PRIVATIZATION, PROPERTY RIGHTS AND DEVELOPMENT POTENTIAL: LESSONS FROM POLAND AND RUSSIA

Marshall I. Goldman
Wellesley College
and
Harvard University

Recent events in Russia have necessitated a re-examination of one of economics' most sacred tenets. No longer can it be asserted that private property rights are necessarily a force for economic growth and political stability. For the most part, private property rights do play such a role, but under the wrong circumstances, private property rights can become a destructive force which may threaten not only economic growth but the political stability of the state. An examination of privatization in Poland and Russia vividly illustrates how property rights can produce such extremes. Indeed it is hard to find a more dramatic contrast than the economic transitions in Poland and Russia. It is not just that in the aftermath of the transition Russia's GDP fell by 40 percent from 1991 to 1998, including a 5 percent decline in 1998, or that Poland's GDP since 1992 has grown an average of 6 percent a year, making it one of the most robust economies in all of Europe [Interfax, 1998]. Poland has also managed to survive the economic upheavals of 1989 with relatively minor damage. By contrast, in Russia, August 17th 1998 was like an economic meltdown. The government defaulted on its debt, the banks became insolvent, and the stock market crashed. Even more important, Poland has been spared many of the more extreme economic and social distortions such as Mafia dominance, corruption, crony capitalism, and the massive thefts of what only a few years ago was state property, all of which characterize Russia today. Certainly Poland is not immune to such blights, but compared to Russia, its problems are barely worthy of concern.

Given that both countries were communist, as well as neighbors, and both began to move to the market and political reform about the same time (Polish political reform began in 1989 and its economic reform in 1990. In Russia political reform began in 1988 and systematic and far reaching economic reform in 1992), why is it that the results have been so different? No one simple set of factors can explain everything. Certainly Poland's proximity to Western Europe, especially West Berlin, as well as the fact that communism was imposed on it by the Soviet Union, and that communism lasted only 45 years in Poland, not the 70 years that it did in the Soviet Union, influenced the outcome.

The adjustment in Poland to the market was also facilitated because of the small but legitimate number of private businesses tolerated at the time by the Polish com-

Marshall I. Goldman: Davis Center for Russian Studies, Harvard University, 1737 Cambridge St., Cambridge, MA 02138. E-mail: goldman@fas.harvard.edu

Eastern Economic Journal, Vol. 25, No. 4, Fall 1999

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Lewandowski, a minister of parliament from the Union of Freedom party and the Minister of Privatization from 1991 to 1993, offered a blueprint for privatization shortly thereafter in 1991 [Goldman, 1997]. Working in conjunction with Leszek Balcerowicz, Lewandowski's proposed programs sparked political debates which prevented implementation of the program until late 1994-early 1996. This inadvertently provided time to build up funds among the broad spectrum of Poles. Had the privatization effort been carried out earlier, the only bidders would have been those who had seized for themselves what had been government assets or members of Mafia-like criminal groups who simply stole the money. In the immediate aftermath of the breakup of the communist state, there were very few who could have legitimately built up a capital state in such a short time. As we shall see, this was exactly the problem in Russia.

Lewandowski deserves enormous credit for having the insight, not only to understand the likely consequences of an unstructured privatization process, but also, for designing a scheme that would serve to nullify at least reduce the likelihood of such abuses. He sought to achieve several goals:

- He wanted to prevent the factory directors from gaining direct or indirect control of their enterprises. Without provision for some outside controlling ownership voice, the factory directors would most likely style any effort to restructure the enterprise, both in terms of changes in personnel, including the firing of the factory director himself, as well as closing down or selling off parts of the enterprise.
- He also wanted to facilitate the bringing of foreign specialists and advisors in order to provide guidance to managers unequipped for dealing in a market economy.
- At the same time, he also wanted to maintain Polish, not foreign, ownership of those assets.
- Finally, he also sought to ensure that every Pole (this meant average citizens as well as workers in the factories being privatized) could derive tangible benefits from the privatization process. That meant not only having access to an initial stake in the about to be privatized enterprises, but also sharing in any increase in value that might come from the future operation of such enterprises.

The Lewandowski proposals had several steps. For the public at large there were the vouchers. In 1991, each citizen was entitled to buy one voucher for 20 zlotys (or about 6.20). 25.9 million Poles, out of an eligible total of 27 million, chose to exercise that option. Each voucher in turn was exchangeable for one share in each of the fifteen state-owned investment funds. These investment funds were the innovative aspect of the Lewandowski plan.

Lewandowski selected 600 out of Poland's 844 state enterprises and those 600 were divided up into fifteen batches [Polish Agency, 1998, 24]. Ultimately, the list of 600 was narrowed to 512. He decided to lump these businesses together in one package because if privatization went one firm at a time it would have been too time-consuming and too hard to supervise. He excluded another of the state's 3,000 enterprises, 1,100 because they were too small, and others because they were weak and needed to be dissolved or liquidated. Another 1,500 were turned over to local authori-
ties to be privatized under their auspices. As of 1997, this left about 4,000 enterprises still owned by the state, primarily in key economic centers such as telecommunications, finance, chemicals, raw materials, steel, and energy. Because of their size and their importance, most of these 4,000 will be privatized one by one. In contrast, the state will retain ownership of the railroads, the electrical grid, and the post office.

The Lewandowski plan was unusually innovative. Lewandowski proposed to divide the 512 companies selected for privatization among 15 National Investment Funds (NIFs). The NIFs would in effect operate as mutual funds and their portfolios would consist of the shares of the 512 companies. But that was not the most innovative part. The privatization authorities recognized that if the shares of stock were divided up into equal parts, the factory director would effectively control the factory as before and operate as the defector owner. When power is diffused over too many different partners, the odds are that no one is able to muster effective control. To prevent this, the authorities decided to divide the 512 companies being privatized into 15 groups of 34 companies each. It then allocated a 33 percent share of stock in each of the 34 companies to one of the 15 NIFs. The NIF's bid against each other in a football player-like auction in an effort to win 55 percent control over the most promising 34 enterprises. That meant that each of the 512 factory directors would be accountable to one dominant outside overseer, an NIF. The other 14 NIFs would then be provided a 19 percent share of the remaining 478 enterprises that were in the privatization pool. See Table 1. Together with their 33 percent holdings in 34 companies and 19 percent in 478 companies, the NIFs would have control of 60 percent of each of the enterprises' stock. 15 percent of the remaining shares would be distributed to the employees and directors of the enterprises, and 20 percent would remain with the state. The state in turn placed 15 percent of its shares into social and pension funds. This was intended as a further effort to ensure that the public at large would benefit from the privatization process.
<table>
<thead>
<tr>
<th>The National Investment Funds</th>
<th>Supervisory Board Chairman</th>
<th>Fund Manager</th>
<th>Principle Participants in the Fund Manager</th>
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<tr>
<td>First National Investment Fund</td>
<td>Mr. J. Janki</td>
<td>BBG-City Credit Management Sp z o.o.</td>
<td>Bank Hipotekarowy (Poland); Bank Zamojski (Poland); Credit Suisse (Switzerland)</td>
</tr>
<tr>
<td>Second National Investment Fund</td>
<td>Mr. M. Wójcik</td>
<td>Kredytobanca Sp z o.o.</td>
<td>Bank Hipotekarowy (Poland); Bank Zamojski (Poland); Credit Suisse (Switzerland)</td>
</tr>
<tr>
<td>Third National Investment Fund</td>
<td>Mr. E. Golabki</td>
<td>Trinity Management Sp z o.o.</td>
<td>Barclays de Zoete Wedel (UK); Bank Polska Kasa and Opolska Company Assistance (Poland)</td>
</tr>
<tr>
<td>Fourth National Investment Fund</td>
<td>Mr. A. Rydki</td>
<td>Konserwacja Rafał Akina Zaradzania Funduszami Sp z o.o.</td>
<td>Raffinolin (Austria); WS Atkins (UK)</td>
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<td>Mr. J. Rymarzyk</td>
<td>Polskie Towarzystwo Prawnyje Zarządzenia Klubowe Sp z o.o.</td>
<td>Kienswort Bienes (UK); Polski Bank Hipoteczny (Poland)</td>
</tr>
<tr>
<td>Sixth National Investment Fund - Magna Polonia</td>
<td>Mr. A. Krajewski</td>
<td>Chace Cedrino Polska Sp z o.o.</td>
<td>Chase Genius (US); Wallopolis Bank Kredytowy and Naum Consulting (Poland)</td>
</tr>
<tr>
<td>Kazimierz Wielki Fund</td>
<td>Mr. J. Zewa (Acting Chairman)</td>
<td>Konserwacja Funduszów Management Co. Sp z o.o.</td>
<td>Lazard Frere (France); UBS Capital (US); Bank Gotycki Krakowiak (Poland)</td>
</tr>
<tr>
<td>Eighth National Investment Fund</td>
<td>Mr. J. Motolski</td>
<td>Katowice Group (US); Bank Handlowy w Warszawie (Poland); Pol学会 Walker and Kennedy Associates (US); York Trust (UK)</td>
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**Eugeniusz Zawadzki**

| Youth National Investment Fund | Mr. H. Skawiński | Poles Management Sp z o.o. | Banque Arjil (France); Agnieszka Nowacka (Poland); Wawrzyniec Grau (Poland) |
| Eleventh National Investment Fund | Mr. J. Kulesza | Wawysterski Wawryszewski Wawryszewski Sp z o.o. | KPMG Financial and Investment (Poland); Wawysterski Wawryszewski (Poland) |
| Twelfth National Investment Fund | Mr. P. Siedzicki | SNP-PHB Fund S.A. | Banque Nationale de Paris (France); Polski Bank Inwestycyjny (Poland) |
| Thirteenth National Investment Fund | Mr. M. Bros | Yamazaki Regent Special Projects Ltd. | Yamazaki International Europe (UK); Regent Capital (UK); Hong Kong; ARC Consulting (Australia) |
| West Investment Fund | Mr. L. Kuczyński | International Investment Holdings Limited | Bank Zamojski (Poland); Centra Europe Trust (UK); Chase Manhattan (UK); Credit Commercial de Paris (France) |

The Principal Investors are those who have an economic interest of 10 percent or more in the activities of the Fund Manager firm. The names of such participants have not necessarily been given and intermediate holding companies are generally ignored. Their principal place of business, rather than that of incorporation, is stated. Program Powrotności Przetwarzania (Ministry of Privatization 1993. 41.

Lessons from Poland and Russia

was essential, not so much for economic as political reasons. He feared a return to communism unless the ownership and control of state enterprises was quickly put into private hands. This meant immediately distributing shares in those companies to the public at large. Once they had an equity in their factory, Chubais reasoned that the factory work force, both management and workers, would resist the return of their newly acquired assets to the state. For its part, with voucher claims to those same companies, the public would react similarly and oppose all efforts by any of the communist leaders seeking a return to state control. Chubais seemed much less preoccupied with the kinds of concerns that bothered Lewandowski. Thus, he did not do much to restrain factory directors from asserting control of their factories. There was no discussion about outside board supervision of the sort introduced in Poland, much less some role for foreign specialists. On the contrary, Chubais agreed, even if reluctantly, to a change in the regulations that gave Russian factory managers special purchasing and borrowing rights so they could in fact assume de facto ownership of their factories.

Chubais's decision was supported andabetted by the encouragement and advice of the International Monetary Fund and other western advisors, particularly Maxim Boycko, Andrei Shilov and Robert Vishny. In their thinking, private ownership was always to be preferred to state ownership (Boycko, 1995, 111). (Moreover, they argued that the Polish approach would be a failure (Boycko, 1995, 83).) Presumably this also implies that if corrupt party officials, or even members of the Mafia, end up as the new private owners, sooner or later (probably sooner), they will be flushed out in a proxy fight by the other stockholders who will demand a more responsible stewardship of their newly acquired assets.

What the advocates of rapid privatization did not take into consideration was that such reasoning may have made sense in a society where there are not only laws that provide for proxy fights, but an environment where such challenges are a relatively commonplace occurrence. Unfortunately, Russia at the time had almost no practice or experience in dealing with such matters, much less effective laws. For 70 years the communist state had suppressed all forms of private activity, not to mention private corporations and corporate security transactions. Indeed, anyone caught engaging in private trade was deemed to be guilty of economic crimes, and economic crimes were punishable by death. Thus, with the collapse of communism and the USSR, and the demise of the economic coordinating and regulating organizations such as GOSPLAN and GOSSINAB, businesses in Russia literally found themselves in a vacuum. There were no viable commercial codes or security regulations, and no political or economic system of checks and balances. For that matter, there was no competitive marketplace, and no procedure for seeking out potential buyers and sellers, not even a phone book. There was just an economy full of state enterprises on whose way to being privatized.

In effect, there were no rules, restraints, oversight by supervisory boards, national investment funds, or codes of behavior. But for those bold enough to act in this unstructured environment, it was an unprecedented opportunity. Those first in can impose restraints on those who follow. Nothing like it had ever occurred in Russia, or for that matter in any other country. The Pole, and to some extent the Chinese, had moved to privatize industry early in their reform process but for one reason or an-
Oligarch went so far as to brag that after the Loans for Shares fiasco, 7 of the country's bankers controlled 50 percent of the country's assets.

In contrast to Poland where the main privatization effort came after or in tandem with the reconstruction or introduction of institutions and property rights designed to restrain or sublimate the princely acquisitive instinct, in Russia similar institutions and property rights were not positive and constructive, but pernicious and destructive. Because governments tend to encroach on property rights, economists, more often than not, feel it necessary to battle on behalf of the privatizers.

They do this even though a new study shows that private ownership is not always more efficient [Friedman, untried]. What the experience in Russia shows is that the premature exercise of property rights can be counterproductive, and undermine and discredit the whole reform effort. Henceforth economists will have to reformulate one of their basic axioms; property rights may indeed be a force for economic growth and political stability but if applied in the absence of a market and competitive infrastructure and without a system of checks and balances, property rights are likely to preclude the development of a healthy competitive market and may even threaten the existence of the state.

Using property rights, Russian Oligarchs quickly built on their control of their newly seized assets to extend their influence over other assets and eventually the media which allowed them to influence, undo the election process and the make-up of future governments. As a consequence today, a redress or a challenge to those vested interests has become a near-impossible task. Those who have tried, such as the former Prime Ministers Sergei Kiriyenko and Yevgeny Primakov, found that they, not the Oligarchs, were pushed from office.

Criticism of the premature privatization effort in Russia does not necessarily mean that the more gradual or more complex approach adopted by the Poles would have spared Russia the grotesque thievery and crony capitalism that ultimately ensued. Nor can it be asserted that a Polish-type effort would have spared Russia the economic upheaval that hit it on Black Monday, August 17, 1998. Yet as a minimum, Poland's more equitable, less corrupt, more gradual and more productive privatization program explains, at least in part, why it is that Poland was only barely touched by the August 1998 economic meltdown. It also helps explain why property rights in Poland are supported while in Russia they are cursed.

NOTES

The author thanks Steve Roedelke for his helpful suggestions.

1. The details in this process are spelled out in Goldin [1996, 123-145].

REFERENCES


STRUCTURAL ADJUSTMENT AND THE AFRICAN CRISIS: A THEORETICAL APPRAISAL

Howard Stein
Roosevelt University

and

Machiko Nissanka
University of London

BACKGROUND

Since the early 1980s, the economic policy and development debate in sub-Saharan Africa has been singularly dominated by structural adjustment programs (SAPs) which have been part of the conditionality tied to donor assistance. The debate concerning the appropriateness of SAPs for sub-Saharan Africa countries continues to be unabated despite nearly two decades of 'adjustments'. Numerous studies have attempted to measure the impact of adjustment on the economic performance in sub-Saharan Africa often by using counterfactual exercises [World Bank/UNDP, 1988; World Bank, 1990; 1992; 1994]. These exercises typically suffer from methodological difficulties, particularly when separating the program impacts from the ephemeral effects of increased external resources through adjustment lending. The accumulated evidence generally points to the weak link between adjustment and performance in Africa [UNCTAD, 1998].

While official donor reports [World Bank, 1994] have often emphasized some improvements, admittedly fragile, in macroeconomic balances in "adjusting" countries, this has not led to a sustained recovery in growth and investment performance. The actual growth record for the region has been dismal. Compared with the early periods, sub-Saharan Africa over the years 1990-1994 recorded a sharp reduction in total output, exports and investment. Both industrial and agricultural production declined (see Figures 1 and 2). With growing population, per capita income fell on average by 0.6 per cent per annum during 1980 - 1994.

After 15 years of reform efforts, the region's growth performance remains far too low to lead the economies along a path of economic development, which would counter growing levels of poverty. Private investment has been subdued, while public investment was cut sharply (see Figure 3). Savings rates in most of sub-Saharan Africa remain very low (see Table 1). The low savings rates of these sub-Saharan African

Howard Stein: Department of Economics, 450 S Michigan Ave., Roosevelt University, Chicago, IL 60605. E-mail: hstein@roosevelt.edu
Machiko Nissanka: Department of Economics, IOAS, Russell Square, University of London, London WC1H OXG, UK. E-mail: mn@ssu.ac.uk

Eastern Economic Journal, Vol. 25, No. 4, Fall 1999