Banking Sector

Legislation enacted in 1989 transformed Poland's old central bank, which had served as the state conduit of credit to enterprises in the command economy, into an independent central bank with responsibilities for macroeconomic policies and supervision of banks. The regional branches of the old central bank were transformed into individual commercial banks, some of which remain state-owned and some of which have been privatized. The government has recapitalized state-owned banks and has made considerable progress in restructuring their problem-loan portfolios. Nevertheless, according to the European Bank for Reconstruction and Development, the International Monetary Fund, and others, bank privatization has been limited; many private and cooperative banks are undercapitalized and badly managed; the country's licensing policies regarding foreign banks lack transparency; and Poland's small rural banks are in poor financial condition. According to the U.S. Agency for International Development and others, Poland's bank supervision capacity needs further strengthening, and bankers need additional training. Organization for Economic Cooperation and Development officials and other observers have reported that small- and medium-sized enterprises in Poland continue to lack sufficient bank credit to develop and expand operations.

Donors have recognized the lack of available credit for small- and medium-sized enterprises and have undertaken various activities to help fill the gap. The U.S.-sponsored Polish-American Enterprise Fund has met with greater success than other donor programs in this area, at least in part because the fund trained its own personnel rather than relying on the existing banking skills in Poland.

Multilateral and bilateral donors have provided strong support for Polish efforts to recapitalize and restructure the loan portfolios of state-owned banks. A key feature of the program entails issuing special government bonds to recapitalize the banks and establishing a fund to service and redeem the bonds after the banks are privatized. This fund was established

using resources that were no longer needed for the Polish Stabilization Fund.

According to Polish officials, early technical assistance in the banking sector resulted in many consultants coming to Warsaw for 1- or 2-week stays, interviewing officials, and producing reports that merely repeated what they had been told. However, more recently, donors have better targeted technical assistance to address Poland's need for enhanced bank supervision capabilities and improved credit analysis skills by providing technical assistance and training to entities such as the Ministry of Finance, the National Bank of Poland, commercial banks, and the Warsaw School of Banking.

Lessons Learned

Despite tremendous differences among countries in Central and Eastern Europe and the former Soviet Union with respect to their economies, their political situations, and a host of other variables, there are a number of lessons learned from Poland's restructuring efforts that, at a minimum, merit consideration by other transition countries and those involved in assisting them. Taken together, the lessons summarized below suggest that while assistance can be important in certain key areas, a transition country's reform progress depends more upon its own actions than it does upon those of external donors.

- Poland's own efforts in coupling tough reform measures with consistent macroeconomic policy over several years have been critical to the country's current economic recovery.
- Some of the most important forms of donor assistance provided in support of Poland's transition were those that backed Poland's early macroeconomic stabilization and liberalization measures.
- Some of the most important factors for improvement in Poland's foreign trade and investment situation require Polish or donor actions outside the confines of assistance.
- Poland's early liberalization of foreign trade played an important role in helping state-owned enterprises adapt to market conditions.
- In the area of privatization, the Polish experience indicates that encouraging the early development of a dynamic private sector is at least as important as the timing for undertaking large-scale privatization.
- When imposing hard budget constraints and other market reforms that include curtailed government-to-industry subsidies for state-owned industry, transition country officials should be vigilant of state-owned

firms circumventing the constraints and continuing to operate at a loss because of existing relationships with state-owned banks.

- While the role of donors is necessarily limited in some areas of the transition process, donors were able to play a useful role in supporting Poland's reform efforts in its banking sector.

Recommendations

This report contains no recommendations.

Agency Comments

In commenting on a draft of this report, the U.S. Agency for International Development said that it agreed with GAO's conclusions and that the report was a fair and balanced assessment of how donor assistance had contributed to Poland's economic reform process. The Department of the Treasury also agreed with the report's conclusions and offered helpful technical comments that have been incorporated into the report where appropriate. Although the Department of State did not provide written comments, State officials said that they agreed with the report's conclusions and that the report accurately depicted Poland's economic restructuring progress, as well as the role that donors have played in the transition process. The Treasury Department's and the U.S. Agency for International Development's comments are reprinted in appendixes III and IV, respectively.

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Abbreviations

| | |
|-------|--|
| CEFTA | Central European Free Trade Area |
| CMEA | Council for Mutual Economic Assistance |
| EBRD | European Bank for Reconstruction and Development |
| ECE | Economic Commission for Europe |
| EU | European Union |
| FREB | Financial Restructuring of Enterprises and Banks |
| G-24 | Group of 24 |
| GAO | General Accounting Office |
| GATT | General Agreement on Tariffs and Trade |
| GDP | gross domestic product |
| IMF | International Monetary Fund |
| KUKE | Polish Export Credit Insurance Corporation |
| OECD | Organization for Economic Cooperation and Development |
| OPIC | Overseas Private Investment Corporation |
| PHARE | Poland and Hungary Assistance for Economic Restructuring |
| SEED | Support for East European Democracy |
| USAID | U.S. Agency for International Development |
| USCS | U.S. Commercial Service |

Introduction

Since the collapse of communism in Central and Eastern Europe, Poland has undertaken some of the most dramatic economic reforms in the region. Donors have actively encouraged Poland in its efforts to make the transition from a communist-led, centrally planned economy to a free-market economy and a democratic political system. The United States has supported Poland's transition both financially and diplomatically.

International Assistance and Donor Coordination

The major industrial countries and the international financial institutions had committed about \$36 billion in assistance to Poland from 1990 through December 1994. These commitments consisted of emergency, humanitarian, infrastructure, and economic transformation assistance; debt forgiveness; private sector investment;¹ export credits; and investment guaranties. The Group of 24 (G-24)² countries committed approximately \$26.8 billion in bilateral assistance to Poland and the International Monetary Fund (IMF), the World Bank, and the European Bank for Reconstruction and Development (EBRD) committed about \$8.9 billion.³ (See tables 1.1 and 1.2.)

¹The European Bank for Reconstruction and Development and the International Finance Corporation, a component of the World Bank, can take an equity position in private sector companies.

²The G-24 is composed of Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. G-24 assistance commitments include the commitments of European Union institutions in addition to those of its individual member states.

³Although the Organization for Economic Cooperation and Development tracks official aid disbursements (as opposed to commitments) to Poland and other countries, the latest data available are for 1993. Officials from the organization told us that they have encountered difficulties in obtaining prompt and accurate information from donor countries.

**Chapter 1
Introduction**

Table 1.1: G-24 Donor Commitments to Poland, January 1990-December 1994

| Dollars in billions ^a | | |
|----------------------------------|-------------------------------|------------------------|
| Donor | Commitment^b | Percentage |
| European Commission | \$1.6 | 6 |
| European Investment Bank | 1.2 | 4 |
| France | 4.2 | 16 |
| Germany | 5.5 | 21 |
| Italy | 0.8 | 3 |
| United Kingdom | 0.9 | 3 |
| Other European Union countries | 1.2 | 5 |
| Canada | 1.5 | 6 |
| Japan | 1.7 | 6 |
| Sweden | 0.8 | 3 |
| Switzerland | 0.8 | 3 |
| United States | 5.5 | 21 |
| Others | 1.1 | 4 |
| Total | \$26.8 | 100^c |

^aCommitments were converted from European Currency Units at a rate of \$1.30 per unit.

^bCommitments take a variety of forms and may include grants, credits, loans, debt forgiveness, and investment guarantees.

^cFigures do not add due to rounding.

Source: European Commission.

Table 1.2: International Institution Commitments to Poland, January 1990-December 1994

| Dollars in billions ^a | | |
|----------------------------------|--------------------------|-------------------|
| Donor | Commitment | Percentage |
| International Monetary Fund | \$4.3 | 48 |
| World Bank | 3.9 | 43 |
| EBRD | 0.8 | 9 |
| Total^b | \$8.9^c | 100 |

^aCommitments were converted from European Currency Units at a rate of \$1.30 per unit.

^bA separate figure for the Organization for Economic Cooperation and Development support was not available.

^cFigures do not add due to rounding.

Source: European Commission.

The G-24 countries designated the European Commission, the executive arm of the European Union (EU),⁴ as the coordinator of these assistance activities. However, the European Commission acts primarily as a clearinghouse for information on G-24 bilateral assistance to the region rather than as a coordinator. One of the Commission's functions is generating the G-24 Scoreboard of Assistance Commitments to the Central and Eastern European Countries,⁵ a listing of donor assistance pledged to the region by G-24 countries.

According to an EU official, the main function of the Commission's delegation in Poland has been to arrange donor meetings. Donor coordination is generally handled by the Polish government's Council of Ministers' Foreign Aid Office. However, donors often bypass this office and deal directly with the relevant ministries, or rely on organizations outside the government of Poland to implement their programs. For example, most U.S. assistance programs have been implemented either directly with the private sector recipients or through contractors and nongovernmental organizations with little direct involvement on the part of the government of Poland.

U.S. Assistance Program to Poland Has Evolved

The Support for Eastern European Democracy (SEED) Act of 1989 (P.L. 101-179) authorized funding for Poland and other countries in Central and Eastern Europe for fiscal years 1990 through 1992. Since 1993, obligations for programs in the region have been funded under both the SEED Act and the Foreign Assistance Act of 1961, as amended (P.L. 87-195). The United States had obligated about \$719 million in assistance as of September 1994 to help Poland's transformation to a democracy and a market-oriented economy; the United States has also provided about \$700 million in Overseas Private Investment Corporation financing and insurance for U.S. businesses to facilitate their investment in Poland, \$355 million in Eximbank loan guarantees and investment credits, and about \$2.4 billion in official debt forgiveness.

Poland was one of the first countries of Central and Eastern Europe to receive U.S. assistance because it took the lead in the transformation from communism to democracy and a market-oriented economy. Poland has

⁴The EU data in this report refers to Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom. Effective January 1, 1995, Austria, Finland, and Sweden became members of the EU.

⁵The term "Central and Eastern Europe" refers here to Albania, Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia, and the former Yugoslavia Republic of Macedonia.

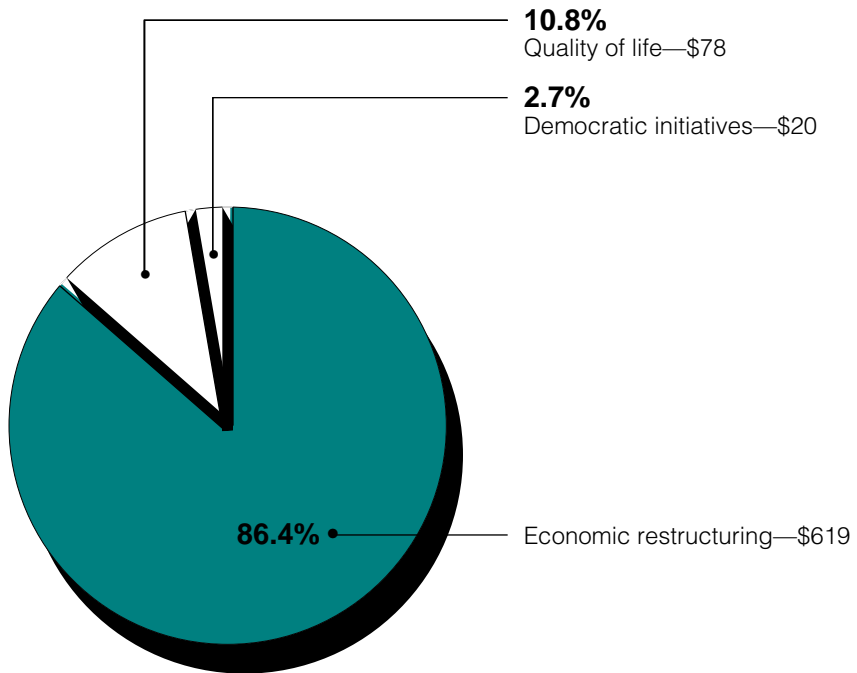
received the largest share of U.S. assistance in the region. This assistance was initially expected to be necessary only for a transition period of about 5 years starting in 1990; however, the U.S. Agency for International Development (USAID) representative in Warsaw now believes that Poland will probably need assistance for at least the next 5 years or until the country is closer to economic integration with the EU.

Pursuant to the SEED Act, the Deputy Secretary of State was designated as the Coordinator of U.S. Assistance to Central and Eastern Europe in 1990. The Coordinator was assisted by special advisors from the Department of the Treasury, the Council of Economic Advisors, and USAID. In 1993, the Coordinator's office was placed within State's Bureau for European Affairs.

The U.S. assistance program in Central and Eastern Europe was initially designed with a regional rather than country-specific approach and was centrally managed in Washington, D.C., with limited authority delegated to U.S. personnel in-country. However, this approach changed in 1993 as USAID devolved many of the management responsibilities to the field at the direction of Congress. The USAID/Poland representative said that he now has an understanding with USAID/Washington that no projects will be initiated in Washington without the field office's concurrence. The USAID representative also said that he has requested control over all contracts and work orders, indicating that this oversight and control was necessary to coordinate and develop strategic plans for future work in Poland.

As shown in figure 1.1, the majority of U.S. assistance to Poland has been devoted to economic restructuring and assisting in Poland's transformation to a market-based economy. The remainder of the funds have been obligated to support democratic initiatives and quality of life issues. Democratic initiatives projects included training for parliamentary and local government officials and grants to support the small and independent press media. Quality of life projects included technical assistance for the Polish public and private housing sector, a model unemployment benefit payment office, and technical assistance to help improve public sector environmental services.

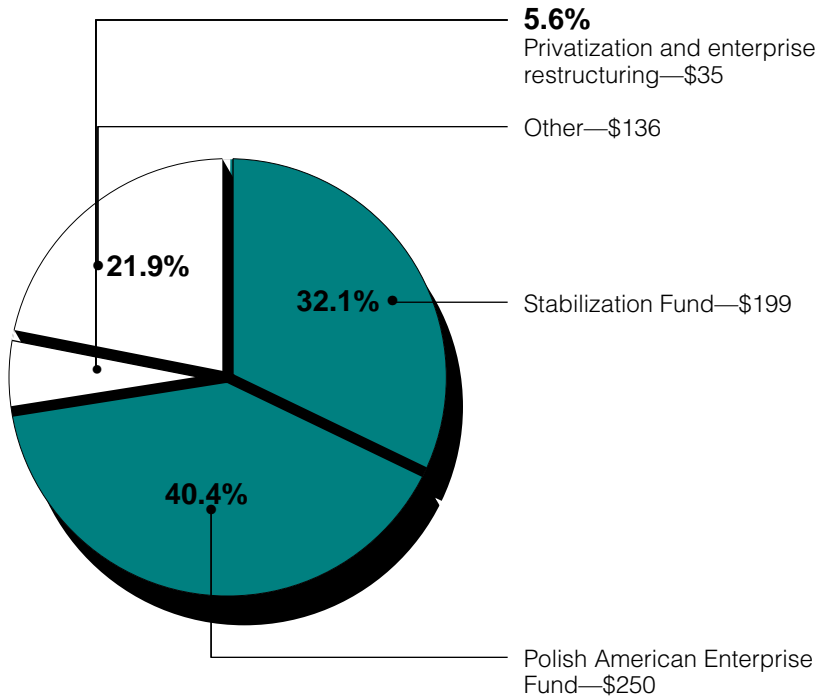
**Figure 1.1: U.S. Assistance to Poland,
Fiscal Years 1990-94** (dollars in millions)



Note: Percentage calculations do not include assistance amounts categorized as "miscellaneous," which comprise only a quarter of 1 percent (\$1.8 million) of total assistance.

The Polish Stabilization Fund and the Polish-American Enterprise Fund account for the majority of funds obligated under the Economic Restructuring Program for Poland. (See fig. 1.2.)

Figure 1.2: Funds Obligated for Poland's Economic Restructuring, Fiscal Years 1990-94 (dollars in millions)



Under the SEED Act, the United States provided a \$199-million contribution to the multi-donor \$1 billion Polish Stabilization Fund. The fund was established to (1) support a relatively fixed exchange rate for the zloty (Poland's currency) after a sharp devaluation and (2) help ensure that the zloty would be convertible for current account transactions; that is, to allow residents to freely purchase currency through authorized foreign exchange banks. These objectives have been accomplished, and the United States has authorized Poland to use the \$199 million held in reserves to recapitalize and privatize the Polish state-owned banks.

The SEED Act also authorized the Polish-American Enterprise Fund as a private corporation with maximum flexibility in implementing the fund's investment policies. As of September 1994, about \$250 million had been obligated and the fund had disbursed about \$227 million. The fund primarily makes loans to, or invests in, small- and medium-sized businesses in which other financial institutions are reluctant to invest.

Objectives, Scope, and Methodology

The objectives of this review were to (1) assess the status and progress of Poland's economic restructuring in the key areas of macroeconomic stabilization, foreign trade and investment, privatization, and banking, (2) describe impediments to these restructuring efforts, (3) discuss the role donors have played in the transformation process, and (4) identify lessons learned that could be useful to other transition countries.

