The dubious success of Polish free market reforms

by Anna Kaczor

Since Polish Prime Minister Hanna Suchocka established her liberal government at the end of last year, the western press (at least till the Parliament voted against the Program for General Privatization) had nothing but compliments for the supposed stability of Poland. The decisiveness of her government in introducing austerity programs that culminated with the proposed state budget for 1993 being held to a 5% budget deficit, and severe spending cuts in health care, education, and the salaries paid from the budget, was touted as a great achievement.

But the criteria used to judge the success of the economy have nothing to do with the standard of living of the Polish population or the growth of the physical economy. Most of the "experts" stress that now shops are full, usually with imports, and the process of privatizing has so far been going pretty fast and smoothly. They almost completely ignore the tremendous negative impact of the reforms on the life of an average citizen, which cannot be simply called a necessary short-term sacrifice.

Social costs of the free market reforms

A recent Unicef survey of the living conditions of Polish children, for example, gives a clear indication of the deterioration of basic infrastructure and the standard of living. According to the study, infant mortality in Poland is 19.5 per 1,000 newborns, three times higher than in some European countries. Low weight is the cause of 70% of these deaths, and 12.3 per 1,000 newborns die at a very early age. About 90% of the children have kinetic problems, 13% constitutional problems, 14% problems with their eyes, and 50% have dental cavities. In 80% of schools, there are children with head lice, 12% of children do not have breakfast, and 22% do not have anything to eat while at school. It happens more and more often that children faint at school because they are undernourished. According to Unicef, 20% of Warsaw schoolchildren go hungry, and 50% of families with three or more children live below the Polish poverty line. In 1992, some 25% of families applied for aid from social welfare.

A free health care system exists only in theory. Serious underinvestment in the system forces most hospitals and clinics to require voluntary donations or at least to demand that patients buy drugs with their own funds. Most patients pay, some because they want to help, some because they do not want to be treated as second-class patients. The health minister looks through his fingers (as we say in Polish) at this procedure, knowing that without additional funds doctors will have to operate by candlelight. In some cases, official fees for admission to hospitals or emergency rooms have been already set up; for example, in Gdynia, where the city council had to issue a special bill enforcing payments for health services in public hospitals. The monthly income from those fees in August 1992 of the whole public health system in Gdynia, was 282 million zlotys (now about $19,000). All of it was spent to buy needles, syringes, and bandages. For another example, in a Poznan children's hospital, doctors routinely present the cost of treatment to parents. Although they do not have to pay, most parents donate at least 100,000 zlotys, which is not a big sum but may become an unexpected burden for families who are already fighting to make ends meet.

A similar situation may be observed in the education system. Limiting the number of school hours and underpaying teachers is justified on the basis of the need to control the budget deficit. There is also a lot of discussion about introducing fees for university education because "they have them in the West" (this argument is good for implementing any stupid reform, although "the West" seems to be limited in most cases to the United States and Great Britain).

Free market reforms do not help Polish farmers, either. Almost unlimited imports of food, especially dairy products, leads to a constant decline in food production. In 1992, milk production was 13% lower than in 1991, and was estimated at 12.4 billion liters. This year it may be even 400 million liters lower. The same is true for meat production. Expensive fodder and a decline in consumption makes production totally unprofitable. Farmers try to sell their stock, but even with very low prices (13-14,000 zlotys per kilogram of livestock) it is difficult to find buyers. According to some economists, the pig stock will decline by 4 million head this year.

All journalists who so happily praise Poland for its reforms fail to find a reasonable explanation for the growing unemployment. This problem obviously belongs to a short-term-sacrifice mythology, therefore it supposedly does not require explanations. The official number of registered unemployed is 2.262 million, which constitutes 14.2% of the work force. Also, at the end of February, over 1 million people lost their unemployment benefits and now live on a small social security stipend. Their chance to get a new job is rather small since, in March, there were 106 unemployed for every job offer. The situation will not improve soon. The deputy minister of labor announced at a press conference in the middle of March that 2,500 enterprises plan to lay off 75,000 people in the near future.

None dare call it stealing

The privatization of state-owned companies is one of the main worries of the Polish government, whose economic policy aims at implementing a free market economy under pressure from the International Monetary Fund (IMF). Already, 54% of the labor force works in private enterprises, and that fact alone is perceived by the western creditors as a great achievement of Polish "shock therapy."

