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Kiel Working Paper, No. 472

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Suggested Citation: Winiecki, Jan (1991) : Privatisation debates in Poland before and after communist demise: A comparative perspective, Kiel Working Paper, No. 472, Kiel Institute of World Economics (IfW), Kiel

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Kiel Working Papers

Kiel Working Paper No. 472

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A Comparative Perspective

by

Jan Winiecki

April 1991

Institut für Weltwirtschaft an der Universität Kiel

The Kiel Institute of World Economics

ISSN 0342-0787

Institut für Weltwirtschaft
2300 Kiel, Düsternbrooker Weg 120

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A9 1722 / 91 Weltwirtschaft Kiel

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ISSN 0342 – 0787

Introduction

Poland and Hungary, the most persistent tinkerers with the Soviet economic system, became also the first communist countries to have allowed debates on the need to rearrange the structure of property rights in the economy as a way to improve its performance. Elsewhere, until the end of the 1980s, these debates were either explicitely rejected (as in Czechoslovakia or former G.D.R.) or much more limited (as in the USSR under Gorbachev).

In what follows, the present writer will explain the politico-economic context, within which these debates were taking place, and will outline major options proposed there. Moving from minor to major changes formulated in the debate, I begin by presenting some proposals that kept the status of state ownership unchanged, and later evaluate further reaching ones. Also, these options, or most of them, had their predecessors in earlier debates in the West. Therefore, wherever important, linkages to these debates have been made as well.

Politico-Economic Context

The 1980s, and most certainly the second half of the decade, became a period of an open crisis in Soviet-type economies (STEs). By calling it 'open' I refer to the fact that communist regimes in most cases were ready to concede as much. Business as usual, even at a slower growth rate, was obviously beyond reach. Rulers of these wasteful economic regimes, who, first, depleted agriculture in order to accomplish forced industrialisation, second, shifted resources to industry at the expense of the ever more antiquated service sector, third, borrowed from abroad, and, fourth, mortgaged the future of their societies by postponing replacement investment and depleting the environment, discovered that they exhausted all possibilities. That is, all possibilities within the framework of the existing economic system.

Further tinkering did not look very promising. This evaluation concerns first of all Poland and Hungary that — over the decades — tried everything reform theorists ever suggested, with adverse or at best marginally positive consequences. The situation was markedly different in, say, the Soviet Union, which could still face many trials of half-solutions, quarter-solutions and outright non-solutions, that failed earlier elsewhere.

A question might be asked why late-comers could not draw conclusions from other countries' experience. There are two answers as to why this should not have been expected, first empirical and second theoretical. The extreme rigidity of the system has long been known to everybody. Let it be noted that the same mistakes (with the same disastrous results) were committed, say, with respect to agriculture in the USSR in the 1930s, in Soviet East European satellites in 1950s, in Cuba in 1960s, in Ethiopia in 1970s and in Nicaragua in 1980s.

Apart from economic system's rigidity, the peculiar politico-economics nexus in the Soviet system created ruling stratum interested in resisting not only political but also economic change (see Winiecki, 1987, 1990a and 1991). Given the power of this stratum, and particularly party apparatchiks and bureaucrats who defend their rent-seeking capability, changes, even the most necessary, have always been reduced to a minimum by the defenders of the *status quo*. Therefore, smaller modifications usually preceded larger ones, regardless of the fate of their earlier applications elsewhere.

Jointly, both factors undoubtedly influenced the pattern of *perestroika* (or the sequence of *perestroikas*), including the range of privatisation options in the Soviet Union. What has been a margin in Hungarian or Polish debates (and, later, decisions) occupied the centre of the stage in the USSR for quite some time.

Communist leaderships in Hungary and Poland did not have the option to offer the non-starters to the increasingly critical and restive population. They used it up long ago. Whatever they were

to offer must have increasingly been something real. Of course, they temporized, they tried to limit the extent of concessions, they even hoped for the next round of loans from the West in return for limited concessions made to their respective populations. Fortunately, Western leaders were resistant enough to their blandishments. Things went their own way, that is from bad to worse. Something real had to be done.

Markedly greater freedom of expression became one of the concessions. So was the removal of some of the taboos, including the issue of ownership. Therefrom stemmed the debates on privatisation in both countries. But obviously it was not enough at that stage of system's decline. With economies in shambles — and indebted to the hilt at that — Communist reformers in these countries had to offer their populations real choice elsewhere in the political sphere.

The offer — after much wrangling and manoeuvering — consisted of free (Hungary) or 'freeish' elections (Poland). The offer itself was undoubtedly influenced by the unfolding Soviet *glasnost* (if not actually approved of by its architect). By implementing this offer communist leaderships in both countries hoped to benefit from the wave of gratitude felt by their respective societies, now so 'generously' endowed with the rights taken for granted in the West and listed anyway in communist constitutions. In neither country communist elites expected to lose. How sure of themselves they had been was shown by Polish communist leaders' concerns what extra concessions to offer to appease frustrated 'Solidarity' after the latter's imminent electoral debacle (as readers may recall, 'Solidarity' candidates won all contested seats except one — and that one to an independent millionaire, not to a communist opponent...).