To address these issues, we interviewed officials of the Departments of State and the Treasury and USAID in Washington, the Economic Commission for Europe (ECE) in Geneva, the EU in Brussels, the Organization for Economic Cooperation and Development (OECD) in Paris, and the EBRD in London. We also met with officials at the British Know How Fund as well as Central and Eastern European experts at the London School of Economics and other organizations. In Warsaw, we met with U.S. embassy officials, USAID representatives, U.N. officials, IMF and World Bank officials, EU officials, and officials of the British and Japanese embassies. We also met with officials from the Polish government, representatives of the Polish-American Enterprise Fund, representatives of private sector promotional organizations, and managers from U.S. and German companies doing business in Poland.

We reviewed pertinent U.S., host, and donor-government documents, as well as reports and studies by international organizations, academia, and private sector groups. We also used information from PlanEcon, Inc., an economic consulting group specializing in Central and Eastern Europe and the former Soviet Union, and information from the Warsaw Economic Research Institute, a policy institute at the Warsaw School of Economics.

To describe factors hindering Polish exports, we relied heavily on the reports and studies of international organizations as well as the opinions of Polish and international organization officials.

The data presented in the tables and figures of this report were obtained from a number of different sources. These data should be interpreted and used with caution since the quality of the data could not be verified in some cases.

We performed our review from January 1994 through May 1995 in accordance with generally accepted government auditing standards.

Early Stabilization Efforts Successful

The foundation for Poland's current economic recovery and continued restructuring was the major stabilization and macroeconomic reform efforts, referred to by some as "shock therapy" or "the big bang approach," which began in late 1989 and early 1990. The Polish government took a wide range of actions to encourage stabilization, including tightening fiscal and monetary policy, liberalizing prices, devaluing the currency, and controlling the growth of debt. Western donors provided important support for such reforms and the United States played a key role in initiating these forms of assistance. Poland's economy is now experiencing healthy growth.

Early Polish Stabilization Measures Created Basis for Market Economy

In October 1989, the Polish government began implementing macroeconomic stabilization and liberalization measures, and accelerated the reform movement in January 1990. Subsidies to industry and households, for example, food subsidies, were sharply cut. Public investment spending was substantially reduced. Money growth was tightly controlled; the zloty was sharply devalued and made convertible.¹ Wage growth was controlled with an excess wage tax designed to limit the rate of increase in the wage bills of state enterprises. Prices were liberalized, bringing about a one-time jump in the price level corresponding to the reduction in the real value of the zloty. Additional liberalization measures included the establishment of a free-trade regime and liberalization of legal requirements for setting up private enterprises.²

Together, these efforts gave Poland the basic operating features of a market economy and were widely considered to be essential first steps toward overall economic restructuring.³ The stabilization measures decreased inflationary pressures, lowered government expenditures, and improved the balance of payments. However, these measures also contributed to declines in economic output and corresponding growth in

¹A currency is considered convertible when it may be freely exchanged for another currency.

²David Lipton and Jeffrey Sachs, "Creating a Market Economy in Eastern Europe: The Case of Poland," *Brookings Papers on Economic Activity 1* (Washington, D.C.: the Brookings Institution, 1990), p. 112; Jeffrey Sachs, *Poland's Jump to the Market Economy* (Cambridge: Massachusetts Institute of Technology Press, 1994), pp. 48, 49; Andrew Berg and Olivier Jean Blanchard, "Stabilization and Transition: Poland, 1990-91," *The Transition in Eastern Europe, Country Studies, Vol. 1* (Chicago: the University of Chicago Press, 1994), pp. 52, 53; and Mark E. Schaffer, *The Economy of Poland*, Discussion Paper 67; and Centre for Economic Performance (London: London School of Economics, Mar. 1992), p. 21.

³Schaffer, p. 21; and Alan H. Gelb and Cheryl W. Gray, *The Transformation of Economies in Central and Eastern Europe: Issues, Progress, and Prospects, Policy and Research Series, Vol. 17* (Washington, D.C.: the World Bank, June 1991), p. 7.

unemployment.⁴ The liberalization measures freed most of the domestic price system, allowed for corrections in the relative prices of goods still under state control, removed the state from large-scale detailed direction of the economy, and provided an environment conducive to the growth of a new private sector.⁵

Some benefits resulted from important linkages between specific measures. For example, Poland's liberalization of trade subjected the state sector to foreign competition. Such competition provided international relative prices that the previous monopolistic Polish firms would not have offered, thus enabling the government to liberalize prices.⁶

Donors Provided Important Support for Polish Measures

Western support for early Polish stabilization measures is cited by Polish and donor officials as among the most significant assistance provided to Poland. For example, the Director of Poland's Bureau for Foreign Assistance asserted that some of the most important assistance efforts to date involved donor support for early Polish macroeconomic stabilization actions in the form of the stabilization fund, balance of payments support, and debt restructuring and forgiveness. The IMF's senior resident representative in Poland said that these forms of assistance were timely and critical to Polish macroeconomic stabilization efforts.

The United States took the initiative in 1989 to mobilize \$1 billion from the international community for a Polish Stabilization Fund to (1) support a relatively fixed exchange rate for the zloty after sharp devaluation and (2) help ensure that the zloty was convertible for current account transactions by creating additional foreign exchange reserves. Poland's foreign exchange reserves were further bolstered by a \$700 million standby arrangement⁷ with the IMF. This balance of payments support helped allow Polish authorities to introduce in January 1990 a convertible and stable exchange rate, and the additional backing for the zloty made defense of the currency more credible.⁸

⁴Berg and Blanchard, pp. 52, 53; and Sachs, p. 56.

⁵Schaffer, p. 21.

⁶Sachs, pp. 49, 50, 65; and Schaffer, p. 23.

⁷IMF standby arrangements provide credit in a number of installments and are conditioned upon implementing certain macroeconomic policy changes aimed at overcoming balance of payments difficulties.

⁸Lipton and Sachs, p. 118; and Sachs, p. 54.

Another important form of early assistance to Poland was temporary cash flow relief from external indebtedness. To increase the chances of successful stabilization, some believed it was important that debt service payments be minimized in the early stages of transition.⁹ Poland's external debt in convertible currencies at the end of 1990 was about \$44 billion. An estimated \$33 billion was owed to official bilateral creditors, referred to as the Paris Club,¹⁰ and \$10.7 billion, including \$1.2 billion of short-term revolving credit, was owed to Western commercial banks, known as the London Club. Poland's gross debt service¹¹ in 1990 was about \$9 billion, or about 80 percent of its convertible currency merchandise export earnings.¹²

In March 1991, under U.S. leadership, the members of the Paris Club agreed to forgive 50 percent of Poland's official debt. In the first stage, which was contingent on Poland's signing an agreement with the IMF to restructure its economy, the official debt was reduced by 30 percent. In the second stage, which was contingent upon Poland's fulfillment of the terms of the IMF agreement, an additional 20-percent reduction was authorized in April 1994. As part of the initial 30-percent reduction, annual interest payments during the first 3 years were reduced by 80 percent. Principal payments were also limited to less than \$600 million annually. For its part in the agreement, the United States agreed to forgive 70 percent of its bilateral debt with Poland, 50 percent in the first stage, and 20 percent in the second, which reduced Polish debt to the U.S. government from \$3.4 billion to about \$1 billion.¹³

Under the Paris Club agreement, Poland also committed to seeking from the London Club of commercial banks¹⁴ a debt reorganization on terms

⁹*Ibid.*

¹⁰The Paris Club is the mechanism the United States and other official creditors use to reschedule debt from foreign countries that are unable to meet their external debt obligations. Paris Club meetings are organized by the French Finance Ministry. Traditional participants of the Paris Club are the industrial country members of the OECD. Membership varies and depends on which countries were official lenders to a specific debtor country. The Department of State represents the U.S. government in Paris Club negotiations.

¹¹Gross debt service includes interest and principal payments on short-, medium-, and long-term debt.

¹²Poland and Hungary: Economic Transition and U.S. Assistance (GAO/NSIAD-92-102, May 1, 1992), p. 24.

¹³GAO/NSIAD-92-102, p. 24.

¹⁴Poland reached an agreement with the London Club banks in October 1994, resulting in an overall rate of debt reduction of slightly more than 49 percent—terms comparable to the Paris Club agreement. See Tomasz Telma, "Outlook for Poland," *Review and Outlook for Eastern Europe*, PlanEcon (Dec. 1994), p. 125.

comparable to the Paris Club, allowing Poland to cease servicing this debt in the interim.¹⁵

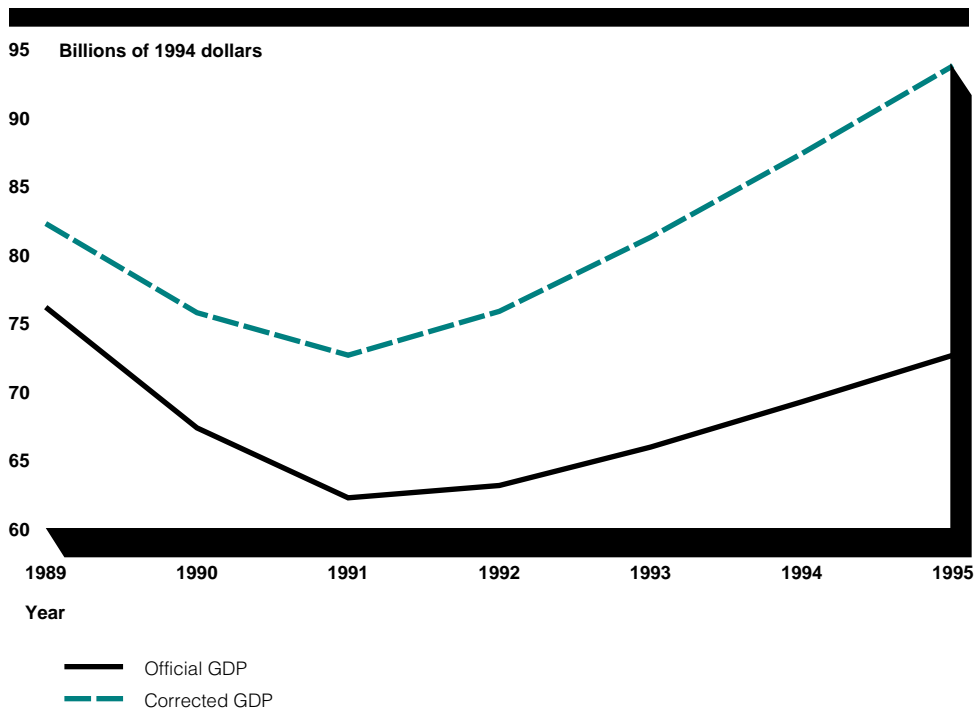
Poland's Economy Is Experiencing Healthy Growth

After suffering substantial declines in gross domestic product (GDP) during the first 2 years of transition, Poland now leads post-communist Europe in economic growth. According to PlanEcon, while Poland has made considerable progress in reducing inflation from the high levels that existed when reforms began in 1989, the country's projected rate of inflation for 1994 remained relatively high at 31 percent. Poland's unemployment rate was projected to gradually decline in 1994 to a level of 15.9 percent by the end of the year. However, the country's official GDP grew by an estimated 5 percent in 1994 and is projected to grow by another 6 percent in 1995. Figure 2.1 shows official and what has been termed "corrected" Polish GDP levels for 1989-95.¹⁶ Although Poland's official figures indicate that the country's GDP has not completely recovered from the substantial output declines experienced in the first 2 years of transition, PlanEcon's "corrected GDP" figures show that the country's GDP has recovered from these declines and surpassed its pretransition levels. The IMF's senior resident representative in Poland said that Poland's early macroeconomic stabilization measures coupled with consistent macroeconomic policy over several years were critical factors in the country's economic recovery.

¹⁵GAO/NSIAD-92-102, p. 24; and Lipton and Sachs, p. 118.

¹⁶PlanEcon has constructed "corrected GDP" figures by including estimates of GDP generated in the unofficial (grey) economy and accounting for quality improvements in goods and services.

Figure 2.1: Official and Corrected Gross Domestic Product Figures for Poland, 1989-95



Note: The 1995 figures are PlanEcon forecasts.

Source: Calculated from PlanEcon Report: Polish Economic Monitor, Vol. X, Nos. 35-36, Nov. 4, 1994, and Vol. XI, Nos. 11-12, May 19, 1995.

Overcoming Trade and Investment Obstacles

Trade is widely viewed as a crucial factor in Poland's economic restructuring. Increased trade with the West, and the EU in particular, is key to Poland's integration into the world economy, especially since the collapse of trade among Poland's former Council for Mutual Economic Assistance (CMEA) trading partners. Although Polish exports increased in 1994, Poland continues to run a large trade deficit with the EU. Despite the importance of Poland's trade with the EU, West European trade barriers continue to hinder Polish exports of certain products to that market, thereby hampering restructuring efforts. Donors have rendered limited assistance to help facilitate Polish exports, and some assistance that has been provided was of questionable usefulness.

Foreign investment is considered essential to Poland's economic restructuring efforts. Although Poland has made progress removing some impediments to foreign direct investment, many obstacles remain that can be corrected by only the Polish government. Nevertheless, a number of U.S. and foreign companies have recently made significant investments in Poland. Some early U.S. assistance geared toward improving the investment climate lacked focus because of pressure to spend the money quickly, and U.S. programs to support Polish investment promotion have had limited impact.

Trade With West Is Increasingly Important for Poland

In 1990, as part of its transition efforts, Poland liberalized foreign trade regimes. This included eliminating many import restrictions, demonopolizing foreign trade, allowing free access to foreign currency, and establishing convertibility of the zloty.

Growth in exports to the West is widely recognized as important to Poland's continued economic recovery and integration into the world economy.¹ In addition to increased imports resulting from opening up its own markets to Western products, Poland achieved dramatic increases in exports to the West, beginning in 1990. As Poland entered the initial stages of reform, exports to the industrialized market economies were essential to preventing even larger declines in output than had already occurred as a result of the collapse of trade with former CMEA countries and the drop in Poland's internal demand. According to OECD, access to the more stable OECD area markets is vital for Poland's continued economic growth and

¹Paul Mylonas, "Integration into the World Economy," *Poland: The Path to a Market Economy*, Occasional Paper 113; IMF, Oct. 1994, p. 69; *Economic Transition in Eastern Europe and the Former Soviet Union*, Transition Report; EBRD, Oct. 1994, p. 116; and *Poland and Hungary: Economic Transition and U.S. Assistance* (GAO/NSIAD-92-102, May 1, 1992), p. 20.

political stability.² The ECE has reported that increased access to Western markets can also act as a powerful stimulant to foreign investment seeking an eastern base for exporting.³

Of the OECD area markets, the large and geographically close EU market represents Poland's most important trade partner. For example, in 1994, about 53 percent of Poland's exports and 54 percent of its imports consisted of trade with the EU. Though the United States represents a potential market for Polish products, it accounts for only 2 to 4 percent of Poland's trade. Tables 3.1 and 3.2 describe aggregate trade for selected countries and regions between 1988 and 1994.

As indicated in tables 3.1 and 3.2, Poland's trade with former CMEA partners has declined in importance. Although a Central European Free Trade Area (CEFTA) agreement was negotiated among Poland, the Czech Republic, Slovak Republic, and Hungary and went into effect in March 1993, the ECE reported that the significance of the agreement has been downplayed within the CEFTA countries and that few steps have been taken to promote these trade links.⁴ OECD officials echoed that sentiment, explaining that while eastern markets could be very important to Poland in the future, Polish companies engaging in restructuring currently do not have enough "margin for error" to emphasize dealings in countries with small markets and little ability to pay for products.

²Barriers to Trade with the Economies in Transition, Center for Cooperation with the Economies in Transition, OECD, 1994, p.9.

³Economic Survey of Europe in 1993-1994 (New York and Geneva: Secretariat of the Economic Commission for Europe, United Nations, 1994), p. 149.

⁴Economic Survey of Europe in 1993-1994, p. 149.

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Table 3.1: Share of Polish Exports to Selected Countries and Regions (1988-94)

Dollars in millions

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Total value of exports | \$13,544 | \$13,528 | \$13,624 | \$14,913 | \$13,186 | \$15,415 | \$17,450 |
| Country or region | | | | | | | |
| EU | 30% | 32% | 47% | 56% | 58% | 53% | 53% |
| United States | 3 | 3 | 3 | 2 | 2 | 3 | 3 |
| CMEA countries ^a | 42 | 31 | 22 | 17 | 15 | 19 | 19 |
| of which | | | | | | | |
| CEFTA ^b | 8 | 7 | 5 | 5 | 5 | 3 | 3 |
| USSR/Former Soviet Union | 25 | 21 | 15 | 11 | 9 | 16 | 15 |
| Other | 25 | 34 | 28 | 25 | 25 | 25 | 25 |
| Total | 100% | 100% | 100% | 100% | 100% | 100% | 100% |

^aCMEA members are countries that were members in 1990. The CMEA ceased to exist on January 1, 1991; however, we continue to use this designation for the years following to account for trade involving countries representing the same geographical area. In 1993, this grouping included Bulgaria, the Czech Republic, Hungary, Poland, Romania, the Slovak Republic, Cuba, Vietnam, and countries of the former Soviet Union, including the Baltic states of Estonia, Latvia, and Lithuania. Trade with East Germany is reported with CMEA countries in 1988. Beginning with 1989, Poland does not report separate trade with East Germany but includes this as trade with Germany. In 1988, trade with East Germany represented 4 percent of Poland's total exports and 5 percent of its total imports.