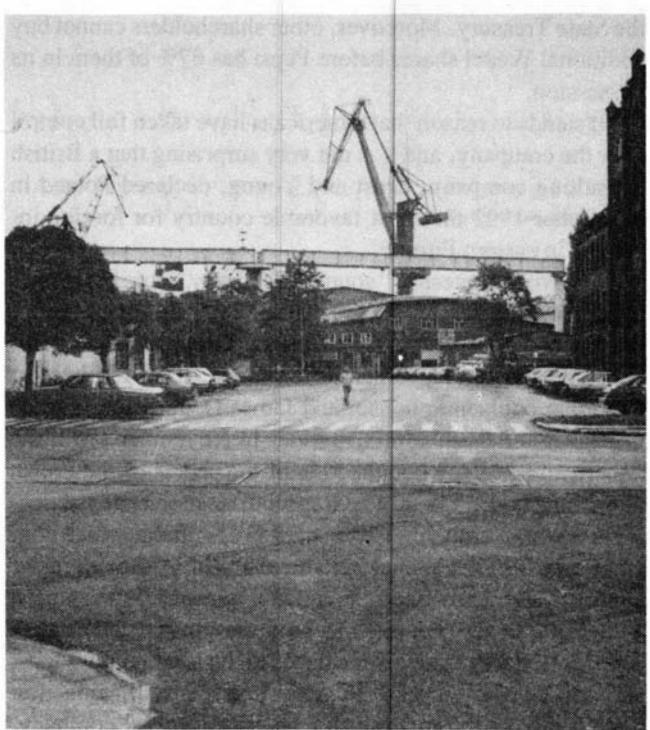
On March 18, the Polish Parliament rejected a long-discussed Program for General Privatization. The program proposes a simultaneous privatization of 600 state-owned companies through 20 investment funds which would oversee the companies and hold controlling shares. The funds would be run initially by western experts, who would be paid in cash depending on the performance of the companies under their jurisdiction. As a means of keeping equity in Polish hands, shares in the funds would be offered at a low cost to Polish citizens. The program was voted against by 203 parliamentarians, 11 of whom belong to the government coalition (mainly from the Christian National Union). They did not agree with the idea that the funds should be controlled by foreigners.

Prime Minister Suchocka announced that after introducing some changes, probably concerning the number of companies to be privatized, the program would soon be presented to the Parliament. At the same time, government officials said the cabinet was ready to start implementing the plan if the Parliament delayed it, since existing laws do not prohibit the government from creating the funds, although it could not start handing out shares without the Parliament's go-ahead.

The approval of the program and its implementation is seen by western financial elites as a test of Polish stability and consistency in introducing a free market economy. Already, the World Bank is threatening that it will not sign an agreement with Poland for a loan of $450 million, which was supposed to be used for debt restructuring of Polish enterprises, if the program is not implemented soon. Many Polish and foreign observers consider the rejection of the program as the first serious defeat of the Polish government.

Case studies

To lure foreign "investors" (as a former student of applied linguistics, I cannot help noticing how nominalism may change perceived reality: Looters are now called investors), a special ministry established to oversee the process of privatization is ready to offer for sale the most tasty pieces of Polish industry at the most inviting conditions.



The Baltic shipyard at Gdansk, Poland. At the nearby shipyard in Szczecin, the Solidarity '80 trade union is fighting the kind of free market forced privatization that left former East Germany in ruins.

The case of Wedel, a well-known candy factory with a long tradition and unquestionably good reputation for its products, is symptomatic of this process. In 1991, Wedel, then owned by the State Treasury, paid 153 billion zlotys (over $15 million; at that time $1 cost 10,000 zlotys; since 1992, $1 costs 15-16,000 zlotys) to the state budget in various tax revenues (including 54 billion zlotys in income taxes), and there was still 85 billion zlotys income left in its pocket. The ministry for ownership restructuring decided to privatize Wedel and, after consulting its western adviser, the Bank of Boston, sold 40% of the Wedel shares to the American company Pepsi-Cola for $25 million, although the board of Wedel also had an offer from the Swiss company Nestlé, which was willing to pay $40 million.

To make it easier for Pepsi to find its place in the Polish market, the government gave to the American company an exemption from paying income taxes for three years. It is easy to estimate that if the income of Wedel stays at the same level as in 1991, the fact that Pepsi will not pay income taxes will allow it to almost recover its $25 million in four years.