As expected by almost everybody, except ruling elites misled by their own propaganda, communists lost heavily in both Poland and Hungary. They now belong to the political past, regardless of the sincerity of their reformist zeal, somewhat greater in the latter than in the former country. The political regime change transformed also the nature of the privatisation debate. Highly academic, in the sense of being removed from the field of policy-making (monopolised until then by the communist ruling stratum), various privatisation options debated within narrow groups of professionals became suddenly competing policy alternatives.

Unconvincing Irrelevancies and Costly Nonsenses: Early Denationalisation Ideas

Although serious privatisation debates started only in the late 1980s, the whole decade was in fact a period of experimenting and theorizing. As usual they started in Hungary in 1982 with the formal acceptance of various forms of small cooperative ventures of which so-called enterprise work partnerships (Hungarian abbreviation VMGK) became most popular. Established by workers and pensioneers from a given enterprise they were little more than work teams performing various production and other tasks on contract basis. Hailed sometimes by some naive collectivists as being the vanguard of the 'cooperative renaissance' (see, e.g., Dellenbrandt, 1988), these ventures were criticised by other theorists.

Instead of accepting this invention as an injection of entrepreneurship into the state enterprise, as suggested by official propaganda, theorists pointed to many disadvantages of enterprises work partnerships. The most damning was the argument that VMGK were, in fact, little more than convenient tools allowing managers to cope with system-specific labour shortages. Teams doing extra work could be paid more on contract basis than overtime rates specified in wage regulations. They were all the more convenient since workers doing extra jobs were paid from other funds than the strongly controlled wage fund (see Laky, 1984 and 1985).

More traditional cooperatives also increased their number in Hungary, as well as in Poland, in the 1980s but did not generate much discussion about their constitutive role in shaping future ownership structure in these economies. This was in marked contrast with what happened in the

USSR in the early stages of Gorbachev's *perestroika*. In the latter country the new cooperative sector has been widely regarded as a substitute for privatisation by the authorities.

Although not only official propaganda but also some well known economists, e.g. a long-time dissident Lisitchkin, support cooperatives as a major step forward, the present writer remains unimpressed. After all, cooperatives are a well known alternative to private ownership. In the West, where genuine cooperative sector has a long history, it has never achieved much in terms of its competitive position *vis-á-vis* private sector. Even the most sympathetic but realistic analysts (see Wiles, 1977) relegate it, however regretfully, to the margin of economic activity.

It is doubtful whether cooperatives in the USSR will face, under more normal circumstances, different future. If, or rather: when private ownership is allowed, it is going to outcompete the cooperative sector in most activities. More probably, a large part of cooperatives will change its ownership form, once such changes become possible (and stable political conditions will guarantee private property rights). One way or another cooperatives will not in all probability become a major factor in the future ownership structure of the Soviet Union (or, more probably: Russia).

Now, if cooperatives as a denationalisation measure are of little more than marginal usefulness, other measures such as leasing of state enterprises may become a very costly mistake. Their ideological origins are the same as in the case of cooperatives: they were tailored to stay within the range of collective ownership-based solutions. In the case of leasing the owner remain the state. But it is theoretical implications of leasing as conceived in the USSR that matter here.

Leasing, especially in agriculture, is a solution with a history stretching in our part of the world back to Middle Ages. The fact that it all but disappeared in the West and private ownership dominates the agricultural scene points unmistakeably to the inferiority of this particular solution as far as efficiency is concerned. Leasing of land has well known disadvantages (need for protecting land against premature depreciation caused by leaseholder's careless treatment, see Eggertsson, 1990, and the literature quoted therein). Still, Soviet long-term lease programme is, theoretically, a step forward compared to *kolkhozes* or *sovkhozes*. In practice, the uncertainty as to the land pricing, the ill-defined tax regime and — more generally — the hostile bureaucratic environment altogether reduce the benefits of the solution.

Leasing in agriculture is obviously an inferior solution relative to private ownership. Since lease-holders have no right to sell or even sub-lease land at scarcity prices, there is no mechanism for moving resources from less efficient to more efficient uses (see Pejovich, 1990). But under the Soviet circumstances it is a kind of half-way house between collectivist solutions of the Soviet system and full-fledged private property. It is imaginable that leasing could become a first step in getting agricultural workers acquainted again with a modicum of care for land and other assets. Privatisation proper would come as a next step.

The same cannot be said about leasing the whole factories, whether to managers or employees' collectives. The former were practiced on a small scale in Poland (see Gruszecki, 1990), while the latter only in the USSR. Agency costs of control over whether the proper care is taken by a leaseholder with respect to leased land (and a few other assets) are peanuts in comparison with the costs potentially involved in control over whether the same proper care is taken of a highly complex set of assets that industrial enterprise consists of.

Huge bureaucracies would have to be maintained, not dissimilar to those created in the traditional Soviet system for that purpose — and without much prospect for success given the informational asymmetry between these bureaucracies and enterprise managers. It should be kept in mind that it is precisely this asymmetry that left hierarchical bureaucracies in STEs at the mercy of state enterprises as far as dependence on information is concerned. The room for shirking and opportunistic behaviour remains enormous.

Agency costs, and resultant efficiency problems, increase still further in the case of leasing to collectives (enterprise employees) due to the collective nature of the lessee. Leasing to a collective

numbering hundreds or even thousands of co-leaseholders would create the need for internal bureaucracy either paid by co-leaseholders or chosen from among them to control opportunistic behaviour of co-leaseholders themselves. Collective leasing, if applied on a larger scale, would add to the enormous problems of the declining Soviet economy rather than bring in some relief (for early critique of such a lease concept, see Winiecki, 1987; see also a critique of similar experiments in China by Savas, 1990).

The same agency cost-based critique may be applied to yet another leasing concept developed by the late Tibor Liska (1988). In his posthumously published book he suggested a kind of perpetual auction of state assets with the lease going to the highest bidder. In this way the state would realize the highest income on its assets.

On top of the agency problems of control over whether the proper care is taken with respect to the complex assets leased to individuals or collectives resulting from informational asymmetry, there are also additional informational problems facing the auctioneer. There would be valuation problems with the initial price, where there is only one bidder (or where there is a collusion among bidders). Even more daunting would be problems with time horizon of an auctioneer. Tardos (1989), criticizing the concept, rightly stresses that there is no rule preventing yet another auction if a new bidder would emerge offering higher initial price than the one for which assets were leased.

This would increase sharply the uncertainty as to the stability of whatever property rights a lessee possesses to the leased property and, accordingly, would reduce sharply the latter's care of that property. Thus, the concept is self-defeating due to the incompatibility of incentives with expected behaviour, very much like the Lange-Lerner concept of central planning board (see the next section).

State Enterprises on the Stock Market or 'Wall Street Made of Plastic'

Privatisation debates of the late 1980s registered also many extensions of the basic idea of preserving state ownership while introducing capital markets as an efficient allocating device. Protagonists of the idea recruited themselves from two different orientations. On the one hand, we had those who were more or less closely associated with the communist ruling elites and looked for solutions that would improve efficiency, while retaining to a large extent control over state assets in the hands of these elites. On the other, we had those who for ideological reasons wanted to salvage socialist ideas from the debacle and, consequently, supported 'market socialism' as a next line of defence. Regardless of their motivation, both based their proposals on the idea that the market can be made somehow to serve socialist goals just as it now serves capitalist ones.

All proposals required the conversion of state enterprises into joint-stock companies and they differed mostly by suggestions as to the distribution of shares of transformed state enterprises. Some protagonists of the idea suggested state-owned institutional investors (banks, insurance companies, other state-owned enterprises, universities, hospitals, etc.), municipal and other local authorities, foundations, etc. (see, i.a., Tardos, 1988a, 1988b, and 1989). Others combined distribution of shares among such non-private institutional investors with specially created state-owned financial institutions: holdings, state investment banks, investment trusts, etc. (e.g., Iwanek and Swiecicki, 1987; Swiecicki, 1988; Matolcsy, 1989) or concentrated purely on the latter (e.g., Gomulka, 1989).

All protagonists of these ideas based their proposals on the (explicit or implicit) premise that the incentive structure under different forms of ownership remains identical. Therefore, it is enough to sever the link between state (public) administration and state enterprises through the distribution of shares of the latter across existing and/or new state institutions and allow the latter to play on the newly established stock market. Rules of such simulated stock market game were outlined in some cases as well (such as the proposal prepared by Gomulka for the last communist government in Poland, identical with ibid.).

Gomulka (1989) suggested the creation of a network of state-owned investment-commercial banks (ICBs) with all enterprise shares divided equally among them. These banks would become what he called de facto owners. In accordance with his proposal (ibid., pp. 3-4), 'banks behave as if they have rights of ownership in ... selling shares among themselves, disposition of dividends and other income for investment purposes ...and a right to elect enterprise board of directors' (the last right whenever a given ICB acquired a high enough percentage of shares in a given enterprise). ICBs would also have a right to sell a limited percentage of shares to the private sector, including foreigners. In his own words, ICBs would have all the rights of private owners, 'except the proportion of incomes for their own needs' (ibid., p. 10).

These premises were augumented sometimes by what was regarded as a historical argument. E.g., Tardos (1989) stressed that in contemporary capitalist economies large part of assets is owned by banks, mutual funds, insurance companies, non-profit institutions, etc. The distribution of a large part of the shares in state enterprises converted into joint-stock companies would achieve the same by government fiat what has been the outcome of long evolution in the West.

These and similar ideas (in the last few years particularly popular on the left in the West, see e.g. Nuti, 1988 and 1989; Market Socialism, 1989) have been criticised from two theoretically different standpoints. Lewandowski and Szomburg (1988), as well as Kornai (1989 and 1990) and Winiecki (1990b), criticized them from the viewpoint of property rights theory.

Lewandowski and Szomburg traced these views to earlier illusions based on 'as-if' thinking. The first floor of illusions was built by Lange, Lerner and others who imagined that some central planning board would be 'playing at the auctioneer'. In response to price stickers state units would respond with quantities and price changes would reduce demand or increase supply or both. Those illusions were laid to rest already during the Stalinist period. Managers of state unit did not behave in accordance with the foregoing illusions. They demanded as much inputs as they could and offered as little output as they dared.

Next floor of illusions was built by those whom Kornai (1986) dubbed 'naive reformers' (and that, as he admitted, included himself). They believed that what was needed for state enterprises was room for independent decision-making with respect to current output to maximize profits. Strategic control over labour and capital allocation were to remain in the hands of the state. However, managers gladly accepted increased room for manoeuvre they gained as a result of devolution of decision-making and used it for their own advantage.

They made more assortment shifts to fulfill plans with smaller quantities of more costly products, lowered quality without commensurate price decreases and, most of all, substituted more profitable pseudo-novelties for standard products. Still larger share of output became a figment of statistical imagination. Furthermore, their demand for production factors did not change. Since the risk of financial failure continued to be nil for managers (for the resources were not their own) they pressed for more of everything as before. Disequilibria were again spilling over from factor to goods markets and excess demand did not disappear.

By late 1980s third, and last, floor of illusions was reached. It became obvious that without markets, where economic agents take capital risk, no meaningful improvements are possible. But illusion persists that it is possible to devise a scheme imitating capitalist financial markets with state-owned institutions substituting for those who risk their own capital. Such schemes usually stress the decision-making based on financial attractiveness and the due weight given to a degree of riskiness of investment.

As the present writer stressed it (Winiecki, 1990b), however, the question is: whose risk? Bureaucrats who would run holdings, investment banks or investment trusts (all state-owned) do not risk their own money in the 'playing the stock market' game. Under such circumstances almost any investment may be attractive and any level of risk deemed low.

There is a world of difference between the shareholder who uses his own knowledge or hires a specialist to play the stock market with his own money and a bureaucrat who risks state (i.e. taxpayers) money. As Kornai (1989 and 1990) aptly points out, 'simulated joint-stock companies, the simulated capital market, and the simulated stock-exchange' and the like 'add up to ... Wall Street — all made of plastic!' (1990, p. 72).

The central pillar of the capitalist market economy is — not surprisingly — a capitalist, an individual who risks his own resources. He is either an owner-manager or a shareholder, and in each case he reaps the rewards of success or suffers the losses of failure. Without such individuals no abstract 'market economy' or 'capitalism without capitalists' is going to perform efficiently. In terms of property rights theory the argument is, then, that private ownership by linking decisions with respect to allocation of capital with capital gains and losses assigns the rights better than state ownership.

This, i.a., disposes of the argument in favour of share distribution across state institutions such as banks, insurance companies, etc. In the West there are individual owners behind most institutions and, dissatisfied with the level of dividend, they can 'exit' (in Hirschman, 1970, terminology), that is to sell shares and,in consequence, facilitate takeover and resultant improved performance. Or, if they are substantial enough shareholders, they may make their 'voice' heard and initiate management shake-out. Bureaucrats running state institutions do not risk their own money and may be much more tolerant of low dividend — and for longer period at that.

Besides, as stressed rightly by Kornai (1989 and 1990), the share of assets held by institutional investors in the West may already have passed the threshold at which efficiency of the system begins to decline. Recent alarms over too passive behaviour of members of the board of directors representing institutional investors (Economist, November 19, 1990) are a case in point. Emulating such pattern may be even more harmful for the fledgling capital markets in countries undergoing transition to the capitalist market economy.

Simulated capital markets with state-owned enterprises and other institutions were criticized in the debate from yet another viewpoint. Kawalec (1989) underlined the unrealistic expectations of non-intervention by state authorities in the affairs of state enterprises in whatever legal form, including joint-stock company. With the representatives of the Treasury and other state institutions sitting on the board of directors, the conflict enterprise profitability vs. wider government goals is inevitable. And the victim is usually profitability.

In the empirical study of West European state-owned companies quoted there, Walters and Monsen (1983) stated conclusively: "We have not been able to discover a single case of a top executive of a European nationalised company who was replaced for failing to earn a required rate of financial return. By contrast, there are dozens of cases of managers who have resigned in protest, been fired, or were not reappointed because of a major disagreement with their governments over policy".

In terms of public choice theory, Kawalec (1989) was saying that (apart from much greater room for opportunistic behaviour in state-owned than in private enterprises) politicians and bureaucrats are not impartial umpires deciding on issues in the best interest of the public. They have their own interests (reelection in the former or empire-building in the latter case) and these interests influence their relations with enterprise managers. The foregoing creates additional inefficiency in the performance of state-owned enterprises.

Employee Participation-Based Options

In Poland there has been a long tradition of workers support for self-management. Naturally, when privatisation (or, more precisely, denationalisation) debate got under way various forms of employee-participation-based options were suggested. Self-management was an earlier proposed one

(see, i.a., Roman, 1987 and 1989; Bugaj, 1989). The extensive theoretical criticism of self-management, however, from Barbara Ward (1958) to property rights analysts (Furubotn and Pejovich, 1970; Furubotn, 1976; Pejovich, 1987 and 1990) on the one hand and disastrous experience of Yugoslavia on the other ensured the unfavourable reception by other participants in the debates.

Lewandowski and Szomburg (1988) stressed the non-transferability of property rights under self-management and resultant adverse consequences for the efficient allocation of resources via capital markets. Kawalec (1989) referred to Ward's criticism of average wage maximization as a maximand of a self-managed enterprise. Gruszecki (1989) was warning against landing on sidelines of the civilization as a result of such choice (tantamount to a 'third road'). He accepted self-management only as temporary trustee of a block of shares alotted to employees at an early stage of privatisation process (1990a).

Over time, this option was relegated to the back seat and believers in employee participation of one sort or another shifted their allegiance to employee share ownership. The experience of U.S. firms with employee share ownership plan (ESOP) as a way toward 'people's capitalism' has been strongly advertised and many self-management enthusiasts referred to these ready-made procedures. ESOP, however, has been a heterogenous phenomenon and included both the facilitation of purchase of fully transferable shares in joint-stock companies by their employees and employee-owned firms, where shares are first offered for repurchase by other employees or by a firm itself. The former version of employee share ownership offers some advantages, the latter — bypassing capital markets — is much less promising. It is the latter type of ESOP option that Kawalec (1989) criticised as having lasting preference of wage increase over profitability increase, thus not differing in reality from self-managed enterprises.

But altogether employee share-ownership was received much better in the privatisation debate than self-management. Some analysts stressed the advantages of privatisation through the free distribution of shares to employees as a most rapid method of privatisation. Especially Krawczyk (1988 and 1990) was the strongest protagonist of the solution. He insisted, rightly, on full transferability of shares that should ensure, in his view, future emergence of the full-fledged stock market.

Others agreed that distribution of shares to employees does offer a shortcut but were more sceptical about the time path leading from wholly employee-owned to a more normal pattern of ownership with outside shareholders having controlling blocks of shares. Therefore, they suggested (see, e.g., Winiecki, 1989) only partial distribution of shares to employees to reduce the time needed to reach such normal pattern.

In the programme prepared at the request of the parliamentary club of 'Solidarity' by a group of economists (Beksiak, Gruszecki, Jedraszczyk and Winiecki, 1989 and 1990) a proposal was made to offer 20% of shares to employees at the start of the privatisation process. In this way a clearly identifiable group of shareholders would emerge from the start to reduce the costs of control over management.The state treasury would own the remaining 80% but without voting rights. Over time, as the remaining shares are sold or distributed free of charge, new controlling shareholder groups would emerge. The authors perceived some of the problems associated with employee ownership of that sort but thought that advantages outweighed them in the short run.

Political unacceptability of the distribution of shares to employees only was also stressed in the debate. Distribution of assets to employees is doubly unjust. First type of injustice was already pointed out more than half a century ago by a noted British economist who said caustically that the slogan 'mines to the miners' means also 'dirt to the dirt collectors'. Quite obviously, those employed in highly capital intensive industries would gain much more than those employed in labour intensive ones. No less obvious is the second type of injustice excluding those who work in what has been conventionally called public sector: teachers, medical personnel, public administrators. (On these points, see Lewandowski and Szomburg, 1988; Tardos, 1989).

Only with time, a more thorough critique of ESOP emerged in the debate. This was determined by the relatively limited knowledge of the working of employee share ownership in practice, as well as by the already stressed heterogeneity of the concept. Only over time came the realisation that the much heralded profitability of ESOP firms has been seriously overstated. The assessments were quoted, which referred to built-in tax advantages of ESOP firms. They can reduce the tax base by subtracting both interest and instalments on credits drawn to finance employee share ownership. Dividends paid to employees are also tax-free. Losses to the treasury in the United States are estimated to be in the range of tens of billion dollars. (These data were quoted in Zarzadzanie, 1990, No. 6/7).

Gruszecki and Winiecki (1991, forthcoming) criticised closed employee ownership firms and those, where the controlling block of shares remains in the hands of employees from the efficiency viewpoint. The authors stressed that these firms tend to choose inefficient factor proportions due to disincentives to employ labour saving technologies and excessive incentives to employ capital intensive ones. Thus, in spite of extending the time horizon of employees-shareholders investment decisions (an improvement over the self-managed firm) the structure of these decisions remains biased. In concordance with earlier critique of Lewandowski and Szomburg the authors also stressed the general decline of efficiency of the economy, where the role of capital markets as the main vehicle of financial resource allocation is reduced due to the dominance of firms, which bypass those markets.

Althogether, the critique did not reject the concept of employee share ownership. Many schemes included an idea of setting aside certain (minority) block of shares to be distributed freely or sold at reduced prices to employees of privatised firms. Closed employee ownership was, however, rejected by all except enthusiasts of the idea.

This was even more true with respect to the idea that ESOP firms should become the dominant form of ownership in the economy. Gruszecki and Winiecki (ibid.) argued that ESOP firms do not fall behind their private competitors for the same reason that state enterprises in the West often do not fall much behind, namely they are forced to behave not too differently than others in the competitive environment of privately-owned firms. The removal of this constraint by making ESOP firms dominant would lead to the overal decline in the performance of the economy.

In contrast to ideas of simulated financial markets by state-owned firms, which by their very nature had to be either accepted or rejected in toto, employee share ownership did not require an 'either-or' approach. This statement pertains in particular to minority share ownership by employees. Therefore, protagonists of other schemes in Polish debates quite often conceded the need for supplementing their preferred scheme by some form of employee share ownership.

Another distinct feature of self-management and ESOP proposals was the fact that they were so important part of only Polish privatisation debates. In Hungary and later in Czechoslovakia they were of marginal importance, while in Yugoslavia they were less a part of intellectual debate than an effort by the communists to save their dominant position and prevailing ideological dogma.

Selling or Giving Away to the Public: Competing Liberal Alternatives

Although regarded as extremely radical even by 1989 (see Tardos, 1989; Asztalos, 1988, and Kawalec, 1988 and 1989), the privatisation through the public sale of shares of state enterprises in the typical British style quickly became regarded as a matter of course with regard to large and medium-sized state enterprises. Variations on the scheme concerned conditions of sale (availability of credit for the purpose of purchasing shares), preferences for enterprise employees (discounted price offer, credit availability, etc.), or the access to share purchase by foreign investors.

The privatisation in the United Kingdom is well known both with respect to its goals and techniques. Therefore they need not be repeated here. What matters is its applicability in the very

specific conditions of post-communist Poland and other countries in transition from plan to market. Many analysts regard the applicability of this scheme as its Achilles heel.

Weaknesses of the scheme are numerous, some of them only serious, while other near fatal. Relatively less damaging is the impossibility of establishing proper price of assets in the economy without the stock market (and, more generally, with very rudimentary financial markets). Neither valuation on the basis of depreciated value of past investment nor replacement cost are minimally satisfactory. What is left is valuation by experts on comparative basis. Less than satisfactory, the latter approach requires nonetheless a lengthy — and costly — involvement of foreign consultants able to apply comparability principle.

As the number of enterprises to be privatised increases, so does the time span and scarce human resources necessary to do the job. It is at this point that serious weakness becomes near fatal. In a country where there are about 7000 industrial enterprises to be possibly privatised privatisation by public sale of shares would have to last for decades if not centuries (Szomburg, 1989; Winiecki, 1989; Gruszecki, 1990b; Gruszecki and Winiecki, 1991).

The most eloquent protagonist of repetition of the British style privatisation, Kawalec (1988 and 1989), expected that the sale of 2/3 of all industrial assets would take in Poland 15-25 years. The present writer regards this expectation as rather optimistic.

Let it be noted that some analysts added other requirements that stemmed from their different ranking of privatisation goals. Thus, Kornai (1989 and 1990) stressed the need of clearly identifiable owners of privatised enterprises. Therefore he suggested privatisation only, when the government found those ready to buy a controlling block of shares in a given enterprise. Once this was accomplished, the remainder could be sold to the general public. For Kornai reduction of agency costs and resultant more efficient owners' control was more important than the goal of spreading widely the shareholding, that is 'people's capitalism'. It is difficult to disagree with Kornai on the overriding importance of efficient owners' control but his insistence on this point makes the lengthy process longer still.

The privatisation by sale, either to general public or to selected parties (or to both, in the reverse order), is additionally complicated by the fact that impoverished societies of post-communist countries do not have sufficiently high savings to be able to purchase existing state assets. Besides, whatever limited savings individuals possess, it is certainly better that they use them to establish new small businesses or put them to other more efficient uses through financial intermediaries. On the other hand, once the money from share purchase finds itself in the state coffers, the probability that it will be used to further the expansion of private sector in one way or another is rather low.

For all these reasons, a consensus emerged only with respect to small enterprises. Almost everybody agreed that they should be sold to the highest bidder on auction basis (see, e.g, Kawalec and Kuczynski, 1989; Winiecki, 1989; Beksiak, Gruszecki, Jedraszczyk and Winiecki, 1989 and 1990c; Kornai, 1989 and 1990; and, less unambiguously, also Tardos, 1989). The same has been true in the case of Czecho-Slovakia, where controversies existed only with respect to the method of privatisation of large and medium-sized state enterprises (see below).

Now, if share sale option as an exclusive solution is criticised as infeasible, what other options emerged as its alternative? Many proposals were formulated but if one cuts through the intricacies they all are varieties of only two basic variants of free distribution of shares. One of them, namely the free distribution of shares to employees, was considered earlier. Thus, the following considerations concern the other variant, that is free distribution to the general public.

The idea of giving state assets back to the public, with whose money it was established in the first place, was not completely new, when it was launched in by two liberal economists Lewandowski and Szomburg (1988, and later 1989a and 1989b; Szomburg, 1989; in an interview with both authors, 1990; etc.). It was first proposed in this fashion by Milton Friedman (1976) as a recipe for ills of public sector in Italy and the United Kingdom. It was reformulated a few years later by

Brittan (1983 and 1984), as an alternative for the official privatisation programme of British government.

Beside classical liberal, property rights-based arguments in favour of free distribution of shares to the public, Lewandowski and Szomburg stressed the extreme shortage of capital in Poland (and elsewhere in the impoverished, then still communist, economies), its skewed distribution (largely in favour of nomenklatura) and — even more importantly — the psychologically reinvigorating effect of becoming owners of something after decades of being atomised objects of economic manipulations by the communist state. They called it 'propertisation' (uwaszczenie) of the society.

In later assessments after the communist collapse a political factor, namely expected wide public support for such a scheme, was also underlined as speaking in its favour (see, e.g., Szomburg, 1989). As noted at the beginning of the paper, political change made intellectual considerations a raw material for political action and, consequently, proposed privatisation alternatives had to take political feasibility into account.

Lewandowski-Szomburg's proposal was first met with severe criticism (if not actually verbal abuse!) but the support for it grew rather rapidly. Furthermore, it spun off a large number of similar, although modified schemes (Kostrzewa, 1989; Dembinski, 1990; Frydman and Rapaczynski, 1990; etc.). The present writer sympathizes with the foregoing aproach (see Winiecki, 1989 and 1990c; Gruszecki and Winiecki, 1991). In its original form, however, the Lewandowski-Szomburg scheme would have some unintended adverse consequences.

Its authors envisaged that all legally adult Poles (i.e. those 18 years old and older) would receive property coupons of a certain nominal value amounting to a fraction of state assets to be privatised in that manner divided by a number of persons entitled to receive the property coupon. Coupons would be registered and would not be transferable. They could be used only to buy shares of privatised enterprises on the stock market.

In reality, no limitatation could stop coupon owners from selling coupons earlier and turning over shares to coupon buyers later on. This is, however, of marginal importance only. A much more serious problem is associated with the fact that the scheme would result in an extremely wide dispersion of ownership. Its consequence would be the dominant position of managers *vis-á-vis* shareholders with all the consequences for efficiency stressed in the Berle-Means type of literature.

Now, these consequences turned out to be grossly overstated (if not actually unfounded) in the case of Western capitalist market economies. But these economies have reasonably well functioning stock markets, markets for corporate control, i.e. threat of takeover is effective, and markets for managerial talents (the classical reference is Jensen and Meckling, 1976). Their existence constrains the range of choices that managers make and reduce agency costs.

This, however, is not the case in post-communist Poland, or elsewhere in East-Central Europe. They have rudimentary financial markets at best, nonexistent or emerging stock markets, possibilities of takeover are untested and markets for managerial talents do not function at all. Thus, until a certain degree of reconcentration is achieved, agency costs will significantly reduce efficiency benefits of privatisation.

Perceiving the problem Lewandowski and Szomburg originally (1988) stressed the need of preferred shares (giving their owners the right to a larger number of votes per share). These shares would be distributed among employees so that there would be from the start an identifiable group of shareholders in control. For unknown reasons this precautionary measure has been later dropped from their scheme with the resultant critique of the sort made above. Let it be reminded that this is what has also been aimed at in the programme prepared in Autumn of 1989 for the parliamentary club of 'Solidarity' (Beksiak, Gruszecki, Jedraszczyk, and Winiecki, 1989 and 1990), although the vehicle used to achieve the same aim was different.

Yet another serious problem of Lewandowski-Szomburg's scheme are very high transaction costs of choosing by each citizen from among shares of very many privatised enterprises. Even in

capitalist West there is only a percentage of the total number of citizens who has ever dealt with commercial papers (shares, bonds, etc.). In countries entering only into the age of financial markets popular knowledge on the subject is next to zero.

Therefore, some protagonists of the free distribution of state assets across citizenry suggested various modifications of the scheme. These modifications generally tended to reduce the transaction costs by suggesting intermediating arrangements and institutions. It is assumed that financial intermediaries are more efficient in their business decisions than average citizen baffled by thousands of opportunities, knowable in priniciple for individuals but at the prohibitively high transaction costs. With the existence of these institutions initial task of individuals would be simpler. Instead of deciding about the relative performance and prospects of hundreds or even thousands of enterprises they would decide about a few dozens of financial intermediaries only. The task of choosing from among them and rearranging their portfolios accordingly would be relatively easier than under the original scheme.

The modifying schemes differ among themselves in some respects. An important difference is the choice of financial institutions. Some analysts suggested mutual funds, institutions interested in financial performance of firms whose shares they own (e.g., Dembinski, 1990) other preferred holdings or investment banks,by their very nature interested also in intervening in the management of privatised enterprises (e.g., Blanchard and Layard, 1990). Frydman and Rapaczynski (1990), although they used the term mutual funds, obviously wanted their funds to intervene in the management rather than influence it through selling shares in those enterprises they are dissatisfied with.

This writer suggested already that mutual funds in their normal functions are better suited to privatising post-communist economies than holdings, because the latter would make the normal functioning of the market for corporate control well nigh impossible. One may imagine a private entrepreneur in Poland or Hungary raising enough money to buy a privatised enterprise whose assets he regards as undervalued. But if this enterprise is controlled by a holding the only way to do it would be to take over the holding as a whole — a financially impossible task at this stage of capitalist development (see Gruszecki and Winiecki, 1991).

Another dividing issue is the attachment to the idea of the activist state doing everything better — even the privatisation. Some analysts, even having accepted privatisation, still think in terms of the state holdings, or state investment banks, or 'state something' that would be main vehicles of such privatisation (see, adjusted scheme by Gomulka, 1989; Blanchard and Layard, 1990;and others). An alternative is to 'privatise privatisation', to use the catchy slogan of Frydman and Rapaczynski (1990) and use private firms as privatisation intermediaries. It is worth mentioning, however, that the original idea of using private institutions acting according to profit-maximizing principles goes again to Milton Friedman (1976). He suggested the use of mutual funds, election to the board of directors by citizens-stockholders, and finally incorporation of these funds as private entities. Their shares would sell on the capital markets.

Whatever their advantages, all these proposals have been mostly reactions to the original Lewandowski-Szomburg scheme. The latter, thought by its authors as an 'intellectual provocation' formulated in last days of the communist system in Poland, became in a very short time span a legitimate privatisation option, and the one finding a lot of political support. (It became also the major privatisation option in the neighbouring Czecho-Slovakia.)

Privatisation Debates: Arguing Means Rather Than Ends

The intellectual *tour d'horison* of privatisation proposals has been completed with the end of the preceding section dealing with two privatisation options based on liberal principles of the need for the dominant capitalist private sector in the post-communist Polish economy. As seen from the

survey of the debates, they mostly concentrated on means or methods of privatisation — or on how to denationalise — rather than on ends. This has been, n.b., a characteristic feature of such debates in other post-communist countries as well.

To be more exact, ends were not completely neglected. Rather, they were formulated in very general way as the 'return to the market', or — more boldly — 'shift from socialism back to capitalism'. But this is not enough. There are many more specific goals of privatisation that are not equally easily achieved by all privatisation methods. Therefore, by concentrating on methods (sale vs. free distribution; distribution to employees vs. the general public; etc.) discussants were putting a cart before a horse (Winiecki, 1990d).

Rarely they tried to rank their goals and then link goals with most appropriate means. No less rare were cases of using the range of privatisation goals to compare alternative proposals. There were some exceptions in Poland (Szomburg, 1989; Beksiak, Gruszecki, Jedraszczyk, and Winiecki, 1989 and 1990d; Winiecki, 1990) and elsewhere (Kornai, 1989 and 1990). In most cases ends were taken as given, without realizing that goals of privatisation, e.g., in the United Kingdom or France, where capitalists are present and active, may be different than, say, in Poland or Hungary, where they do not exist. Therefore a goal of spreading widely asset ownership, although important, may not be of overriding importance. The creation (or rather re-creation) of the capitalist class may take precedence as a privatisation goal. The foregoing implies also a need for an evaluation to what extent post-communist societies should take Western privatisation as a model.

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