^bBeginning in 1993, the two separate countries of the Czech Republic and the Slovak Republic replaced Czechoslovakia. CEFTA did not go into effect until 1993; however, we use this designation for the years prior to account for trade involving countries representing the same geographical area.

Source: Compiled from Polish-reported trade figures, International Monetary Fund Direction of Trade computer database.

**Chapter 3
Overcoming Trade and Investment
Obstacles**

Table 3.2: Share of Polish Imports From Selected Countries and Regions (1988-94)

Dollars in millions

| | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 |
|--------------------------|-------------|-------------|-------------|-------------|-------------|-------------------------|-------------|
| Total value of imports | \$13,834 | \$11,357 | \$8,974 | \$17,084 | \$15,204 | \$23,169 | \$24,099 |
| Country or region | | | | | | | |
| EU | 27% | 34% | 43% | 50% | 51% | 53% | 54% |
| United States | 2 | 1 | 2 | 2 | 3 | 4 | 3 |
| CMEA countries | 44 | 28 | 25 | 19 | 16 | 17 | 17 |
| of which | | | | | | | |
| CEFTA | 8 | 7 | 4 | 4 | 4 | 2 | 3 |
| USSR/Former Soviet Union | 27 | 18 | 20 | 14 | 11 | 15 | 14 |
| Other | 27 | 37 | 30 | 29 | 30 | 25 | 26 |
| Total | 100% | 100% | 100% | 100% | 100% | 100%^a | 100% |

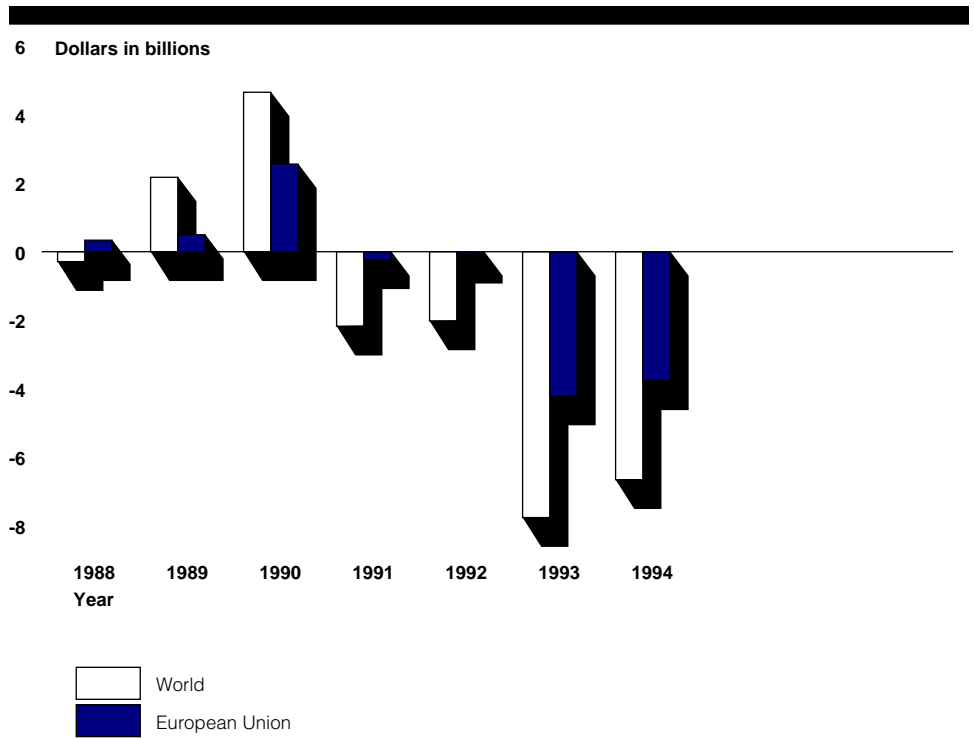
^aFigures do not add due to rounding.

Source: Compiled from Polish-reported trade figures, International Monetary Fund Direction of Trade computer database.

Trade Deficit With the EU

Although Polish exports increased in 1994 to over \$17 billion, Poland continues to run a large trade deficit with the West, primarily the EU. Poland's 1993 trade deficit of \$7.8 billion was the largest in its history, and \$4.2 billion of this amount was with the EU (see fig. 3.1). However, in 1994, as a result of slower growth in imports versus that of exports, Poland's trade deficit narrowed to \$6.6 billion, a 14-percent decline compared to 1993. Poland's 1994 trade deficit with the EU was \$3.8 billion, a 10-percent decline compared to 1993.

Figure 3.1: Poland's Balance of Trade
(1988-94)



Source: Compiled from International Monetary Fund [Direction of Trade](#) computer database.

Trade Barriers Persist

A preferential trade agreement between Poland and the EU is part of the EU-Poland Association Agreement, which became fully effective on February 1, 1994. The trade segments of the accord went into force on March 1, 1992, in the form of an interim agreement, but under the agreement barriers to trade in certain sensitive areas such as textiles are to be removed only over a number of years. Major improvement in Poland's access to agricultural markets in the EU is not expected soon.⁵ Further, Polish officials maintain that the EU continues to limit access to

⁵Economic Survey of Europe in 1993-1994, pp. 149-157.

its markets through contingent protective measures such as anti-dumping duties, countervailing duties, and safeguard actions.⁶

The Association Agreement is considered a precursor to Poland's eventual membership in the EU, and a key feature is the gradual elimination of tariffs over a 10-year period, leading to a free trade area between the EU and Poland. The agreement is considered to be asymmetric in that the EU is required to grant immediate duty free access on many goods, while Poland has a longer period of time to grant full reciprocity.⁷

The Association Agreement also provides for immediate elimination of quantitative restrictions on many industrial products, with the exception of textiles, coal and steel, which are accorded special treatment as "sensitive products." Tariff reductions and phase-out of quantitative restrictions for these sensitive products will take place more gradually.⁸ Customs duties levied on exports are also slated for eventual elimination. While the agreement provides for limited trade preference for selected agricultural products over 5 years, in many cases, tariffs and tariff rate quotas will remain in place at the end of the phase-in period, with the agreement merely calling for the parties to consult on the possibility of granting further concessions.⁹

According to a report published by the IMF, the EU decided in 1993 to further improve market access for Poland and other CEFTA countries in response to criticism that, under the Association Agreement, the EU was delaying access to those markets in which CEFTA countries have the

⁶Dumping is the sale of a commodity in a foreign market at a lower price than its fair market value in the domestic market. Dumping is generally recognized as unfair because the practice can disrupt markets and injure producers of competitive products in an importing country. Article VI of General Agreement on Tariffs and Trade permits imposition of anti-dumping duties equal to the difference between the price sought in the importing country and the normal value of the product in the exporting country. A countervailing duty is a special duty imposed by an importing country to offset the economic effect of a subsidy and thus prevent injury to a domestic industry caused by a subsidized import. A safeguard is a temporary import control or other trade restriction that a country imposes to prevent injury to domestic industry from increased imports. It is designed to facilitate the adjustment of domestic industries to the influx of fairly traded imports.

⁷Summary of the EU-Poland Association Agreement, provided by the Department of Commerce; Economic Survey of Europe in 1993-1994, pp. 149-157; Paul Mylonas, pp. 69, 70; and Economic Transition in Eastern Europe and the Former Soviet Union, p. 112.

⁸Duties for textiles and clothing are scheduled to be phased out over 6 years and quotas eliminated by 1998. Steel and coal duties are to be removed over 5 years, quantitative restrictions for steel are to be eliminated immediately and those for coal, with limited exceptions, after 1 year. See the discussion by Paul Mylonas, pp. 69, 70.

⁹Summary of the EU-Poland Association Agreement; and Economic Survey of Europe in 1993-1994, pp. 149-157.

highest export potential.¹⁰ The IMF and ECE reported that this EU decision (1) accelerated by 2 years the scheduled reduction of EU customs duties on certain imports of sensitive basic industrial products, (2) increased by 10 percentage points the annual expansion in quotas and ceilings for certain industrial products, (3) implemented 6 months earlier than scheduled a reduction in levies/duties on certain agricultural products subject to quotas, and (4) began exempting from customs duties outward processing operations in 1994.¹¹ The IMF report indicated that the most important remaining restrictions appeared to be quotas on textiles, nontariff barriers on agricultural products, and the threat of resorting to safeguard provisions or anti-dumping actions.¹²

Under the Association Agreement, tariffs existing in the EU and Poland as of February 29, 1992, served as the base from which reductions were to occur. Reduced tariff levels agreed to in the General Agreement on Tariffs and Trade (GATT) Uruguay Round replace these tariffs as the base once such reductions go into effect.¹³ Certain trade liberalization clauses in the Association Agreement are contingent on agreements reached in the Uruguay Round. For example, the ECE reported that, for textiles and clothing, the agreement provides for the elimination of EU quotas on imports from Poland over a period equaling half of that agreed to in the Uruguay Round, but not less than 5 years.¹⁴

Poland was a member of GATT before undertaking economic reforms; however, it was required to accept special terms reflecting the state-controlled nature of its economy. According to a Polish official, Poland is now renegotiating its terms of accession with GATT to reflect its economic reforms,¹⁵ and the country became a founding member of the new World Trade Organization, an outcome of the Uruguay Round agreements, on July 1, 1995.

Under the Association Agreement, anti-dumping actions and other contingent protective measures are permitted in accordance with GATT articles. The EU no longer includes Poland in its list of state-trading

¹⁰Paul Mylonas, pp. 69-71.

¹¹Economic Survey of Europe in 1993-1994, pp. 149-157.

¹²Paul Mylonas, p. 71.

¹³Summary of the EU-Poland Association Agreement.

¹⁴Economic Bulletin for Europe, Volume 45 (1993); (New York and Geneva: Secretariat of the Economic Commission for Europe, United Nations, 1994), pp. 4,5.

¹⁵Economic Survey of Europe in 1993-1994, p. 151; and Economic Transition in Eastern Europe and the Former Soviet Union, p. 116.

economies for purposes of determining “normal prices” in anti-dumping actions, but the ECE has reported that a country’s classification as a market economy does not necessarily imply that it will be subject to fewer actions.¹⁶

On the other hand, the ECE reported that transition countries such as Poland will benefit from a Uruguay Round strengthening and extension of GATT rules and authority, especially if this leads to stricter control of anti-dumping procedures and contingent protective measures.¹⁷ A recent and as yet unpublished OECD study reported that the Uruguay Round agreement should bring more clarity and certainty regarding the initiation of anti-dumping actions. However, another recent, unpublished OECD study reported that how the new rules are implemented will determine their actual impact and that Uruguay Round results will probably make only modest changes to the way anti-dumping regulations are applied to transition economies such as Poland’s. The report also said that less stringent conditions on safeguards may cause sufferers of import competition to choose this method of protection rather than an anti-dumping investigation.

Polish government and ECE officials told us that Poland’s membership in the World Trade Organization will help the country become more fully integrated into the world economy. Poland’s representative for GATT issues at the Polish Mission in Geneva said that Poland hoped to benefit from the Uruguay Round and membership in the World Trade Organization in that it would help the country consolidate its own reforms in trade-related management and systems, rendering such systems more stable, predictable, and coherent. An ECE official added that this development means that Poland is becoming more fully grounded in the market system, making it more difficult to backtrack on market reforms.

Barriers Hamper Restructuring Efforts

The Directors of Poland’s Bureau for European Integration and Bureau for Foreign Assistance, the Director of the Trade Instruments Department of the Polish Ministry of Foreign Economic Relations, and the Economic and Commercial Counselors of the Polish Embassy in London told us that they support the EU-Poland Association Agreement. However, they maintained that the EU continues to limit Polish access to its markets through contingent protective measures (anti-dumping duties, countervailing

¹⁶Economic Survey of Europe in 1993-1994, p. 155.

¹⁷Economic Bulletin for Europe, Volume 45 (1993), pp. 4,5; and Economic Survey of Europe in 1993-1994, pp. 11, 12.

duties, and safeguard actions) or the threat of such measures. These officials said that when Poland proves to be competitive in a particular area, these barriers often come into play. The ECE reported that imports of certain sensitive eastern goods generated complaints in West European countries that culminated in a number of import restrictions. The result was that while standard measures of protection (such as tariffs and quotas) diminished, contingent protection measures were used more frequently. They also reported that a steady stream of warnings in addition to official actions may result in eastern exporters making voluntary reductions in the growth of sales to reduce the probability of formal complaints being lodged.¹⁸ Table 3.3 lists EU protectionist measures against Polish imports between July 1992 and December 1993, as reported by the IMF.

¹⁸Economic Bulletin for Europe, pp. 99-116, 122-123, 141-154; and Economic Survey of Europe in 1993-1994, pp. 149-157.

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**Table 3.3: Protectionist Measures
Introduced by the EU,
July 1992-December 1993**

| Product | Description | Introduction date |
|--|--|--------------------------|
| Silicon | EU imposed provisional duties of 32 percent on imports of silicon after Commission determined that dumping had occurred. | 7/06/92 |
| Frozen black currants and strawberries | EU imposed countervailing duties in amount of the difference between Polish prices and EU minimum import prices. | 10/01/92 |
| Seamless steel tubes | EU imposed provisional anti-dumping duties of 10.8 percent for 4 months pending an inquiry. | 11/15/92 |
| Steel tubes | EU made preliminary affirmative determination in dumping case. | 11/15/92 |
| Hermalite pig iron | EU initiated a dumping investigation of imports. | 12/09/92 |
| Ferro-silicon | EU imposed definitive anti-dumping duties of 32 percent on imports. | 12/14/92 |
| Steel tubes | EU extended for 2 months preliminary anti-dumping duties on steel tubing. | 3/08/93 |
| Frozen black currants and strawberries | EU amended a regulation imposing minimum prices on imports. | 4/01/93 |
| Live animals and fresh meat | EU imposed import prohibition on animals and fresh meat because of cases of foot-and-mouth disease in Italy. | 5/10/93 |
| Urea | EU initiated a dumping investigation of imports of urea. | 5/13/93 |
| Urea ammonium nitrate | EU initiated a dumping investigation of imports of urea ammonium nitrate. | 5/13/93 |
| Steel tubes | EU imposed definitive anti-dumping duties on imports of steel tubes (10.8 percent). | 5/15/93 |
| Seamless pipes and tubes of iron and steel | EU imposed definitive anti-dumping duties on imports (11.7 percent). | 5/15/93 |
| Cherries | EU agreed to introduce minimum port prices on cherries. | 7/19/93 |

Source: Liam P. Ebrill, Ajai Chopra, Charalambos Christofides, Paul Mylonas, Inci Otker, and Gerd Schwartz; Poland: The Path to a Market Economy, Occasional Paper 113; International Monetary Fund, Oct. 1994, p. 107.

As earlier noted, Polish exports to the EU grew substantially in recent years. (See table 3.1.) For example, between 1990 and 1993, Poland's total exports to the EU increased at an annually compounded rate of 11.5 percent.¹⁹ However, for the selected commodities that were targeted by the EU contingent protective measures listed in table 3.3, Poland's exports to the EU declined at an average annual rate of 8.1 percent during the same period.²⁰ In 1990, these exports, valued at \$429 million, accounted for 6.5 percent of Poland's total exports to the EU. By 1993, the value of these exports had declined to \$334 million, or 3.6 percent of Poland's total exports to the EU. These data indicate that although EU protectionist measures did not prevent Poland from expanding its total exports to the EU, such measures did have an adverse impact on Polish exports of the targeted products.

According to the Director of Poland's Bureau for European Integration, one of the most unfair examples of contingent protection measures involves the filing of anti-dumping cases. A study prepared for the OECD found that although EU authorities had agreed to speed up tariff reductions and enlarge zero-duty ceilings and quotas for some sensitive goods, EU anti-dumping investigations had the effect of minimizing these actions.²¹ The above-mentioned Polish official and the Economic and Commercial Counselors of the Polish Embassy in London said that the idea that Polish companies can afford to engage in predatory dumping on the EU markets is not logical.

Another example of contingent measures involves the use of EU health and sanitation standards to restrict Polish agricultural exports. OECD officials told us that some EU countries abuse these standards to protect their own industries, while technically complying with GATT rules. For example, in May 1993 the EU imposed a 1-month ban on imports of live animals, meat, milk, and dairy products from across Eastern Europe for sanitary reasons. The OECD reported that, although EU officials portrayed the action as an urgent health measure, Polish and other East European officials described

¹⁹We used EU reported imports from Poland as a measure of Polish exports. These figures vary somewhat from Polish-reported exports. For example, freight and insurance charges are handled differently.

²⁰We used 1990—the year Poland liberalized its foreign trade regimes—as the base year for this analysis. The latest year for which commodity-level data for EU imports are available is 1993. Commodity-level data for Denmark was not available for 1993. We used two alternative methods to approximate 1993 Danish imports of the selected products from Poland. Both methods gave similar results when combined with the remaining 1993 EU trade data.

²¹Source: OECD, Paris, 1994.

it as a protectionist measure.²² The Director of Poland's Bureau for Foreign Assistance told us that his government had estimated Poland's losses related to the temporary ban at \$60 to \$80 million. The ECE quotes reported estimates of Poland's losses related to the ban at closer to \$30 million.²³

Polish officials pointed out that now, when Poland is engaging in the painful aspects of economic restructuring, the country is in need of export markets. Limited market access could necessitate extremely disruptive scaling down, which may be of a magnitude greater than necessary in some industries. Such disruption makes it more difficult for Polish politicians to maintain support for reforms. Polish officials added that barriers such as anti-dumping mechanisms are being employed by the EU in areas where Poland is undergoing some of the deepest and most disruptive economic restructuring. Polish officials noted the irony in the fact that it is necessary to use EU technical assistance to obtain advice on how to shrink Polish industries that have been negatively affected by EU trade barriers.

Another problem with barriers to Polish exports is that it makes it difficult for Polish politicians to resist demands for increased Polish protectionism. Polish officials told us that recently the government of Poland has paid increased attention to calls for protecting certain of its own markets. Indeed, the IMF reported that, in 1992, Poland raised duties on a variety of products and that, in 1993, Poland further revised its tariff structure, lowering duties on imported raw materials and semi-finished products and increasing it on finished products and agricultural goods. Poland also introduced a tax on sugar content, established licensing requirements on the imports of chicken meat, milk products and wine, and, in 1994, introduced variable import levies on several agriculture products.²⁴ The ECE reported that Polish authorities claim that such measures are a response to protectionism in the West.²⁵ Some observers fear that increased Polish protectionism could boost domestic fiscal imbalances and erode trust and much needed financial support abroad or that such policies could become entrenched, as they are in the West.²⁶

²²Barriers to Trade with the Economies in Transition, p. 18.

²³Economic Bulletin for Europe, p. 113.

²⁴Paul Mylonas, p. 70.

²⁵Economic Bulletin for Europe, p. 111.

²⁶Tomasz Telma, "Outlook for Poland," PlanEcon Review and Outlook for Eastern Europe, July 1994, p. 149; and Economic Survey of Europe in 1993-1994, p. 157.

Donor Assistance to Facilitate Polish Exports Has Been Limited

Donors have not been helpful in responding to Polish requests for assistance in establishing an effective export credit insurance program in Poland. Although numerous donor and Polish officials stressed the importance of developing Poland's capability in this area, officials from Poland's fledgling export credit insurance cooperation (known by the Polish acronym "KUKE") experienced difficulty in obtaining capital or any other practical assistance aside from consultant-produced studies. KUKE has established a limited commercial risk insurance program, but it has been unable to establish a political risk insurance program. While commercial risk insurance is useful for exporting to the stable OECD countries, both types of insurance are considered important for Poland to reenter riskier markets in former Soviet Union countries. KUKE officials told us that the Polish government had estimated export losses of \$2 to \$3 billion per year due to the lack of political risk insurance.

Impediments to Foreign Investment

Foreign investment is expected to play a major role in the transformation of Poland's economy.²⁷ Although Poland has made progress removing some impediments to foreign direct investment, a number of obstacles remain. The country's 1991 Foreign Investment Law is generally regarded as a satisfactory legal foundation for foreign direct investment, and the telecommunications and transport infrastructures in large urban areas have been much improved. Nevertheless, bureaucratic, tax, and other impediments persist that only the Polish government can correct.

Polish and donor officials as well as foreign investors repeatedly told us that bureaucratic bottlenecks and indecision at the middle management level in Polish ministries were persistent obstacles to individual investment deals. The officials said that while there is strong support for foreign investment at the highest levels of the Polish government, there is a large disparity between such high-level support and actual practice within ministries. Some officials pointed to suspicion about foreign investment on the part of the Polish people and media as having increased the wariness of local governments and a middle-level bureaucracy already deeply steeped in a culture of indecision. A lack of access to credit was

²⁷Foreign Direct Investment in Selected Central and Eastern European Countries and New Independent States: Policies and Trends in Fourteen Economies in Transition, Center for Cooperation With the Economies in Transition, OECD, 1993, p. 7; Investment Patterns of Companies from OECD Member Countries into Central and Eastern Europe and the Newly Independent States, a study prepared for the OECD by Arthur Anderson, Aug. 1993, p. 2; The Investment Challenge in Central and Eastern Europe, Chairman's Summary of "Opportunity East" Conference, OECD, Apr. 1992, p. 1; Economic Survey of Europe in 1993-1994, p. 134; Economic Bulletin for Europe, p. 85; "Foreign Investment in Former Communist Central Europe: U.S. Firms Play a Vital Role," *International Economic Review*, Feb. 1994, p. 13; and (GAO/NSIAD-92-102, p. 24).

also cited as a continuing obstacle to investment—a situation related to legal impediments insofar as inadequate collateral law and other such difficulties contribute to the problem. (See ch. 5 for a discussion of Poland's banking sector.)

Private sector and investor officials in Poland repeatedly cited uncertainties and inconsistent interpretation of tax law on the part of various governmental bodies from the Minister of Finance down to local tax authorities as a recurring investment impediment. For example, the Chairman of the American Chamber of Commerce in Poland told us that he knew of investors that had begun construction on new plants predicated on the assumption that they would receive certain tax exemptions, only to see the tax exemptions repealed for all but those already transacting business. Officials at the Foreign Investors Chamber of Industry and Commerce²⁸ said that there have been cases where the Finance Ministry declared that a company was not liable for a particular tax, only to find several years later that the local tax authority disagreed. The officials said that the interest and penalties associated with such multiyear discrepancies are at a level spelling bankruptcy for companies choosing to acquiesce to the local tax authority.

In another case involving tax obstacles, the investor retreated. In October 1992, Amoco signed a \$20-million contract with Poland for petroleum exploration and exploitation. According to company officials, the agreement was conditional on the resolution of certain tax issues that would have involved aligning Poland's oil and gas taxation with that in Western Europe and other developed countries. The officials said that they engaged in negotiations with the Ministry of Finance through December 1993, culminating in high-level meetings with the President, Prime Minister, and Finance Minister and that progress was slow but encouraging up until that time. They were poised to sign the final agreement with the Minister of Finance, when the Prime Minister dismissed him, followed by a Finance Ministry retrenchment from previously agreed to positions. After several months of indecision within the Ministry, in April 1994, Amoco finally relinquished its rights to explore. According to company officials, if agreement had been reached and sizable deposits were found, it could have led to a development contract of \$100

²⁸This organization's membership includes about 600 companies in Poland, some of which are wholly foreign-owned and some of which are joint ventures between foreign and Polish companies. The Chamber defends the interests of foreign investors, but differs from other such organizations in that it does not represent one particular country's companies in Poland; rather, its membership features a variety of nationalities. Most member companies are manufacturing firms, but the Chamber's membership also includes some banks and trading companies.

to \$150 million. Company officials recently told us that although the Polish government has since resolved the tax issues and the company has proceeded with other exploration projects in Poland, the original exploration project will not be resumed.

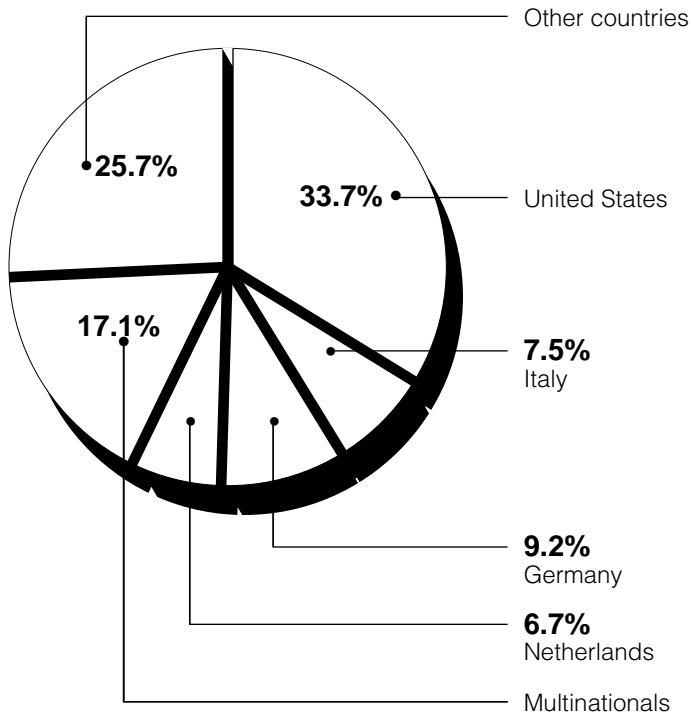
Foreign Companies Invest in Poland

Notwithstanding the existing impediments, a number of U.S. and other foreign companies have recently made significant investments in Poland. According to PlanEcon, the inflow of investments is expected to accelerate in coming years now that a London Club²⁹ agreement has been reached and as more state-owned enterprises are offered for sale. According to the Polish Agency for Foreign Investment, the value of direct investment in Poland exceeded \$5 billion, and another \$5.1 billion had been committed as of March 1995.³⁰ The United States is the largest investor country in Poland, accounting for more than one-third of investments, or \$1.7 billion, followed by multinational companies, Germany, Italy, and the Netherlands. (See fig. 3.2.)

²⁹Poland reached an agreement with the London Club banks in October 1994, resulting in an overall rate of debt reduction of slightly more than 49 percent. See Tomasz Telma, "Outlook for Poland," *Review and Outlook for Eastern Europe*, PlanEcon (Dec. 1994), p. 125.

³⁰These figures include only those investments that exceed \$1 million.

Figure 3.2: Cumulative Foreign Direct Investment in Poland by Leading Countries, January 1990-March 1995



Source: Polish Agency for Foreign Investment, government of Poland.

Many U.S. firms investing in Poland are among the Fortune 500 companies, including Coca-Cola, PepsiCo, International Paper, and others. German investors are predominantly represented by small- and medium-sized businesses, giving Germany the largest number of individual investments in Poland. In contrast, Italy's ranking as a leading investor in Poland is primarily due to the investment of one company, Fiat. Table 3.4 shows the 10 largest company investors in Poland from January 1990 to March 1995.

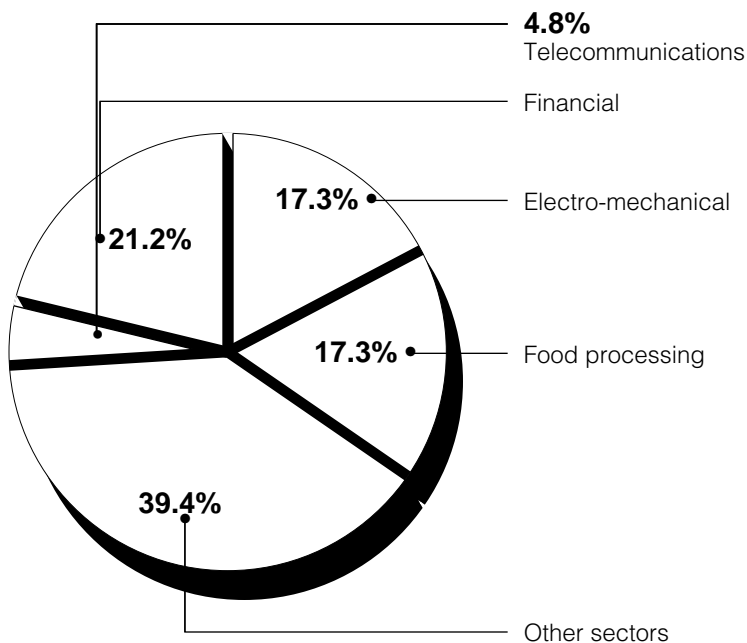
**Table 3.4: Ten Largest Company
Investors in Poland,
January 1990-March 1995**

| Dollars in millions | | | |
|------------------------------|---------------------------|--------------------------|------------------------------|
| Investor | Funds invested | Funds pledged | Country of origin |
| International Paper | \$275 | \$45 | United States |
| Fiat | 260 | 1,581 | Italy |
| Coca-Cola | 235 | 50 | United States |
| ABB | 150 | 0 | International |
| Thomson Consumer Electronics | 147 | 37 | France |
| ING Group | 140 | 0 | Netherlands |
| Procter & Gamble | 113 | 170 | United States |
| Curtis | 100 | 0 | United States |
| Unilever | 98 | 0 | International |
| Epstein | 90 | 110 | United States |

Note: This information was provided by the Polish Agency for Foreign Investment. We could not determine if adjustments for inflation and currency values had been made.

According to the Polish Agency for Foreign Investment, the largest investment outlays went into the financial, food processing, electro-mechanical, and telecommunications industries. (See fig. 3.3.) Polish and donor officials told us that the size of Poland's domestic market, with 38 million inhabitants, is the single most important factor in companies' decisions to invest in Poland.

Figure 3.3: Foreign Investment in Poland by Sector, January 1990-March 1995



Source: Polish Agency for Foreign Investment, government of Poland.

Some Early Assistance Was Unfocused

Some early U.S. technical assistance geared toward improving the investment climate in Poland was unfocused. For example, the United States launched a program to help Poland improve its commercial law, but the program design included few specific goals. Rather than designing projects to complement other efforts addressing key economic restructuring impediments, USAID simply contracted with a number of institutes and the Department of Commerce to develop projects that would fit into several broad areas of commercial law development—an approach that USAID officials said was driven by congressional pressure to “get the money spent quickly.” According to USAID officials, the result has been scattered activities in an area where efforts should be sparing and cautionary because of the need for new laws to intermesh properly with existing legal codes.

For example, one project involved having volunteers spend 4 to 6 weeks in Poland working on specific tasks such as helping to draft legislation. A USAID contractor working on a related project was critical of this approach.

He indicated that it was too dependent on the personalities of individual volunteers who generally have little Polish language ability or lack the professional stature to work with officials in Poland. As an illustration of the difficulties posed by such an approach, the contractor cited a recent endeavor to work with Polish legal associations to establish a commercial law library in Warsaw. The volunteer in charge of this task, an American divorce lawyer with no Polish language skills, had difficulty getting the legal associations to work together effectively, and the project faced delays in getting started. USAID officials acknowledged that the person in charge was “not the best person” for the job.

The USAID contractor also expressed concern that Polish officials were unable to use the results of a World Bank-sponsored project in the area of collateral law. He said that the Bank sponsored a Western expert to draft legislation in London but that the work was not useful to Polish officials because it did not intermesh properly with existing laws. He told us that, based upon his experience, no important piece of legislation will be adopted in Poland that is not prepared by Polish lawyers and that, while Polish legal experts appreciate assistance and guidance from western specialists, the legislation must ultimately be the work of Polish legal experts.

U.S. Investment Promotion Assistance Had Limited Impact

The United States supported a variety of efforts to help promote investment in Poland, but many of these activities had limited impact. For example, the United States established an American Business Center in Warsaw, and the U.S. Commercial Service (USCS)³¹ in Warsaw was given responsibility for running it. The centers were specifically authorized under the SEED Act and were intended to provide temporary office space, phone, fax, and copy capabilities on a reimbursable basis to U.S. companies doing business in Central and East European countries where reliable services of this sort were not readily available when the transition process began. The center in Warsaw experienced difficulty in obtaining property and equipment in a timely manner and found that the USCS office could not effectively do its own work and run the center. The center served over 500 firms but lost money, partly because comparable services quickly became available through the private sector. Nevertheless, according to a USCS official in Warsaw, the center served as a good test case for centers opening later in the countries of the former Soviet Union.

³¹Formerly the U.S. & Foreign Commercial Service.

USAID also financed a project to (1) support the identification, analysis, and marketing of large infrastructure projects; (2) promote investment and trade, joint ventures, and co-ventures; and (3) assist in project packaging and marketing. However, USCS officials in Warsaw said that the project was wasteful because it utilized expensive consultants while lacking a clear plan. USAID officials acknowledged that the project was unsuccessful and said that they had retargeted it.

The Overseas Private Investment Corporation (OPIC) has provided \$700 million in insurance and financing for U.S. businesses investing in Poland. OPIC insures U.S. investments in that country against political risks and provides investment financing in the form of direct loans and loan guaranties. According to OPIC officials, a 1990 OPIC effort to provide guaranties for an investment fund targeted toward Poland and other Central and East European countries was dropped because the investment company managing the fund was unsuccessful in obtaining the necessary private, counterpart funds. However, OPIC is now providing debt guaranties to cover a significant portion of the capitalization for a venture capital fund to invest in small- and medium-sized private enterprises in Poland. The fund had raised about \$65 million in capital as of May 1995. OPIC is currently developing three additional investment funds targeted toward Poland and other Central and East European countries. OPIC also sponsors investment missions to Poland for U.S. executives to learn about Poland's investment climate and to meet with government officials, banks, prospective joint venture partners, and officials from U.S. companies already doing business there.

Poland's Progress Toward Privatization Has Been Mixed

Probably the most fundamental change in transitioning from a socialist command economic system to a market-oriented system is privatization or changing the system of ownership.¹ Despite numerous reforms, many of which were intended to lessen the role of government in the economy, Poland's record in privatization thus far is mixed. The country's private sector has grown and many small- and medium-sized retail businesses have been privatized. Privatization laws have set the framework for reducing the rest of the state sector, but the pace of privatization for larger state-owned enterprises has been slower than expected, and significant portions of the Polish economy remain in the hands of the government. The United States and other donors are actively supporting Poland's efforts to restructure enterprises and implement the country's Mass Privatization Program; however, persistent delays threaten continued donor support. Changes in government, the reluctance among state-owned enterprises to enter the privatization process, and the poor financial condition of many enterprises have delayed privatization efforts.

Poland's Private Sector Is Growing

When reforms began in late 1989 and early 1990, Polish reformers and many Western economists were convinced that, to improve the efficiency of the Polish economy, the state-owned enterprises had to be converted to private ownership. By transferring such enterprises to private ownership, it was argued, the new owners would have a vested interest in the success of the enterprise and therefore seek to maximize profits by better utilizing labor, improving management, and investing in capital improvements.

At the outset of reforms, Poland was in a better position with respect to ownership transformation than most other transition countries in Central and Eastern Europe. Since Poland had not collectivized its agricultural sector during the socialist years as other countries in the region had, most of this sector was already private. Further, the nonagricultural private sector was allowed to expand between 1982 and 1989 as an element of the limited socialist economic reform taking place during that period. At the end of 1989, over 23 percent of the Polish workforce was employed in private agriculture, over 10 percent was employed in the nonagricultural

¹Mark E. Schaffer, *The Economy of Poland*, Discussion Paper 67; Centre for Economic Performance, London School of Economics, Mar. 1992, p. 43; and Mark Schaffer, "Polish Economic Transformation: From Recession to Recovery and the Challenges Ahead," *Business Strategy Review*, Vol. 4, No. 3, Autumn 1993, p. 61.

private sector, and 30 percent of the country's GDP was located in both the agricultural and nonagricultural private sector.²

After reforms began, Poland's private sector grew larger, both through the privatization of existing firms and through the establishment of new private firms. Poland's early privatization efforts, termed "small privatization," concentrated on rapidly selling small labor-intensive firms, such as hotels, restaurants, and shops.³ Hundreds of thousands of small- and medium-sized retail businesses have now been privatized, placing over 90 percent of this sector in private hands. After legal requirements for the set-up of private enterprises were liberalized, many new private businesses also emerged. By December 1993, the number of small businesses had risen to about 1.8 million, the number of private companies employing more than 5 people had grown to over 66,000, and about 60 percent of Poland's employment and over 50 percent of its GDP were located in the private sector.⁴ Poland's private sector is now the primary source of the country's GDP growth. A World Bank economist estimated that Poland's private sector GDP grew by 13 percent in 1993, while its public sector GDP declined by 4.1 percent.

Despite the increased importance of Poland's private sector in generating economic growth, the country continues to rely on state-owned enterprises for a substantial portion of its industrial production. While the private sector share of Poland's industrial output is rapidly growing, state-owned enterprises still accounted for about two-thirds of the country's industrial production at the end of 1993.

The Polish government took steps to encourage these state-owned enterprises to operate more independently as part of its initial reforms. The elimination of price controls, the opening of the economy to international competition, the removal of most state subsidies and the discontinuance of Central Bank soft money policies encouraged some state-owned enterprises to become more cost conscious and to search out market opportunities. A 1993 World Bank paper on the performance of

²Mark E. Schaffer, *The Economy of Poland*, Discussion Paper 67; Centre for Economic Performance, London School of Economics, March 1992, pp. 44,45; Mark Schaffer, "Polish Economic Transformation: From Recession to Recovery and the Challenges Ahead," *Business Strategy Review*, Vol. 4, No. 3, Autumn 1993, p. 65; Georg Fischer and Guy Standing, *Structural Change in Central and Eastern Europe: Labour Market and Social Policy Implications*, OECD, 1993, pp. 133-135; and *Economic Survey of Europe in 1993-1994* (New York and Geneva: Secretariat of the Economic Commission for Europe, United Nations, 1994), pp. 199-212.

³Fischer and Standing, p. 135.

⁴*Economic Survey of Europe in 1993-1994*, pp. 199-212; and *Poland: Fundamental Facts, Figures, and Regulations*, Polish Agency for Foreign Investment, Mar. 1994, pp. 20, 25.

75 large, Polish state-owned enterprises following the introduction of reforms reported that two-thirds of the studied enterprises showed signs of adapting to the new marketplace conditions.⁵ One of the paper's authors later wrote that two of the most important lessons learned from the study were that (1) hard budgets and competition can stimulate state-owned enterprises to restructure before privatization and (2) the incentive effects of anticipated privatization are very important.⁶

Nevertheless, Poland's state sector is being outperformed by the country's emerging private sector. According to a 1994 World Bank paper, Poland's state-owned enterprises lag behind emerging private firms in output growth, employment growth, investment growth, and profitability.⁷ The authors used a sample of 40 emerging private firms, 45 privatized firms, 41 State-Treasury companies,⁸ and 81 state-owned enterprises. Leszek Balcerowicz, Poland's former finance minister and author of the country's 1989 and 1990 economic reform program, wrote that while Poland's early reform measures induced many state enterprises to adjust to the conditions of the market economy, an even larger increase in their overall economic performance could be achieved if they were privatized.

Pace of Large-Scale Privatization Slower Than Expected

Notwithstanding Poland's success in privatizing small- and medium-sized retail firms, relatively few of the larger state-owned enterprises have been privatized. The Privatization Law for State-Owned Enterprises of July 1990 established the legal framework for Poland's privatization program. The law allows for two methods of privatization: (1) capital privatization⁹ for larger enterprises and (2) liquidation¹⁰ for small- and medium-sized

⁵Brian Pinto, Marek Belka, and Stefan Krajewski, *Transforming State Enterprises in Poland: Microeconomic Evidence on Adjustment*, Feb. 1993.

⁶Brian Pinto, "Brian Pinto Explains Why Polish State Firms Are Restructuring," *Transition Newsletter*, World Bank, Sept. 1993.

⁷Marek Belka, Saul Estrin, Mark E. Schaffer, and I.J. Singh, *Enterprise Adjustment in Poland: Evidence from a Survey of 200 Private, Privatized, and State-Owned Firms*, Sept. 1994.

⁸State-owned enterprises are converted into State-Treasury corporations as either joint stock or limited liability companies through a process called "commercialization." Among other things, commercialization establishes a clear supervisory structure, adjusts enterprise operations to meet the requirements of Poland's commercial code, and changes the legal status of the enterprise to allow foreign capital participation. The final step is either the sale of the State-Treasury corporation to private investors or participation in the Mass Privatization Program. (See app. I.)

⁹Capital privatization entails converting the state-owned enterprise to a State-Treasury corporation operating under the commercial code, followed by sale to a private investor.

¹⁰Liquidation entails immediately selling a state-owned enterprise, transferring it to an existing business, or leasing it in part or whole.

enterprises.¹¹ The workers and management of the state-owned enterprises, in consultation with the Ministry of Privatization, select the method of privatization.

Poland's privatization program called for the sale of 50 percent of Poland's state-owned enterprises over 3 years with the eventual goal of privatizing 80 percent of such enterprises. In December 1994, 4-1/2 years later, Poland's Ministry of Privatization reported that approximately 36 percent of the original 8,441 state-owned enterprises had been transformed under the privatization process.¹² (See fig. 4.1.) In addition, the government continues to play a significant role in many of these transformed enterprises. For example, more than 500 of these enterprises are commercialized corporations belonging to the State Treasury that are awaiting either capital privatization or participation in Poland's Mass Privatization Program.

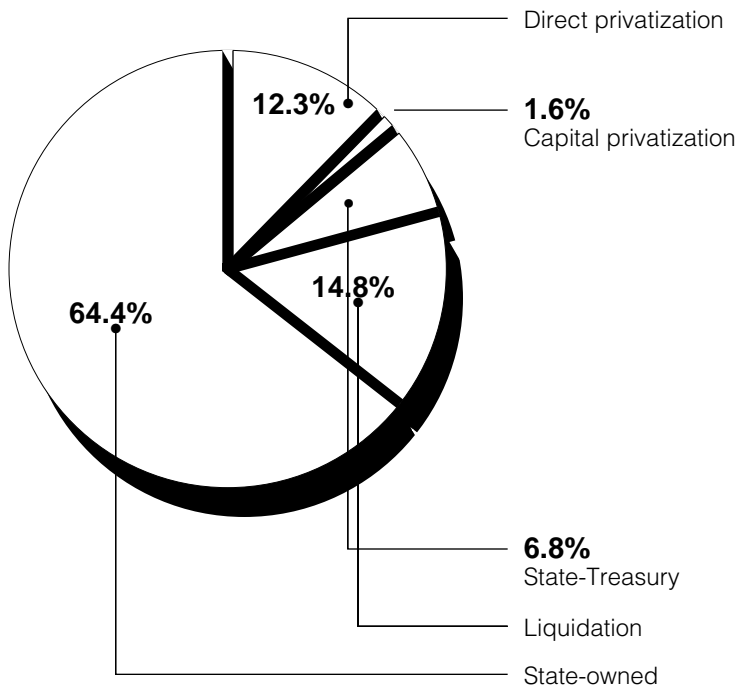
The World Bank's Resident Representative in Poland recently acknowledged some advantages to commercialization of state-owned enterprises; however, he emphasized that commercialization is not an effective substitute for privatization. He stated that privatization is one of the main policies for further developing the productive potential of the economy and that it is therefore of crucial importance that it be accelerated rather than slowed down.¹³

¹¹The small enterprises referred to here were not part of the early "small privatization" of retail shops and other similar small businesses.

¹²Transformed here means the status of the state-owned enterprise has changed. This number does not reflect the number of enterprises still awaiting approval for one of the privatization methods.

¹³"Privatization Update," *Monthly Digest of Investment Opportunities*, No. 26, The Warsaw Voice, Polish Agency for Foreign Investment, Polish Ministry of Privatization, Polish Development Bank, Dec. 1994, p. 1.

Figure 4.1: Poland's Privatization
Results (as of December 31, 1994)



Note: Percentages were calculated using the Polish government's baseline of 8,441 original state-owned firms.

In commenting on a draft of this report, the Department of the Treasury emphasized the importance of large-scale privatization. Treasury said that while some of Poland's state sector may have been successful at restructuring, a still-large state sector continues to promote misallocation of investment, poor fiscal controls, and excessive monetary growth, and that repeated delay in the privatization of larger concerns continues to be a drag on economic growth and inflation control. (Appendix I provides a discussion of the various privatization processes available to Polish

enterprises, as well as the number of enterprises that have participated in each process.)

Implementation of Mass Privatization Has Been Stalled

Early in the restructuring process Poland determined that the restructuring and privatization of state-owned enterprises on an individual basis would be too time consuming and expensive, and as of January 1991, only five such enterprises had been successfully sold. Thus, the Ministry of Privatization sought to develop a program that would privatize hundreds of state-owned enterprises at once.

On April 30, 1993, the Polish Parliament passed the Law on National Investment Funds that provides the legal framework for Poland's Mass Privatization Program. The goal of the program is to (1) improve the efficiency and value of several hundred Polish state-owned enterprises, (2) accelerate the privatization process in Poland, and (3) provide each adult citizen with a stake in the privatization process.

As part of the Mass Privatization Program, Poland was to establish 20 specially constituted National Investment Funds. These funds were to assist in the restructuring of Polish companies by holding the shares of state-owned enterprises taking part in the Mass Privatization Program.¹⁴ Each fund, operating as a joint stock company, was to be run by a management team under contract to a specially selected supervisory board. The funds were to seek a listing on the Warsaw Stock Exchange within a year of operation and remain in existence for at least 10 years.

Each state-owned enterprise entering the program is expected to have its shares divided as follows: 33 percent held by a lead National Investment Fund; 27 percent distributed equally to all other such funds; 25 percent retained by the State Treasury; and 15 percent distributed free of charge to enterprise employees. Special share certificates are to be offered free of charge to certain pensioners and state employees.

Donor Commitments to Poland's Mass Privatization Program

Ministry of Privatization documents state that donors have committed approximately \$245 million in assistance to Poland's Mass Privatization Program. (See table 4.1.)

¹⁴The number of funds has since been reduced to 15.

Chapter 4
Poland's Progress Toward Privatization Has
Been Mixed

Table 4.1: Donor Commitments to Poland's Mass Privatization Program (as of February 1994)^a

| Dollars in thousands | | |
|-----------------------|---|------------------------------|
| Donor | Assistance | Amount |
| World Bank | Distribution of share certificates, fund manager fees, advisors, printing, etc. | \$112,500 |
| EBRD | National Investment Fund working capital funds and loans/equity for companies | 110,000 ^b |
| USAID | Common back office and assistance to companies | 11,800 ^c |
| EU PHARE ^d | Advisers, fiscal agent, printing, and training | 10,140 |
| Know How Fund | Distribution adviser | 450 |
| Total | | \$244,890^e |

^aSome of the committed assistance has already been provided to the Ministry of Privatization.

^bThis figure includes \$60 million to support the National Investment Funds and \$50 million for loans and/or equity to companies.

^cThis figure includes \$10 million in technical assistance to the Mass Privatization Program and \$1.8 million for the post-privatization program. It does not include separate but related work at the Ministry of Privatization.

^dPoland and Hungary Assistance for Economic Restructuring.

^eThe Ministry of Privatization did not provide amounts for some assistance projects; therefore, the actual total could be higher.

Source: Poland's Ministry of Privatization.

Based on available figures, the World Bank has provided the largest share of funding and technical assistance to date.¹⁵ The EBRD has also committed a large share of this assistance, mostly in National Investment Fund working capital and assistance to privatized enterprises. USAID, EU PHARE, and the British Know How Fund have provided additional advisors and technical assistance to the program.

Potential Problems in the Mass Privatization Program

Continued delays in the Mass Privatization Program have caused many donors to question the Polish government's commitment to the privatization process, and some donors have indicated that they may consider cutting their assistance in this area. Donor officials have stated that progress in implementing the Mass Privatization Program is necessary for continued commitment of assistance.

¹⁵In 1991, the World Bank provided a \$280-million loan to assist Poland's efforts to develop and implement a broad privatization program and implement restructuring.

In May 1994, Ministry of Privatization officials were confident that the program would demonstrate satisfactory progress and the National Investment Funds would begin operation in late 1994. Nonetheless, since then implementation of the program has slowed. Although by the end of August 1994, approximately 466 state-owned enterprises had committed to participation in the program,¹⁶ the government of Poland delayed final approval of the participating enterprises until mid-October. As of October 1994, approximately 444 state-owned enterprises were approved for the Mass Privatization Program. However, government differences over the composition of the National Investment Fund managers continued to delay implementation until late 1994.

Some donor officials expressed concern about the signal being sent to state-owned enterprises by delays in implementing the Mass Privatization Program. An OECD official told us that the beneficial restructuring of such enterprises will not continue if privatization is put on hold. He said that an important motivation for some of the state-owned enterprises to restructure themselves is that they anticipate that they will eventually be privatized. Without the certainty of eventual privatization, these enterprises might not continue restructuring but instead might lobby the government to reinstate subsidies. Another donor official said that some state-owned enterprises, particularly the larger ones, are avoiding necessary changes in the hope that the government will announce a program to alleviate their problems without the enterprise having to go through privatization.

USAID officials in Poland also expressed concerns about the effect of delays in the privatization process. According to one USAID official, some members of the Polish government have discussed a program of mass commercialization without any specific date for privatization. This proposed program would involve more than 1,000 state-owned enterprises, which, once commercialized, would be part of the new "Ministry of Treasury." This new Ministry would act as a holding company for Poland's commercialized enterprises.¹⁷ USAID and State Department officials in Poland were concerned that such a program could have a negative effect

¹⁶According to a USAID official, more enterprises may be added to the program in 1995.

¹⁷According to a U.S. embassy official in Warsaw, a new privatization bill passed in the Polish parliament on June 30, 1995. The bill includes provisions that would provide for commercialization of state-owned enterprises, while allowing the government to maintain indefinite ownership; however, the bill does not specifically provide for a new "Ministry of Treasury." The bill also would not affect state-owned enterprises that are included in the Mass Privatization Program. A Polish law expert at the Library of Congress said that the Polish president vetoed the bill on July 17, 1995, but that the parliament subsequently voted successfully to override the veto.

on the overall privatization process, potentially creating a commercialized state sector without a plan for privatization. A Polish law expert at the Library of Congress agreed that the proposed program would cause further privatization delays and would allow the government to maintain indefinite ownership of commercialized firms. Some donors have indicated that they may consider cutting their assistance in this area if privatization is further obstructed or delayed.

The Ministry of Privatization has expressed some concerns about continued donor support for the Mass Privatization Program. A Ministry official said he was concerned that the EBRD's Special Restructuring Project¹⁸ would absorb some of the money already set aside for the Mass Privatization Program. For example, he said the EU PHARE may decide to reallocate money to the Special Restructuring Project if it is the first program to get underway. Another official said the EU PHARE has been upset with the delay in the Mass Privatization Program and may cut or end all future assistance to the program. According to the EU PHARE representative in Poland, no additional PHARE funding was provided to the Ministry of Privatization in 1993 because the Ministry had spent very little of the earlier assistance. According to the representative, Poland now has a 2-year funding pipeline of PHARE assistance, and therefore, no new funding is needed.

U.S. and EBRD support for post privatization was announced in July 1994, in connection with President Clinton's visit to Poland. The United States proposed a new effort to provide \$75 million of equity capital and technical assistance to support Poland's Mass Privatization Program. Under the new proposal, the Polish American Enterprise Fund and EBRD will each commit \$15 million for equity investment, USAID will commit \$10 million to technical assistance, and an additional \$50 million in financing will be generated by the EBRD and others. A U.S. Treasury official familiar with the proposal said the EBRD is expected to put forward the majority of the capital. The EBRD had already announced that the newly privatized enterprises were eligible for approximately \$300 million in EBRD restructuring assistance that would be available to any Polish enterprise on a case-by-case basis.

Although more than 5,000 state-owned enterprises may remain after implementation of the Mass Privatization Program, Poland and the donor community expect the program to restart a delayed privatization process,

¹⁸The EBRD developed the Special Restructuring Project to assist Polish banks in restructuring Polish state-owned enterprises. (See app. II.)

provide millions of Polish citizens with a stake in the transformation process, and set the stage for continued privatization in Poland. According to the Department of the Treasury, enterprises in the Mass Privatization Program account for only 8 percent of the state sector. However, a USAID official said that the state-owned enterprises being privatized under the Mass Privatization Program and other privatization initiatives represent a significant share of Poland's state sector, with most of these privatized enterprises coming from the ranks of the larger state-owned enterprises.

Privatization Delays Have Several Causes

Poland's slow progress in privatizing larger state-owned enterprises can be attributed to at least three factors: (1) government indecision brought about by the changes in Poland's government over the past 4 years, (2) the reluctance among state-owned enterprise employees and management to enter the privatization process, and (3) the poor financial position of many state-owned enterprises.

Government Indecision

The government of Poland announced its Mass Privatization Program in June 1991, but did not enact laws to make such a program possible until April 1993. Meanwhile, the rate of privatization slowed as each new coalition government reassessed the privatization approach in the face of public criticism of the process. For example, the new government elected in 1993 reevaluated the country's privatization efforts, and debates over revisions to the privatization legislation and the roles of various ministries in the privatization process have also delayed the process. Also, high unemployment, fear of foreigners buying up the country's assets, and concern over undervaluation of state-owned enterprises have given advocates of the status quo greater representation in the government.

Reluctance of State-Owned Enterprise Employees and Managers

Uncertainty among workers and management at the state-owned enterprises has also delayed privatization. Under the Privatization Act of 1990, the founding body¹⁹ and the managers and workers' councils at the state-owned enterprises must mutually agree on a method of privatization and then apply to the Ministry of Privatization for approval. The Mass Privatization Program is also dependent on workers and managers volunteering their enterprise for the program. While a large number of smaller state-owned enterprises were liquidated in the early years of reform, the larger ones and related trade unions were able to maintain the status quo until they were granted a larger role in the privatization

¹⁹The founding body is usually either the Ministry of Industry and Commerce or a regional government.

process. According to one Ministry of Privatization official, the state-owned enterprises were more or less self-governing under the Solidarity unions before the privatization process began. Many state-owned enterprises perceived any change in their status as a threat.

A ministry official said that both management and workers at these enterprises need to be educated on the benefits of privatization. Some of the worker and management concerns were addressed in the Enterprise Pact, a document that came out of talks between the government, state-owned enterprise managers, and trade unions. The provisions of the agreement were intended, among other things, to increase employee participation in the management and equity distribution of privatized enterprises and encourage the financial restructuring of state-owned enterprises. The Enterprise Pact was signed by all parties in February 1993, and implementing the provisions of the pact was a Ministry of Privatization priority for 1994.²⁰

Poor Financial Condition of State-Owned Enterprises

The poor financial condition of many state-owned enterprises has also delayed the privatization process. A Ministry of Privatization official stated that many of the healthiest state-owned enterprises have already been privatized, and before the remaining enterprises will be attractive candidates for privatization, they need to be restructured—a process that takes additional time. A number of these state-owned enterprises also have assets not related to their core business that need to be sold separately, such as schools, housing, hotels, resorts, and police stations.

Various financial restructuring paths are available to these troubled state-owned enterprises, all of which may require added time before privatization can take place. Among other methods, restructuring can occur under (1) the Law on Financial Restructuring of Enterprises and Banks, (2) the EBRD's Special Restructuring Project, and (3) the Ministry of Privatization's Restructuring Through Privatization Program. (Appendix II provides a more detailed discussion of these three methods.)

²⁰According to a U.S. Embassy official in Warsaw, the new privatization bill that passed in the Polish parliament on June 30, 1995 did not include many of the Enterprise Pact provisions. As earlier noted, the Polish president vetoed the bill on July 17, 1995, but the parliament subsequently voted successfully to override the veto.

United States Adjusts Program Emphasis Because of Delays

The United States adjusted the emphasis of its assistance program to Poland when Poland's privatization programs experienced delays and some of the U.S. assistance efforts proved ineffective. The U.S. government, through its reprogramming of earlier contributions, has assisted in the restructuring of Polish state-owned enterprises prior to privatization. In addition, USAID has shifted its assistance program to work more closely with the government of Poland after USAID's initial approach proved costly and time-consuming.

In 1989, both Poland and the donor community were in favor of the rapid privatization of the country. However, as the financial condition of many state-owned enterprises became apparent and the pace of privatization began to slow, the U.S. and donor community responded by helping to develop restructuring programs. This included using donor resources from the no longer needed Polish Zloty Stabilization Fund, including the \$199 million U.S. contribution, to establish the \$415 million Polish Bank Privatization Fund. The Bank Privatization Fund was created to support the recapitalization of Poland's ailing banks and to indirectly stabilize and restructure Poland's indebted state-owned enterprises. (See ch. 5 for a discussion of donor assistance in Poland's banking sector.)

The enterprise restructuring being implemented by Poland and the donors may better prepare some of the state-owned enterprises for eventual privatization. An October 1994 EBRD report stated that rapid privatization is "often at the expense of ownership and governance quality," whereas financial restructuring prior to the sale of a state-owned enterprise "aims to attract high-quality owners."²¹

USAID's initial privatization strategy in Poland was based on the assumption that the privatization process would take only a few years. The USAID office in Poland supported privatization through assistance to individual enterprises or sectors with short-term contractors.

USAID provided assistance to a number of large Polish enterprises, including LOT Airlines, the Huta Warszawa steel mill, and the Sandomierz glass company. USAID also assisted Poland's furniture and glass sectors. According to a USAID official, the agency believed that privatizing a few large enterprises in the airline, steel, glass, and furniture industries would have a ripple effect on the economy. Although USAID/Poland noted some achievements while utilizing this approach, the mission concluded that

²¹Transition Report: Economic Transition in Eastern Europe and the Former Soviet Union, EBRD, Oct. 1994, p. 49.

firm-specific and sectoral assistance was too time-consuming and costly. For example, the \$3.7 million in USAID funding for the glass sector led to only four state-owned enterprise privatizations, a cost of more than \$900,000 per enterprise privatized. In addition, as of May 1994, only four of eight targeted enterprises had been privatized under the almost completed furniture sector project.

USAID's sector-specific strategy problems were due in part to the Ministry of Privatization's unwillingness to relinquish control over certain state-owned enterprises and withholding of important information related to the restructuring and privatization efforts. According to a USAID official, the government of Poland had initially supported the firm-specific and sectoral assistance, but the Ministry of Privatization wanted to include these enterprises in the Mass Privatization Program and proved to be a powerful opposition force to the USAID-supported contractors.

Other USAID projects encountered government unwillingness to follow through with privatization. For example, USAID spent more than \$1 million restructuring LOT Polish Airlines in preparation for its privatization. This was USAID's largest single firm-specific privatization effort in Poland. Although the assistance has been a restructuring success, the project's goal of privatizing the airline has not been met. According to a USAID official, foreign investors have shown interest in the airline, but the Polish government has rejected these overtures.

In 1993 USAID's privatization work in Poland began to shift from the firm-specific and sectoral assistance approach and toward projects assisting the Ministry of Privatization with the privatization process. According to the USAID representative in Poland, the early privatization efforts were misdirected because they were based on an assumption that the privatization work was short term and could be performed with a 90-day consultant team.

USAID is now building on its earlier work at the Ministry of Privatization. Beginning in 1992, USAID assisted the Ministry with the National Investment Funds as well as share trading and distribution practices. USAID assistance in late 1993 included a project that placed specialists in corporate finance as well as mergers and acquisitions in the Ministry to assist with privatization transactions. Additional projects to assist the Ministry with the Mass Privatization Program were being planned as of May 1994.

Chapter 4
Poland's Progress Toward Privatization Has
Been Mixed

USAID has also started a regional privatization project with the Ministry of Privatization to assist Polish regional governments with the privatization of state-owned enterprises. The Ministry is providing technical assistance to state-owned enterprises undergoing privatization, assisting the regions with privatization strategies, and helping to identify possible investors. USAID is supplying the training component for the overall program, while the EU PHARE program will provide advisory services. According to a USAID official, the agency's Warsaw office is also planning a new pilot program to assist some of these state-owned enterprises with their privatization transactions, helping them to become eligible for credit and capital from the Polish-American Enterprise Fund and other donor programs.

Reforms in Poland's Banking Sector

Over the last 5 years, Poland has fundamentally reformed its banking sector. Multilateral and bilateral donors have provided important support for recapitalizing Poland's state-owned banks and for restructuring the banks' problem loan portfolios. Early problems with donor technical assistance have been resolved. Nonetheless, bank privatization has been limited; many small private and cooperative banks are in poor financial condition; policies regarding the licensing of foreign banks are unclear, and small- and medium-sized businesses continue to lack sufficient bank credit to develop and expand their operations. Donors have undertaken various activities to help.

Fundamental Reforms Accomplished

Poland's banking sector has undergone fundamental changes since the beginning of reforms in 1989. The country's old command economy central bank has been transformed into an independent central bank and its old regional branches have been converted into individual commercial banks, some of which have been or are being privatized. A number of new private banks have also been established. The government has recapitalized the country's state-owned banks and has made significant progress in restructuring their problem loan portfolios.

The National Bank of Poland Act and the Polish Banking Act, both enacted in 1989, provided the framework for reforming the Polish banking system. These laws transformed the old central bank, which had served as the state conduit of credit to enterprises in the command economy, into an independent central bank with responsibilities for macroeconomic policies and supervision of banks.

The 1989 legislation also transformed the regional branches of the original central bank into nine new state-owned commercial banks, three of which have since been privatized. These nine banks dominate Poland's banking sector, and, along with four specialized banks¹ that remain from the prereform era, accounted for over 75 percent of total banking sector assets as of mid-1993. The remaining banking sector assets are located in about 1,600 small cooperative banks, which existed prior to reforms to serve agrarian interests, and 60 private and foreign banks established pursuant to the 1989 legislation.

¹These specialized banks are dedicated to (1) foreign trade, (2) foreign currency, (3) agriculture and cooperative banks, and (4) savings and home mortgages. A fifth specialized bank, the Polish Development Bank, was established in 1990. An export development bank was established in 1988 and privatized in 1992.

In 1991, the profitability of state-owned enterprises deteriorated following the collapse of Poland's trade with its former CMEA partners. As a result, many state-owned enterprises relied increasingly on debt to finance operations while their ability to service such debt diminished. The state-owned banks rolled over credits, capitalized unpaid interest, and extended new loans to these firms.

In mid-1991, a Ministry of Finance audit of the state-owned commercial banks revealed a high percentage of problem loans. The audit classified 16 percent of outstanding loans as not recoverable, 22 percent as having doubtful recovery, and 24 percent as not current, and revealed that the banks' capital adequacy ratios were significantly less than those required by Polish banking regulations. A USAID-contracted study reported that, despite divergent interests within the government,² the Ministry of Finance directed the state-owned commercial banks to tighten credit discipline over delinquent enterprise borrowers in 1991 and 1992. By 1992, according to an IMF study, the quality of the portfolios had stabilized somewhat.

To deal with the bad debts of state-owned enterprises and the inadequate capitalization of banks, the government of Poland enacted the Financial Restructuring of Enterprises and Banks Act (FREB), in February 1993. The FREB approach involved banks in the restructuring of state-owned enterprises with delinquent debts. In the process, the portfolios of the state-owned commercial banks³ were improved, and the banks were recapitalized in preparation for privatization. In September 1993, the Polish government recapitalized these banks using special government restructuring bonds. The bonds held by a particular bank are to be serviced by the central government until privatization occurs, after which the bonds are to be serviced and redeemed by the \$415-million Polish Bank Privatization Fund created with resources from the former Polish Stabilization Fund.

²There are conflicting incentives within the government as owner of both state-owned enterprises and state-owned banks. The cessation of state subsidies to the enterprises generated pressure on the banks to provide credits. However, as insurer of the state-owned banks, the state also had an interest in bank solvency.

³Three of the original nine state-owned commercial banks have since been privatized—Wielkopolski Bank Kredytowy, Bank Slaski, and Bank Przemyslowo Handlowy. The first had its reserves increased during its privatization in August 1993; the second did not require recapitalization before its privatization in autumn 1993. According to the Treasury Department, the third was privatized in 1995. In addition to the state-owned commercial banks, coverage under the FREB was extended to two special cases, Bank Gospodarki Zywnosciowej (the Bank for Food Economy) and Powszechna Kasa Oszczednosci (the household savings bank).

The primary elements of the program required banks to segregate loans by likelihood of repayment, create reserves against those loans considered unlikely or doubtful of recovery, set up workout departments to manage the bad loans, and restructure their loan portfolios.

The restructuring act prohibited giving new loans and advances to enterprises with loans classified as substandard. Under the act, each bank was to liquidate or restructure its loans assigned to a problem portfolio by the end of April 1994, unless (1) the loans had been restructured, (2) the debtor had been declared bankrupt, (3) liquidation proceedings had been instituted with respect to the debtor, or (4) the debtor had been servicing his debt obligations for at least 3 months without interruption. Considerable progress has been made under this plan, and according to PlanEcon, by April 1994, the seven state-owned commercial banks had settled over one-half of the bad debts that qualified for the program.

Several Major Hurdles Remain

Notwithstanding Poland's progress in reforming its banking sector, several major hurdles remain. According to Polish and donor officials as well as other observers, bank privatization has been limited; many small private banks are undercapitalized and badly managed; the country's licensing policies for foreign banks lack transparency; and Poland's small rural cooperative banks are in poor financial condition. According to these officials, Poland's bank supervision capacity needs further strengthening, and bankers need additional training. Also, small- and medium-sized enterprises in Poland continue to lack sufficient bank credit to develop and expand their operations.

Bank Privatization Delays

Although Poland has made considerable progress in restructuring the portfolios of state-owned commercial banks, the government's plans for reforming the financial sector go beyond improving the banks' health. A final goal of the FREB act is to privatize the remaining state-owned banks, but progress has been slow. Three of the nine original state-owned commercial banks have been privatized, and another is scheduled for privatization by the end of 1995. However, PlanEcon recently reported that those remaining will take more time to privatize due in part to the weak performance of the Warsaw Stock Exchange.⁴ At the end of 1994, the Polish government was still the largest shareholder in the banking sector, with over 69 percent of the equity of all commercial banks and control of almost 80 percent of all assets.

⁴PlanEcon Report: Commercial Banks in Poland—Who's Best, Vol. X, Nos. 46-47, January 31, 1995.

Small Private Banks Have Had Problems

According to Polish government and donor officials, between 1990 and 1992, liberal bank licensing requirements led to the establishment of a large number of small banks, many of which were undercapitalized and badly managed. Poland's central bank significantly tightened regulations in 1993, resulting in a decline in the number of new bank licenses issued. However, donor officials told us that about 25 percent of these banks remain technically insolvent and qualify for closure; and IMF reports confirm that many of these banks have loan portfolio problems.

Poland's central bank has directly "bailed out" some private banks. However, according to donor officials, the Polish government is reluctant to close banks without compensating depositors. Because the central bank is concerned about the cost of closing banks, it is, instead, encouraging the consolidation of financially troubled banks with banks that are financially sound.

The government recently made progress on another problem affecting most private banks—a lack of deposit insurance. In December 1994, the government passed a law creating the Bank Guarantee Fund, which will insure deposits at all banks—private and state-owned. Donor officials said that requirements for banks to submit to the Guarantee Fund's strict lending standards and supervision would encourage better lending policies and provide more stability for private banks.

Licensing of Foreign Banks Lacks Transparency

Foreign banks currently constitute the strongest portion of the banking sector; however, a donor official told us that foreign financial institutions are concerned about a lack of transparency in the bank licensing process. PlanEcon reported that, despite many applications, Poland's central bank had issued only one new license to a foreign bank between March 1992 and late 1994 and that the government's licensing policy had been unclear. According to an EBRD official, Poland's central bank has tried to "force" Western banks to buy problem banks as a prerequisite for obtaining banking licenses in Poland. However, he said that this policy has not been well received by Western banks. The PlanEcon report noted that the central bank appeared to have become more willing to negotiate the licensing of foreign banks by the end of 1994.

Cooperative Bank Financial Problems

According to Polish and donor officials, Poland's 1,600 small cooperative banks serving largely rural areas are also in poor financial condition. According to an IMF report, about 200 of 1,000 banks examined by the central bank qualified for bankruptcy as of March 1994.

PlanEcon reported that about 1,200 of the cooperative banks are affiliated with the Bank for Food Economy, which was recapitalized under Poland's FREB program in 1994. However, the restructuring of this bank's bad debts has been addressed only recently. Because many of the bad loans were owed by farmers, restructuring these loans is considered politically difficult.

The cooperative banks represent only 6 percent of Poland's banking assets; however, they are a principal source of banking services for Poland's agricultural population. The failure of these cooperatives would have severe budget consequences as these deposits are guaranteed by the Treasury. Additionally, given the large number of institutions, they require a disproportionate amount of supervision from the central bank.

Banking Supervision and Banker Training Inadequacies

According to Polish government and donor officials, it is important to create a cadre of Polish experts in areas such as banking supervision and credit analysis before good lending practices can be fully integrated into Poland's banking system. A USAID-contracted study concluded that while Poland's central bank has made rapid progress in building its capacity in some areas, additional work remained to be done in developing the bank's capacity to supervise the banking sector. The study also reported that training of bank staff in Poland was needed and would continue to be needed for some time.

Small- and Medium-Sized Enterprise Credit Shortage

According to Polish and donor officials as well as other observers, small- and medium-sized enterprises in Poland continue to lack sufficient bank credit to develop and expand their operations. Poland's emerging private sector has generally encountered a risk-averse, domestic banking system, and foreign commercial banks that are unwilling to lend to new Polish ventures.

According to Poland's Ministry of Finance, more than 80 percent of the country's banking sector's business continues to take place in state-owned banks. While state banks have concentrated their attention on working out the bad debts of state-owned enterprises and providing new loans to the

healthier state-owned enterprises, these banks have remained cautious about providing new loans to small- and medium-sized enterprises. According to a development expert at the London School of Economics, the reluctance to make loans to small- and medium-sized businesses is compounded by Polish bankers' lack of expertise in evaluating small business propositions. He added that poor collateral laws also limit the amount of credit available to such firms.

The government of Poland expects state-owned banks to continue focusing on state-owned enterprises. The Ministry of Finance's "Strategy for Poland" commits the state banks to supporting such firms in future years, stating "the government will be using [state-owned] domestic banks to a larger extent for managing state-owned wealth, for the privatization of state-owned enterprises, and for bringing them back to health." The Ministry's financial sector strategy says very little about bank assistance to Poland's emerging private sector, particularly the small- and medium-sized enterprises.

Foreign commercial banks in Poland also have been cautious with their lending. According to an OECD official, the few foreign commercial banks operating in Poland have limited their activities to larger Western investors. One Western banking official said his bank would prefer a few large transactions over numerous small transactions. Some of this cautiousness was also attributed to the lack of a debt accord between Poland and its commercial creditors; however, this obstacle was resolved in October 1994 when Poland and the London Club of commercial creditors signed an agreement to reduce and reschedule Poland's more than \$13 billion in private sector debt.

Donors have recognized the lack of available credit for small and medium-sized enterprises and have undertaken various activities to help fill the gap. According to Polish government and donor officials, the U.S.-sponsored Polish-American Enterprise Fund⁵ has been more successful than other donor programs in this area. The Enterprise Fund's small loan component, the Enterprise Credit Corporation, has assisted Poland's small- and medium-sized enterprises with more than 2,300 small business loans worth over \$56 million. Fund and donor officials attribute the program's success in reaching the smaller enterprises to the fact that it did not depend upon the existing banking skills in Poland, but instead

⁵Established under the SEED Act of 1989, the Enterprise Fund promotes private sector development in Poland through equity investments, grants, loans, technical assistance, and training.

trained and monitored the staff of the banks used as intermediaries. We reported on the Enterprise Fund's success in 1994.⁶

Donor Assistance Has Been Instrumental in Reforms

The centerpiece of assistance in the Polish banking sector was donor support for Poland's FREEB program to restructure enterprises and banks. In collaboration with the World Bank, the Polish government issued bonds to recapitalize the banks that are to be serviced and redeemed by the Polish Bank Privatization Fund after the banks are privatized. This fund was established using resources that were no longer needed for the Polish Zloty Stabilization Fund.

The World Bank also provided a \$450-million loan to assist in the FREEB program. As part of this effort, the World Bank plans to help the Polish government supervise an intervention fund. This fund is intended to act as a "hospital" for state-owned enterprises that are too large to be liquidated.

Donors Provide Technical Assistance and Training

According to Polish government officials, some early technical assistance to Poland's financial sector was of limited value, but many of these problems have been resolved and donors are now providing more useful assistance. For example, officials told us that in the early stages of reform, many consultants came to Warsaw for 1- to 2-week stays, interviewed some officials, and then produced reports that merely repeated everything they had been told.

Polish officials told us that donor technical assistance and training is now addressing some of the most important needs remaining in this area, such as bank supervision and credit analysis. For example, the United States has provided long-term Department of the Treasury advisors to various banks, Poland's central bank, and the Warsaw School of Banking. In addition, Peat Marwick-KPMG, through a USAID contract, is working with the central bank to develop an on-site inspection manual for bank supervision. The manual development is accompanied by advice on strategic planning for bank supervision. Peat Marwick-KPMG also provides advisers to the central bank to help develop operations procedures for the General Inspectorate of Banking Supervision, the central bank's unit for bank supervision and examination.

⁶Enterprise Funds: Evolving Models for Private Sector Development in Central and Eastern Europe (GAO/NSIAD-94-77, Mar. 9, 1994).

U.S. Treasury advisers have been assigned to Polish commercial banks, the central bank, and the Ministry of Finance. Typically, these advisers are fluent in Polish, reside in Poland, and are assigned for a year or more. They provide advice and training on a multitude of subjects. The adviser in the General Inspectorate of Banking Supervision provides daily assistance to the officials and staff on all aspects of banking supervision; helps formulate policy, develop examination techniques, and train staff in financial analysis and inspections; assists in development of the supervision manual; and serves as a liaison with donors.

The U.S. Treasury Department also provides a long-term adviser to the Warsaw School of Banking, along with some short-term instructors, through a contract with Peat Marwick-KPMG. This school is one of three banking schools in Poland and focuses on training middle and senior level managers. With approximately 100,000 to 150,000 banking personnel in Poland, a primary goal of the school is to develop a cadre of Polish trainers to multiply the training effect of the Western advisers.

The Financial Service Volunteers Corps is also supported by the U.S. program, and provides volunteer technical expertise to countries making the transition to a market economy. The advisers provided by this program tend to be short term and have worked on projects such as drafting legislation and regulations, training bank managers, advising policymakers, and assisting with the development of basic financial products and services.

Other bilateral and multilateral donors are also active in the banking sector. For example, the British Know How Fund supports 14 advisers at 3 Polish banks and the Ministry of Privatization, and has 2 advisers in the Ministry of Finance. The fund has been instrumental in the privatization of a major bank, and has funded training for bank staff at the Katowice Banking School.

The EU PHARE Program has provided training to many financial institutions, provided consultants to the workout departments of the state-owned commercial banks, performed audits, and provided audit assistance to the General Inspectorate of Banking Supervision.

Conclusions and Lessons Learned

Since the reform process began in Central and Eastern Europe, Poland has undertaken some of the most dramatic economic reforms in the region. While Poland continues to face a number of impediments to its restructuring efforts, the country has made significant progress toward economic restructuring in key areas such as macroeconomic stabilization, foreign trade and investment, privatization, and banking. The United States and other donors have actively supported Poland in its transition efforts, although this assistance has been more useful in some areas than in others.

After 5 years of reforms, Poland's experience in transitioning to a market-oriented system offers some lessons that could be of interest to countries such as Russia, Ukraine, and others not as far along the reform path as Poland. Because there are tremendous differences among transition countries in Central and Eastern Europe and the former Soviet Union as to the size of their economies and populations, their political situations, their ethnic compositions, and a host of other variables, the lessons of Poland have differing applicability to each of the other transition countries. Nevertheless, there are a number of lessons learned from Poland's restructuring efforts in several key areas that, at a minimum, merit consideration by the other transition countries and those involved in assisting these countries.

Two such lessons involve Poland's early efforts to stabilize and liberalize its economy. The first is that Poland's own efforts in coupling tough reform measures with consistent macroeconomic policy over several years were critical to the country's current economic recovery. The second is that some of the most important forms of donor assistance provided in support of Poland's transition were those that backed Poland's early macroeconomic stabilization and liberalization measures. The Polish government took a wide range of actions, including cutting subsidies to industry and households, tightening monetary policy, devaluing the currency, liberalizing prices, establishing a free-trade regime, and liberalizing the legal requirements for setting up private enterprises. Donors supported these measures in the form of the Polish Stabilization Fund, balance of payments support, and debt restructuring and forgiveness. By creating the basic operating features of a market economy, Poland effectively set the stage for further economic restructuring and integration into the world economy. The country is now experiencing healthy economic growth.

While Poland's economy is currently among the fastest growing in Europe, the country's continued economic growth and integration into the world economy is widely considered to depend at least in part upon increased foreign trade and investment. Some of the most important factors for improvement in these areas require Polish or donor government actions beyond the confines of assistance. Poland has achieved dramatic increases in its exports to the West, and a number of U.S. and other foreign companies have recently made significant investments in the country. However, Poland continues to run a large trade deficit, trade barriers hamper its exports of certain products to the EU, and a number of obstacles continue to impede foreign investment. Some of the most persistent investment impediments, such as bureaucratic and tax uncertainties, demand the attention of the Polish government rather than of donors. On the other hand, further reducing EU trade barriers could help Poland increase its exports, diminish its trade deficit with the EU, and earn additional foreign exchange for further restructuring.

In addition to its long-term importance for economic growth, foreign trade had a more immediate bearing on the success of early reform measures, and early liberalization of foreign trade played a critical role in helping state-owned enterprises adapt to market conditions. Poland liberalized foreign trade regimes as an element of the country's early stabilization and liberalization measures. By doing so, Poland subjected its state sector to foreign competition and provided international relative prices that monopolistic Polish firms would not have offered in an environment of liberalized prices. The opening of the economy to international competition, the removal of state subsidies, and the discontinuance of central bank soft money policies encouraged some state-owned enterprises to become more cost conscious and search out market opportunities.

Poland's experience in creating market conditions suggests another important lesson—that encouraging the early development of a dynamic private sector is at least as important as the timing for undertaking large-scale privatization. While the pace of privatization for Poland's larger state-owned enterprises has been slower than expected, this slow progress has been offset by the success of the country's private sector. Poland's early measures to remove the state from large-scale detailed direction of the economy and to provide an environment conducive to private sector development resulted in a rapidly growing private sector. Many new businesses have emerged and a large number of small- and medium-sized retail businesses have been privatized. Poland's private sector is now the

primary source of the country's economic growth and a substantial base of Polish employment.

Notwithstanding the success of Poland's private sector, significant portions of Polish productive capacity and employment remain in the hands of the government. Some are concerned that without the certainty of the eventual privatization of larger state-owned enterprises, such firms might not continue restructuring but instead might lobby the government to reinstate subsidies. Donors have actively supported Poland's efforts to restructure enterprises and implement the country's Mass Privatization Program despite waning public and governmental support. However, donors are concerned about continued delays in implementing the program. If the Polish government fails to follow through on its promise to move forward on the Mass Privatization Program in 1995, donor support for the program may erode.

Poland's experience in restructuring its banking sector offers some additional lessons. Although several major problems remain in this area, the country's banking sector has undergone fundamental changes since the beginning of reforms in 1989. Nevertheless, even when faced with hard budget constraints and other market reforms that included curtailed government-to-industry subsidies, many state-owned enterprises were able to circumvent the constraints and continue financing loss-making operations through their relationships with state-owned banks. When the profitability of state-owned firms deteriorated following the collapse of Poland's trade with its former CMEA partners, many such firms relied increasingly on debt to finance operations while their ability to service such debt diminished. The state-owned banks reacted by continuing to lend, rolling over credits, and in many cases capitalizing unpaid interest, contributing to a high percentage of problem loans and technical insolvency.

Poland's experience in restructuring its banking sector shows that donors were able to play a useful role in supporting the country's reform efforts in this area. Multilateral and bilateral donors provided strong support for Polish efforts to recapitalize and restructure the problem loan portfolios of state-owned banks, and considerable progress has been made under this plan. In addition to recapitalizing the banks, the program has contributed to the restructuring of many of the indebted state-owned enterprises. Donor technical assistance has also been useful in the banking sector.

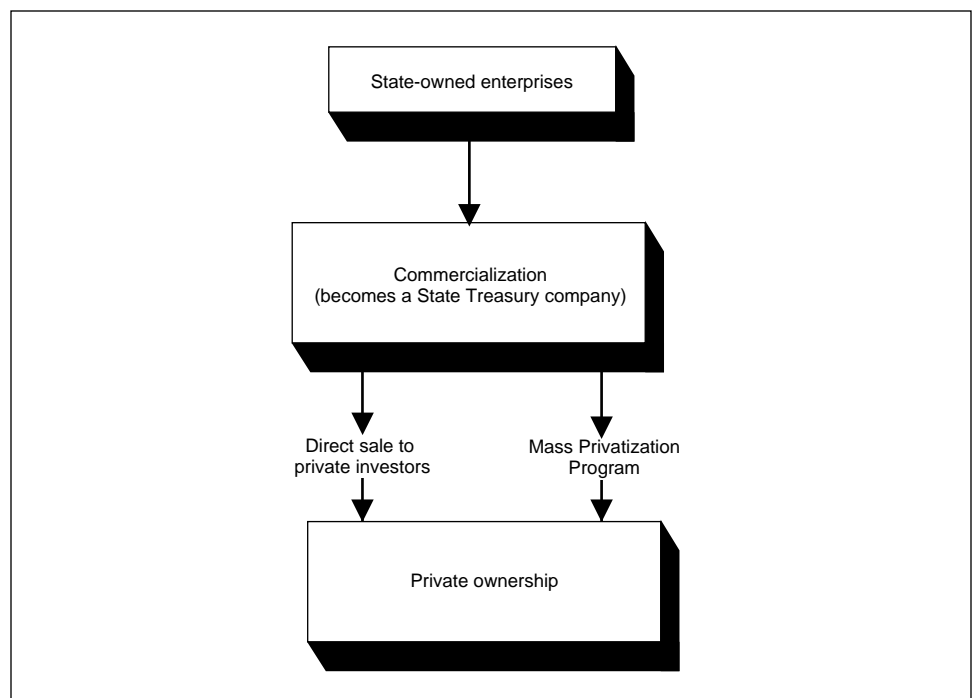
Although a great deal of economic restructuring remains to be done in Poland, the country has made impressive progress toward the goal of transforming its economy into a full-fledged, market-oriented system. Poland's task would certainly have been more difficult without donor support in certain key areas; however, donor assistance is not a guarantee of success. Without Poland's consistent commitment to reforms, its determination to take early and decisive reform actions, and its persistence in building the basic institutions and legal infrastructure required for a functioning market economy, the country's progress could not have been as substantial. Poland's experience suggests that the ultimate success or failure of reform efforts is far more dependent upon the actions of the transition country than it is upon those of outside participants.

Methods of Privatization

Capital Privatization of State-Owned Enterprises

A state-owned enterprise undergoing capital privatization must first be converted into a State-Treasury corporation as either a joint stock or a limited liability company, a process called “commercialization.” Among other things, commercialization of a state-owned enterprise establishes a clear supervisory structure, adjusts enterprise operations to meet the requirements of Poland’s commercial code, and changes the legal status of the enterprise to allow foreign capital participation. The final step is the sale of this State Treasury corporation to private investors within 2 years. (See fig. I.1.) Some of these State-Treasury companies have also been put aside for the planned Mass Privatization Program, a program that is discussed in chapter 4. The government has used capital privatization rather than liquidation in the case of the larger, more strategically important enterprises.

Figure I.1: Capital Privatization Process



The pace of commercialization slowed dramatically in 1993. (See table I.1.) While the number of ownership transformations into State-Treasury companies in 1994 compensated for some of the slowdown in 1993, the pace of commercialization still lags behind the first few years of the

transformation process. However, a new privatization bill passed by the Polish parliament in June 1995 may increase the number of enterprises undergoing commercialization.

The number of companies that underwent capital privatization has also slowed. Although the number of State-Treasury companies sold through capital privatization increased from 1990 to 1993, as shown in table I.1, this number decreased in 1994. Another two State-Treasury companies underwent capital privatization in the first 2 months of 1995.

Table I.1: Status of Commercialization & Privatization

| Status | 1990 | 1991 | 1992 | 1993 | 1994 | Total |
|--|------|------|------|------|------|-------|
| Number of enterprises commercialized (becoming State Treasury companies) | 38 | 222 | 220 | 47 | 186 | 713 |
| State Treasury companies that underwent capital privatization | 6 | 21 | 24 | 48 | 37 | 136 |

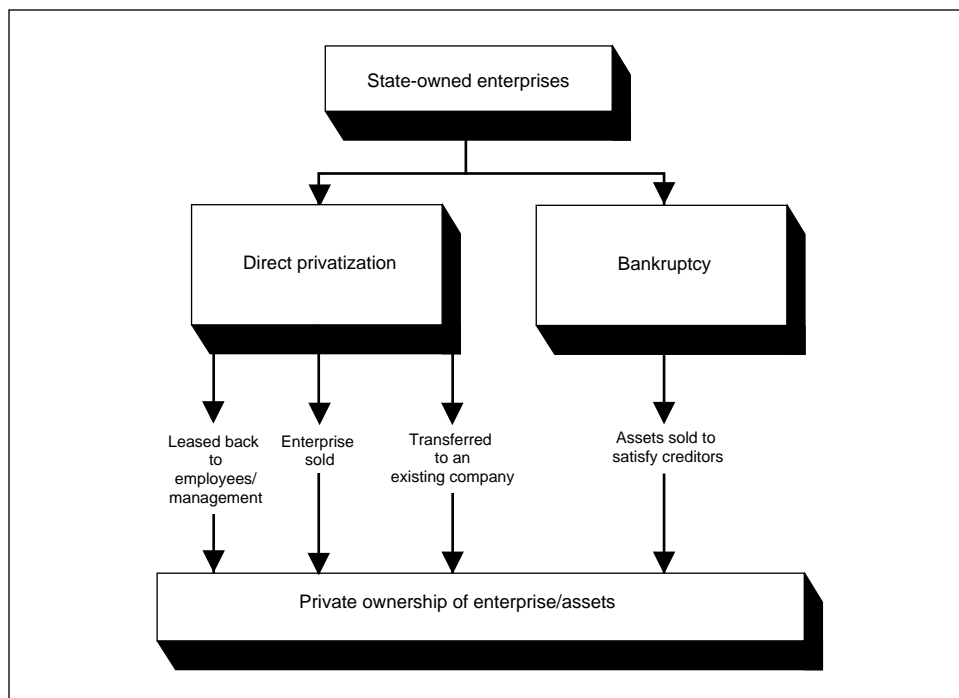
As the numbers in table I.1 indicate, the majority of State-Treasury companies still await either capital privatization or implementation of the Mass Privatization Program.¹ These companies remain state-owned enterprises, albeit commercialized state-owned enterprises. Even in the case of the State-Treasury companies that underwent capital privatization, the government can still retain an equity position in these companies. The Ministry of Privatization considers a state-owned enterprise to be privatized when at least 51 percent of its shares are in private hands.

Liquidation of State-Owned Enterprises

A Polish state-owned enterprise can also undergo liquidation. After liquidation has been chosen, an enterprise is to be sold, transferred to an existing business or leased in part or whole. Liquidation can be performed through “direct privatization” or bankruptcy. (See fig. I.2.) Under the process called “direct privatization,” a state-owned enterprise is either sold, transferred to an existing company, or leased in part or whole. The second option, bankruptcy, is most often used with state-owned enterprises in poor financial condition. In this case, the assets of the state-owned enterprise are sold in order to satisfy creditors.

¹Under Poland’s Mass Privatization Program, 444 state-owned enterprises are to be privatized in 1995.

Figure I.2: Liquidation Process



Direct privatization has been more popular than capital privatization, comprising about 88 percent of all privatization by the end of 1994. Most enterprises privatized through direct privatization were leased back to the employees and/or management at the enterprise. (See table I.2.) A Ministry of Privatization document states that these leased enterprises employed approximately 220,000 workers at the end of December 1993.²

Table I.2: Method of Direct Privatization (as of February 28, 1995)

| Direct privatization method used | Number of enterprises |
|--|-----------------------|
| Enterprise leased back to employees/management | 776 |
| Enterprise sold | 188 |
| Enterprise transferred to an existing company | 49 |
| Combination of above methods | 67 |
| Total | 1,080 |

The rate of direct privatization has slowed since the beginning of the process. The number of state-owned enterprises privatized through direct

²More current employment numbers were not available in March 29, 1995, documents prepared by the Department of Foreign Relations of the Ministry of Privatization.

privatization decreased from 1991 to 1994. (See table I.3.) In addition, although 1,248 enterprises had initiated liquidation by bankruptcy by the end of 1994, the rate of new cases over this period has steadily declined.

Table I.3: Status of Liquidation

| Status | 1990 | 1991 | 1992 | 1993 | 1994 | Total |
|---------------------------|-------------|-------------|-------------|-------------|-------------|--------------|
| Direct privatization | 31 | 418 | 270 | 195 | 127 | 1,041 |
| Liquidation by bankruptcy | 18 | 522 | 317 | 260 | 131 | 1,248 |

The government of Poland maintains an interest in the state-owned enterprises that underwent direct privatization. In about 72 percent of the cases, the enterprises were leased back to the management and employees, often at a subsidized interest rate.³ One U.S. embassy official said since the assets in these new enterprises are held by the government, the new enterprises should still be considered state-owned. A Polish government official stated that continued state ownership of these enterprises may also forestall restructuring and new investment as long as their assets remain in the hands of the state.

Foreign direct investment has assisted Poland's privatization efforts. Foreign investors are offered two methods of investment in state-owned enterprises. Foreign investors can (1) purchase a state-owned enterprise through capital privatization or direct privatization, with the invested capital going to the State Treasury or (2) start a joint venture with a state-owned enterprise, with the invested capital going to the enterprise itself. According to the Ministry of Privatization, capital privatization has been the most successful in attracting foreign direct investment. As of February 1994, foreign investors had participated in 40 sales through capital privatization.

³A U.S. embassy official in Poland told us that these leases will run for about 10 years.

Methods of Restructuring

Bank Supervised Restructuring

In February 1993, the Polish government enacted the Law on Financial Restructuring of Enterprises and Banks. This law, discussed in greater detail in chapter 5, was intended to recapitalize the banks carrying bad debt from state-owned enterprises and, indirectly, restructure such bank-supported enterprises. These state-owned enterprises, previously unattractive for privatization because of excessive debt, now have access to new credit and debt restructuring if they agree to undergo bank-supervised restructuring. Once enterprises and their creditors agree to undergo restructuring, the healthier enterprises will be restructured while the worst enterprises will be liquidated. The banks performing the restructuring are entitled to swap the enterprise debt for an equity position or sell equity in the enterprise to outside investors.

Another element of the Law on Financial Restructuring of Enterprises and Banks is an intervention fund. This fund acts as a “hospital” for the worst state-owned enterprises in the bank portfolios. These enterprises are generally too large to be liquidated. The government of Poland, with the help of the World Bank, supervises the intervention fund.

Polish Special Restructuring Project

Another restructuring program, the Polish Special Restructuring Project, was developed by the EBRD to assist Polish banks with the restructuring of Polish state-owned enterprises. The project will help to stabilize, restructure, and privatize about 30 such enterprises. One EBRD official said the two criteria for entering the program are that a state-owned enterprise cannot be in the Mass Privatization Program and the enterprise must be in worse condition than the Mass Privatization Program enterprises but still be “potentially viable.” The official said he expects some of the project’s candidates to be former Mass Privatization Program candidates whose condition has deteriorated while waiting for the Mass Privatization Program to begin.

In November 1994, the EBRD signed a framework agreement to provide \$40 million in the form of equity investment and another \$40 million in loans to the Polish banks involved in the Special Restructuring Project. Another \$12 million in technical assistance has been committed by the EU PHARE program. However, according to an EBRD official, no disbursement had been made under the project as of June 30, 1995. The officials said that implementation of the project is awaiting final agreements between the EBRD and the Polish government and between the EBRD and the Polish banks involved in the project.

**Privatization Through
Restructuring**

Another Ministry of Privatization initiative, entitled Privatization Through Restructuring, allows the Ministry to hire a management group to restructure and privatize small- and medium-sized state-owned enterprises. Under the program, such enterprises are expected to be privatized within 2 years of the assigning of the contract, but extensions can be granted. An enterprise will be considered privatized when at least 51 percent of its equity has been transferred to private investors. As of February 1994, 27 state-owned enterprises were participating in the pilot phase of the program.

Comments From the Department of the Treasury

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 21, 1995

Mr. Henry L. Hinton, Jr.
Assistant Comptroller General
National Security and
International Affairs Division
United States General Accounting Office

Dear Mr. Hinton:

Thank you for giving us the opportunity to review and comment on your draft report on economic restructuring and donor assistance in Poland. As the largest recipient of US assistance, Poland's experience can provide a useful model for other assistance programs. Treasury agrees with the report's conclusion that donor assistance cannot substitute for a country's own efforts to restructure its economy. I will direct my comments specifically to the sections on bank privatization and technical assistance for tax reform in Poland, since these are areas where Treasury is most involved.

In its discussion of the impediments to Poland's further economic development, the report cites numerous barriers to trade and foreign investment which need to be reversed by the government itself and benefit little from donor assistance. It is correct that bilateral donor assistance does not directly facilitate foreign trade and investment. Instead, multilateral fora, such as the WTO, OECD, and the EU can be more effective at encouraging Poland to reform its trade and investment climate. As Poland strives for admittance to the latter two organizations, it will have to comply with their standards. The OECD in the documents it recently prepared for Poland's review under the Committees for Capital Movements and Invisible Transactions and International Investment and Multilateral Enterprises cites Poland for its liberal regime for foreign direct investment, and commends Poland for avoiding precautionary reservations to the OECD's investment codes, that is that the country's reservations reflect only actual restrictions in pertinent laws and other regulations.

Treasury's technical assistance program provides extensive tax assistance to twenty-one central European and FSU finance ministries. Structural reform in the tax area is critical to the economic growth and fiscal condition of these transition economies. Your report cites complaints from private investors about "uncertainties and inconsistent interpretations of tax law...as a recurring investment impediment." (p. 52) In Poland, several treasury advisors are helping to implement more efficient revenue estimation, standardization, and collection methods. These reforms are also critical to Poland's efforts to rationalize its social insurance system. A more consistent and

Now on p. 39.

Appendix III
Comments From the Department of the
Treasury

fair method of tax administration can address the issues cited above and, in turn, is likely to encourage increased foreign investment and greater voluntary compliance among Polish corporate and individual taxpayers.

Chapter 4 of the report discusses Poland's progress (or lack thereof) in privatization. The lesson offered is that "the early development of a dynamic private sector is at least as important as the timing for undertaking large-scale privatization." This lesson may inadvertently understate the importance of large-scale privatization. While some of Poland's large state concerns may have been successful at restructuring, a still large state sector continues to promote misallocation of investment, poor fiscal controls, and excessive monetary growth. Ideally, privatization of the large state dinosaurs should occur in tandem with private sector development. Poland's private retail sector development was quite successful early on, but the repeated delay in the privatization of larger concerns continues to be a drag on economic growth and inflation control.

Concerning the mass privatization program, the report comments that the poor financial condition of many enterprises has delayed privatization efforts (p. 63). Causality may be difficult to determine, however, the delayed mass privatization program has also caused the financial condition of many enterprises to worsen. The report incorrectly states that government differences over the composition of the National Investment Fund managers continues to delay the MPP's implementation (p. 74). Former Prime Minister Pawlak designated the national investment fund managers in late 1994. It is also important to note that the enterprises in the MPP account for only 8% of the state sector in Poland. (p. 76)

The report's comments on banking sector reform are correct for the most part. However, there are several inaccuracies. First, three of the nine state owned commercial banks have been privatized: WBK and Bank Slaski in 1993 and BPH in 1995. Bank Gdanski is scheduled to be privatized by the end of 1995 and PBK is slated to be sold early in 1996. In addition, the Polish Bank Privatization Fund does not total \$650 million, (ps. 80 and 88) but \$415 million.

The report's appendix "Methods of Privatization" will probably need some revision since the GOP's new privatization bill passed its first reading in the Sejm on June 9. Its main provisions aim to streamline the privatization process by allowing the Ministry of Privatization to initiate the process rather than having to wait for the enterprise to request commercialization. The enterprise will have to be consulted, but its ultimate approval will not be required. It also provides for only two privatization methods: direct (formerly called capital privatization, or a direct sale to outside investors, managers, or workers) and indirect (restructuring through outside investment or leasing to employees, while still owned by the

See comment 1.

Now on p. 46.

Now on p. 53.
See comment 2.

Now on p. 55.
See comment 3.

Now on pp 57 and 61.
See comment 2.

See comment 4.

Appendix III
Comments From the Department of the
Treasury

government). Workers will be entitled to receive 15% of company shares free and will be required to hold these shares for at least 2 years before selling them.

I hope that you find these comments useful. If you have any further questions, please feel free to contact Susan Rzemien at 622-2887.

Sincerely,

Mark Sobel

Mark Sobel
Director, Former Soviet Union
and Eastern Europe

The following are GAO's comments on the Department of the Treasury's letter dated June 21, 1995.

GAO Comments

1. We agree that large-scale privatization is important. In chapter 4, we point out some of the concerns related to continued delays in privatizing larger state-owned firms and note that state-owned firms lag behind private firms in output, employment, and investment growth as well as profitability. We also note a World Bank official's observation that commercialization is not an effective substitute for privatization and include his opinion that it is of crucial importance that privatization be accelerated rather than slowed down. We have added Treasury's concerns about delays in privatization to those already noted.
2. We added this updated information to our report.
3. We include the Polish government's baseline figure of 8,441 original state-owned firms and note that 64.4 percent of these firms remain state-owned. We also note that as of October 1994, about 444 state-owned firms were approved for the Mass Privatization Program and that more than 5,000 state-owned firms may remain after implementation of the program. We have added Treasury's calculation that enterprises in the Mass Privatization Program account for only 8 percent of the state sector.
4. According to a U.S. embassy official in Warsaw, while the original draft of the new privatization bill favored a more rapid privatization process, the version that passed in the Polish parliament on June 30, 1995, is expected to slow the pace of privatization. For example, one provision in the bill states that the commercialization of state-owned enterprises does not have to end in privatization. The official indicated that this provision would allow the government to maintain indefinite ownership. In addition, while the original draft bill would have allowed the Ministry of Privatization to initiate the privatization process without the approval of the enterprises and founding organs (various ministries and local governments), the bill that passed states that the founding organs must give their approval. The bill also states that privatization of "strategic" enterprises must be approved by parliament. A Polish law expert at the Library of Congress said that the Polish president vetoed the bill on July 17, 1995, but that the parliament subsequently voted successfully to override the veto. We have added a footnote in chapter 4 to reflect these recent developments.

Comments From the United States Agency for International Development



U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

JUN 26 1995

Mr. Henry L. Hinton, Jr.
Assistant Comptroller General
National Security and International
Affairs Division
U.S. General Accounting Office
441 G Street, N.W. -- Room 4039
Washington, D.C.

Dear Mr. Hinton:

I am pleased to provide the U.S. Agency for International Development's (USAID) formal response to the draft GAO Report entitled "POLAND: Economic Restructuring and Donor Assistance." USAID considers this draft report to be on-target, balanced, and fair in its review of how donor assistance has contributed to Poland's economic restructuring and to the transformation of its economy from a planned to a market and private enterprise based one. It gives an excellent description of obstacles to further reforms, the effectiveness of donor assistance and how these obstacles are being overcome.

The effectiveness of USAID's Polish-American Enterprise Fund in providing financing for private enterprises and innovations in the financial sector, and of banking technical assistance provided through the USAID program, as the report points out, is especially evident, and we are glad to have these examples pointed out.

This is a very well-researched study, with good coverage of the issues. We agree with the conclusions of the report and do not have any substantive comments. Thank you for the opportunity to respond to the GAO draft report and for the courtesies extended by your staff in the conduct of this review.

Sincerely,

A handwritten signature in cursive script that reads "Larry E. Byrne".

Larry E. Byrne
Assistant Administrator
Bureau for Management

320 TWENTY-FIRST STREET, N.W., WASHINGTON, D.C. 20523

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