The question is not only money. Although Pepsi has only 40% of the shares, every share gives it five privileged votes which add up to 75% of the votes in shareholder meetings; that also gives Pepsi the right to nominate members of the company management board, except for one nominated by the State Treasury. Moreover, other shareholders cannot buy additional Wedel shares before Pepsi has 67% of them in its possession.

It stands to reason that Americans have taken full control over the company, and it is not very surprising that a British consulting company, Ernst and Young, declared Poland in November 1992 the most favorable country for foreign investors in eastern Europe.

The word "investors" sounds especially ironic in the case of an American company founded in 1991 in Luxembourg, the Luxembourg Cambridge Holding Group, whose members include, among others, Ron Besse from the biggest Canadian publishing house, and James D. Jameson, a trade official in the Bush administration. In November 1992, the American company bought 51% of the shares of the Polish publishing house PWN, which specializes in science publications. The Luxembourg Group paid $1.2 million, which constituted half of the annual income of PWN. Although in the contract the American company promised to invest $400,000, so far, nobody has seen the money. The Polish director of PWN says it is available in the Luxembourg bank and will be transferred to Poland in eight installments after PWN presents the program for restructuring the company. The purpose of privatizing PWN became even more mysterious when this author learned that 70% of the books published by the company are still subsidized by the government! Supposedly it was done only for the good of scientists, since the director of PWN stated that, now that it may be more difficult for them to publish their work, the fame should be much bigger.

Not all privatized companies are in such good shape as Wedel. Some of them are declared bankrupt before the process of privatization starts. Although some bankruptcies may be the result of bad management or old technologies, it is clear that many state-owned companies have been driven to total collapse by the free market reforms initiated three years ago by essentially the same crowd of people who today are pushing for a general privatization.

Let's take the example of the modern, well-equipped footwear company Podhale. A few years ago it employed 10,000 people; in 1992, only 3,700 still had jobs in the factory. For years it was producing good quality shoes, also for Puma, Adidas, and Royce. Despite many orders and good potential for production, from 1989 the company started to sink into debt and eventually faced the possibility of being declared bankrupt.

The director of Podhale sees the cause of its present problems in a 1989 decision to open the Polish market to vast imports and to dissolve most of the state distribution companies, which in the past took care of Podhale's production for the home market. New, small private distributors and petty businessmen preferred shoes from Thailand, Hong Kong, or Malaysia. As a result, the 1989 output of the company of 600 million pairs of shoes declined by half in 1991. Moreover, before the crisis started, the company had begun new expensive investment projects and bought new production lines from Czechoslovakia and other new machinery which has never been used since the decline of production. Of course, that made it impossible to pay back old debt or even pay wages on time, which led to strikes and a further decline in output. After such "therapy," Podhale is probably ready to be privatized and accept any deal which would make the company look more valuable in the eyes of its creditors.

In search of an alternative

In another state-owned company, Szczecin shipyard, the trade union "Solidarity '80" is currently fighting against that kind of forced privatization. Although the shipyard has orders till the end of 1994 from all over the world, the old debts, accumulated often as a result of political rather than economic decisions of communist governments (for example, a contract for building a ship for India which lost the shipyard thousands of dollars), constitute a serious obstacle for getting new credits for production and are seen by free market zealots as a reason for instant privatization, i.e., selling to a foreign investor.

Solidarity '80 has presented its own program for privatization which would allow the shipyard workers to keep the shares of the company in their hands. If they manage to convince the government to allow this kind of privatization, it would be a good example not only for Polish enterprises but also for other former communist countries, including former East Germany, where privatization brought more destruction then development.

Already some desperate Polish enterprises, namely two pump factories from Leszczyn and Brzeg, have started a semi-legal process of privatizing by directing some of their income to special funds which then give cheap, long-term loans to the workers who want to buy out 20% of the available shares and take the factories in leasing. Some politicians claim that from a moral point of view this is not a legal procedure and hope that the Finance Ministry will stop this self-privatizing for the state money.

The ideology that privatization alone can solve the problems of the Polish economy has brainwashed some people to such an extent that they seem to have lost their common sense. The director of a small state-owned porcelain factory in Walbrzych, which is quite successful and sells 70% of its production to the United States, Germany, and Italy, complained recently about not being privatized yet. "Our problem is," he said, "that we are doing pretty well in these difficult times. Otherwise we would have been liquidated or declared bankrupt and privatized a long time ago." It is also worth noting that, according to the State Work Inspection Office, 25% of private enterprises should be closed immediately due to terrible working conditions. In many private companies workers are treated like slaves, but growing unemployment does not stimulate employers to change the situation.

One could only wish that some Polish politicians who do not seem to know much about the economy would at least study history. In the rush to attract foreign investment to Poland in 1920s and 1930s, the Polish government sold on very good terms (no income tax paid) some of the Polish steel mills and coal mines to an American company, the Harriman Fifteen Corporation, controlled by Averell Harriman, who helped financed Hitler, and his German partner Friedrich Flick. In view of the fact that a great deal of Polish output was exported to Hitler's Germany, the Polish government thought that the company should at least pay full taxes on their Polish holding. The U.S. and Nazi owners responded with a lockout. When 25,000 workers ended up on the street, the Polish government was brought to its knees.

Dissatisfaction with reforms

In the last few months, the rosy picture of a new democratic Poland in the western press (democracy and free market economy are synonymous in the press jargon) has been disturbed by the reports of social unrest. One might think that after the strike of the coal miners in December 1992 which involved 300,000 workers, the Polish people finally decided to grit their teeth and accept a Chinese-style Great Leap Forward. Such an impression could not be further from the truth.

Almost every week the Polish press writes stories about demonstrations and protest actions from all over the country. In March, there were a lot of signs of anger and desperation among the population: a hunger strike of 15 unemployed people in Slupsk, the city in North Poland; a demonstration in Warsaw organized by Rural Solidarity demanding credits for agriculture and more control of food imports; and a demonstration organized by state employees (teachers, doctors, nurses, public transportation workers) demanding more spending on health care, education, and other vital social services. The banners held by demonstrators read: "Poland, Wake Up! The Nation Is Dying!" and "You Go to London to Treat Our Ills, While We in Poland Get Poison Pills," which obviously referred to Suchocka's frequent trips to Great Britain.

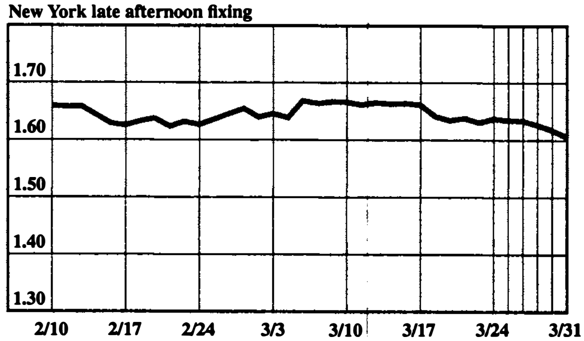
Another rural trade union, Samoobrona, is preparing a demonstration for the beginning of April to protest the policies of the IMF. In addition, Polish teachers are considering a general strike (60-90% of them support the idea). There has also been a referendum among the coal miners in the Walbrzych coal mines concerning a strike to protest the lack of investment promised by the government during the December strike.

President Lech Walesa probably considers both the Polish Parliament and the society as very uncooperative in implementing a free market economy. His efforts remind this author of her father's joke about a farmer who tried to cure his horse's habit of eating. "I would have succeeded," said the farmer, "but the beast died on me."

Currency Rates

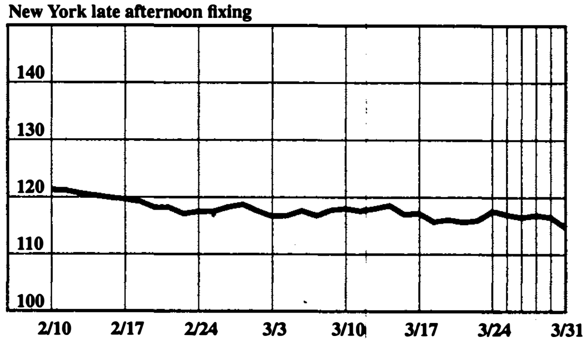
The dollar in deutschemarks

New York late afternoon fixing



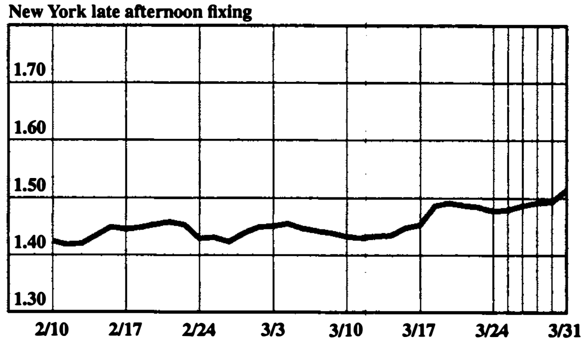
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing