

# *Fordham International Law Journal*

---

*Volume 17, Issue 1*

1993

*Article 3*

---

## A Privatization Test: The Czech Republic, Slovakia and Poland

Michele Balfour\*

Cameron Crise†

\*

†

# A Privatization Test: The Czech Republic, Slovakia and Poland

Michele Balfour and Cameron Crise

## **Abstract**

The nations of the former Communist bloc face a task unparalleled in the annals of world history. By promoting allocation of market resources based on politics and social policy instead of economic efficiencies, the former regimes created economies of inefficiency. Committed economic reformers face the task of reallocating resources from inefficient producers dependent on government monies to competitive independent market players. This transformation is known as privatization. Privatization is an arduous process, which cannot be accomplished all at once. By shifting assets from uncompetitive players to competitive ones, privatization will impose economic hardship on the public, which will demand the relief it is accustomed to receiving from political leadership. Often, the reformers do not know how to garner public support for privatization. Positive results will emerge only after long-term sacrifice by the people. This article will identify eight requirements for a successful privatization program and discuss the privatization efforts of the former Czechoslovakia, its successor states, and Poland, comparing them and evaluating them against the eight criteria.

# A PRIVATIZATION TEST: THE CZECH REPUBLIC, SLOVAKIA AND POLAND

*Michele Balfour  
Cameron Crise\**

## CONTENTS

Introduction.....	85
I. Requirements for Successful Privatization .....	86
A. Institutional Environment .....	87
1. Property Rights .....	87
2. Contract Law .....	88
3. Entry and Exit Laws: Competition and Bankruptcy .....	89
4. Securities Legislation .....	90
5. Political Stability .....	91
B. Market Functions.....	91
1. Information Flows .....	91
2. Capital Markets .....	92
3. Financial Intermediaries .....	92
II. The Czech Republic and Slovakia .....	93
A. Privatization Efforts .....	93
1. Czech Republic .....	96
2. Slovakia .....	97
B. Institutional Environment: Czech Republic and Slovakia .....	98
1. Property Rights .....	98
2. Contract Law .....	99
3. Entry and Exit Laws: Competition and Bankruptcy .....	99
4. Securities Legislation .....	102
5. Political Stability .....	102

---

\* Michele Balfour is an attorney in the International Division of the Bureau of Competition of the Federal Trade Commission. Ms. Balfour is involved in the Federal Trade Commission and Department of Justice assistance efforts to Poland, the Czech Republic, and Slovakia. Cameron Crise works at Swiss Bank Corporation as a trading assistant in foreign currency options. Opinions expressed within this paper, as well as errors and omissions, are the responsibility of the authors alone and do not necessarily reflect opinions of the Federal Trade Commission, the Swiss Bank Corporation or any employees, members, agents, or representatives, thereof. The authors wish to thank Julie Gearty for her research assistance.

C.	Market Functions: Czech Republic and Slovakia	104
1.	Information Flows	104
2.	Capital Markets	105
a.	Czech Republic	106
b.	Slovakia	107
3.	Financial Intermediaries	108
a.	Czech Republic	109
b.	Slovakia	109
III.	Poland	110
A.	Privatization Laws	110
B.	Institutional Environment: Poland	116
1.	Property Rights	116
2.	Contract Law	117
3.	Entry and Exit Laws: Competition and Bankruptcy	118
4.	Securities Legislation	120
5.	Political Stability	121
C.	Market Functions: Poland	122
1.	Information Flows	122
2.	Capital Markets	122
3.	Financial Intermediaries	123
	Conclusion	124

*INTRODUCTION*

The nations of the former Communist bloc face a task unparalleled in the annals of world history. By promoting allocation of market resources based on politics and social policy instead of economic efficiencies, the former regimes created economies of inefficiency. Committed economic reformers face the task of reallocating resources from inefficient producers dependent on government monies to competitive independent market players. This transformation is known as privatization.

Privatization is an arduous process, which cannot be accomplished all at once. By shifting assets from uncompetitive players to competitive ones, privatization will impose economic hardship on the public, which will demand the relief it is accustomed to receiving from political leadership. Often, the reformers do not know how to garner public support for privatization. Positive results will emerge only after long-term sacrifice by the people. This article will identify eight requirements for a successful

privatization program and discuss the privatization efforts of the former Czechoslovakia, its successor states, and Poland, comparing them and evaluating them against the eight criteria.

Different countries envision different privatization schemes. Voucher-system privatization, where the state distributes ownership shares in public companies to citizens, is one method.<sup>1</sup> A second method of privatization is through a joint venture, in which, typically, a foreign company forms a joint venture with a state company.<sup>2</sup> A third method is liquidation of a company through the sale of productive assets to the highest bidder and junking the remains.<sup>3</sup> Variations and combinations of these methods are also used.<sup>4</sup> For instance, smaller state enterprises, like retail shops or restaurants, may be sold off through an auction system to the general public. Medium size companies with proven or potential profitability could be made available for joint ventures and voucher system privatization. Some large scale companies could be transformed through liquidation and others through voucher system privatization.

### I. REQUIREMENTS FOR SUCCESSFUL PRIVATIZATION

There are a number of elements that must be in place before the privatization process may be successfully completed. Some may be legislated, some are dependent on external factors, and others are completely intangible. Generally, the crite-

---

1. See MICHAEL A. GOLDSTEIN & N. BULENT GULTEKIN, CENTRAL EUROPEAN PRIVATIZATION: A THEORETICAL ANALYSIS 22-29 (June 28, 1991) (unpublished draft) (on file with the *Fordham International Law Journal*) (describing voucher system privatization as one of three methods of privatization).

2. See MORRIS MENDELSON, STRATEGIC CONSIDERATIONS FOR PRIVATIZING CENTRAL-EASTERN EUROPE 19-20 (Weiss Center for Int'l Fin. Research, The Wharton School, Univ. of Penn. 1991). Although joint venture privatization has frequently been used in Central and Eastern Europe, there is fundamental conflict of ideologies between state and joint venture partners. *Id.* The advantage of this approach from the private sector perspective is that it enables a company to establish itself in new markets. *Id.*

3. Ben Slay, *Poland: The Role of Managers in Privatization*, 2 RADIO FREE EUR./RL RES. REP., No. 12, Mar. 19, 1993, at 53-54. Liquidation privatization occurs when the physical assets of state enterprises are privatized in their entirety or through the piecemeal sale of plants and equipment. *Id.* Some argue that liquidation privatization has advantages over voucher system privatization because it relies upon already existing markets for physical assets for valuation of the property while the voucher system requires determining the value of the shares in the companies. *Id.*

4. *Id.* In Poland, for example, liquidation privatization and a voucher system form part of the privatization plan. *Id.*

ria for success fall into two overlapping categories: institutional environment and market functions.

### A. *Institutional Environment*

Privatization requires an appropriate legal and political framework to provide the skeleton of a market economy.<sup>5</sup> Without a complete and proper institutional environment, the foundation of the market will be shaky, resulting in failures and non-competitive situations. Part of the goal of the institutional framework is to create an environment conducive to entry and exit of resources, a necessary step to achieve efficient allocation of resources. The order of implementation of reform measures should be based on promoting entry of efficient producers and exit of inefficient producers, who hold scarce resources better used by new entrants. Five key aspects of the institutional environment are vital for the implementation of a privatization program: property rights, contract law, entry and exit laws, securities laws, and political stability.

#### 1. Property Rights

Property rights,<sup>6</sup> or the right to exercise ownership of property, furnish incentives to use resources efficiently.<sup>7</sup> A legal system that protects and enforces property rights will allow owners of property to "have confidence that they will obtain returns

---

5. See PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, *ECONOMICS* 37 (14th ed. 1992) (defining markets and market economies). According to Samuelson and Nordhaus, [a] market is a mechanism by which buyers and sellers of a commodity interact to determine its price and quantity.

In a market system, everything has a price, which is the value of the good in terms of money. Prices represent the terms on which people and firms voluntarily exchange different commodities.

*Id.* A problem with the economies of the former Communist bloc is that prices were set by the government and exchanges were not voluntary. *Id.* The real value of goods was distorted and resources were allocated based on fictitious values. *Id.*

6. WERNER Z. HIRSCH, *LAW AND ECONOMICS: AN INTRODUCTORY ANALYSIS* 24-25 (2d ed. 1988). According to Hirsch,

[t]he concept of property rights relates to the set of privileges and responsibilities accorded to a person in relation to the owning of property . . . . The right to property is the power to exclude others from or give them access to a benefit or use of the particular object."

*Id.*

7. *Id.* at 25.

from the use of property."<sup>8</sup> In the search for greater returns, owners will put their property to its most productive use and therefore create greater efficiency in the economy as a whole.

In order to promote efficiency, property rights must apply to real property, movable property, and intellectual property. Rents from all three contribute to the economy and protection of these rents encourages private investment. In the effort to encourage private parties, governments must consider the need to attract foreign as well as domestic investment. While domestic producers may be willing to invest even while property rights are unclear based on their sense of comfort in the country, large scale foreign investors will be wary of large investments in an insecure environment.

Property law forms part of the foundation of free market economies and is the first step in economic reform. Private ownership creates the right to collect the rents from property and the responsibility to assume the losses; it takes government out of the mix and relieves it of its responsibility to finance producers who should be out of business.

## 2. Contract Law

Contract law is another criteria for privatization and stems from property rights.<sup>9</sup> The principles of contract law, such as "freedom of contract," aid in the privatization process, stating that voluntary exchange should be freely permitted in order to maximize value<sup>10</sup> and imposes sanctions for reneging on one's promise to perform.<sup>11</sup> Where performance is over an extended period of time, there is uncertainty regarding the conditions under which performance will occur such that a party's initial cost-benefit analysis may be inapplicable.<sup>12</sup> Contract law enforces the allocation of risk initially agreed to by the parties.<sup>13</sup> The underlying assumption is that the parties will negotiate for

---

8. *Id.*

9. See ANTHONY T. KRONMAN & RICHARD A. POSNER, *THE ECONOMICS OF CONTRACT LAW* 7 (1979) (stating that freedom of contract implies system of transferable property rights) [hereinafter KRONMAN & POSNER].

10. *Id.* at 2; see HIRSCH, *supra* note 6, at 129 (defining contract as "a promissory agreement for future exchange, freely and voluntarily arrived at").

11. KRONMAN & POSNER, *supra* note 9, at 4.

12. *Id.*

13. *Id.*

the most efficient risk allocation. Over time, firms that are unable to risk-allocate while maximizing profits will be driven out of business, leaving the more efficient survivors. The creation and protection of contract rights contributes to a stable environment, which will decrease the risks of economic activity, thereby encouraging actors to enter the marketplace.

### 3. Entry and Exit Laws: Competition and Bankruptcy

To create a healthy economy, assets must be encouraged to enter and exit industries so that they are put to their most productive use. Competition laws are needed to promote new entry. Bankruptcy laws are needed to shift resources from weak competitors to strong ones.

Privatization will serve little purpose if state-owned monopolies are simply turned into private monopolies that erect barriers to entry and create deadweight loss. Therefore, a clear set of competition laws must be enacted to ensure that new firms enter a market where they have a chance to succeed.

Competition considerations should be part of the privatization decision. To allow anticompetitive privatizations to occur and to attempt to undo them later is far more complicated than to address them initially. The issue in many countries is whether to privatize quickly versus efficiently.<sup>14</sup> Some tension is inherent between the goals of the country's privatization agency, which attempts to sell an attractive package to foreign investors immediately, and those of the competition agency, which attempts to create long-term efficiencies.

In many cases, state monopolies have to be fragmented into several different competing firms. The vertical relationships that are so common in command economies must be examined closely. If these relationships give firms with market power<sup>15</sup> an

---

14. See, e.g., *Making It Work*, *ECONOMIST*, Mar. 13, 1993, at 93 (opining that Czech officials are correct in deciding to privatize state property quickly, rather than wait until all details of market economy are decided). Comparatively, the Polish and Hungarian privatization programs have sold off a relatively small number of state enterprises. *Id.*

15. See *Re Continental Can Co. Inc.*, J.O. L7/25 (1972), [1972] 11 C.M.L.R. D11 (discussing monopoly power in European Community). In the European Community, market power is seen in the prohibition against abuse of a dominant position in Article 86 of the 1957 Treaty of Rome. Treaty Establishing the European Economic Community, Mar. 25, 1957, 1973 Gr. Brit. T.S. No. 1 (Cmd. 5179-II), 298 U.N.T.S. 3 (1958). Dominant position is defined by the Commission as follows:

Undertakings are in a dominant position when they have the power to behave

advantage in procuring supplies or distributing goods thereby preempting entry by competitors, these relationships may need to be undone.

Competition laws will also guard against bid-rigging in auctions. When a state decides to sell a company, it also should reap the benefits of competition law. Bid-rigging must be prohibited to ensure that the state will receive the highest possible price for the company it is selling. Getting the best price for state companies will not only benefit state coffers, it will also send a signal to a public holding vouchers in recently privatized enterprises that their assets are valuable, thereby encouraging consumer confidence in the economy.

Bankruptcy laws are also part of the picture. Uncompetitive players using scarce resources need an organized means of exiting the marketplace. The justified fear of policy-makers in former communist countries, however, is that massive bankruptcies will occur upon passage of bankruptcy legislation. Such an event would surely work to unhinge politicians coaching their public towards free markets.

#### 4. Securities Legislation

Privatization schemes generally envision an important role for nascent securities markets. Either through stock offerings or mutual funds, private ownership of enterprises will come in some form of security. However, without legislation regulating

---

independently, which puts them in a position to act without taking into account their competitors, purchasers or suppliers. That is the position when, because of their share of the market, or of their share of the market combined with the availability of technical knowledge, raw materials or capital, they have the power to determine prices or to control production or distribution for a significant part of the products in question. This power does not necessarily have to derive from an absolute domination permitting the undertakings which hold it to eliminate all will on the part of their economic partners, but it is enough that they be strong enough as a whole to ensure to those undertakings an overall independence of behaviour, even if there are differences in intensity in their influence on the different partial markets.

Re Continental Can Co. Inc., J.O. L7/25, at 35, [1972] 11 C.M.L.R. at D27.

In the United States, market power is seen in the offense of monopolization under Section 2 of the Sherman Act. *See* United States v. Grinnell Corp., 384 U.S. 563 (1966) (discussing monopoly power in United States). Market power is the ability to raise prices and restrict output profitably. The test for monopolization is "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *Id.* at 570-71.

the securities market, inefficiencies and abuses are likely to occur. Insider trading, overpricing, misrepresentation, and fraud must be guarded against. Because the true value and financial health of most enterprises is unknown, the inside information of present and past state employees will be extremely valuable when the distribution of ownership occurs. Misuse of this information must be avoided.

### 5. Political Stability

There are several reasons why political stability is necessary for successful privatization. First, stable governments, secure in their power, can make privatization a top priority. When governments are shaky or change frequently, the focus becomes the creation of a strong government over privatization.<sup>16</sup> When a stable government is able to prioritize its economic reforms without fear of upheaval, it gives programs like privatization a sense of continuity and legitimacy. Reforms are allowed to develop and flourish under the guidance of stable governments. The continuity of reform eventually leads to economic stability as plans are given enough time to work. Economic stability inspires confidence. Privatization can work only if people are confident that the market is stable and viable. Indeed, consumer confidence is the key to any successful economy. Without complementary political stability, however, such confidence can be impossible to achieve.

#### B. *Market Functions*

Even after the legal and institutional framework is in place, a number of intangible factors arise that are necessary for the success of privatization. These functions represent integral components of a successful free market, the ultimate goal of privatization.

#### 1. Information Flows

One of the primary characteristics of the perfectly competi-

---

16. See, e.g., *Poland on a Detour*, FIN. TIMES, June 2, 1993, at 15 (quoting Hanna Suchocka, Polish Prime Minister, stating that unless stable government is maintained, it may be impossible to advance with economic reforms). Hanna Suchocka, Polish Prime Minister, has been in office for 11 months. *Id.* Polish President Lech Walesa called for general elections on September 19, 1993. Christopher Bobinski, *Walesa Prunes Parties in Poll*, FIN. TIMES, June 3, 1993, at 2.

tive market is the possession of perfect information. For example, information is an extremely important consideration for a securities market where share price, actual value, and company performance are all used to reach bid and offer decisions. In the newly-formed stock markets of Central and Eastern Europe, however, the flow of information is limited. The actual value of shares is difficult to determine as modern accounting and auditing systems need to be developed and implemented. The financial health of various companies will be hard to measure. Additionally, without securities laws, parties with accurate information will have a distinctly unfair advantage relative to the general public.

The government must promote information flows either by providing incentives to private actors to assume this role or by divulging such information itself. Official stock prices should be announced and firms should submit public statements of profit and loss. Evaluation of a firm's true worth will take time to develop since such an evaluation requires a preexisting market mechanism. Without a market in which prices can change to reflect demand, investment in stocks may slow as shareholders become unwilling to trade due to poor information.

## 2. Capital Markets

Capital markets trade financial resources, including money and stocks. Capital markets, along with financial intermediaries such as banks, are institutions through which savings in the economy are transferred to investors.<sup>17</sup> While some countries may have sufficient domestic resources for private citizens to fund privatization, most will require foreign investment. Despite its potential political impalatability, foreign capital can play a positive role in joint ventures and liquidation. Protection of the property rights of foreign investors is particularly important as those investors will require more assurances of safety and protection of their assets than domestic investors, since they will be facing more variables by virtue of investing in a foreign country.

## 3. Financial Intermediaries

A strong private banking system is a must for enduring privatization. Private banks play several vital roles in market

---

17. SAMUELSON & NORDHAUS, *supra* note 5, at 731.

economies. Commercial banks represent a medium for savings and lending. A reliable source of loans is required to finance private ventures and people need a place where they can save and build upon earnings and profits. Without strong commercial banks, the incentive for savings and financial support for risk-taking does not exist. Furthermore, money market mutual funds and investment banks are needed to handle the securities market and to facilitate the buying and selling of publicly owned companies.

## II. THE CZECH REPUBLIC AND SLOVAKIA

Until July 1992, privatization efforts of the former Czech and Slovak Federal Republic ("CSFR") were progressing with relative ease.<sup>18</sup> Employing several methods of ownership transfer, the Czechoslovak government created a program that made significant progress towards placing enterprise ownership into private hands. The decision to divide the CSFR into the Czech Republic and Slovakia, however, has created serious obstacles to the successful completion of the project.

### A. Privatization Efforts

The "small privatisation" law, presented to the Czechoslovak Federal Assembly on October 25, 1990, provided a process for the auctioning off of local shops and enterprises.<sup>19</sup> It granted the Czech and Slovak Ministries for State Property Control and its Privatization<sup>20</sup> the authority to conduct public auctions of enterprises not contested under the Restitution Law, which allows descendants of pre-war property owners to file claims to regain ownership.<sup>21</sup> Over 10,000 enterprises were privatized through

---

18. See *Czechoslovakia Takes Further Steps to Privatize Ownership*, Xinhua General News Service, Oct. 2, 1991, available in LEXIS, Nexis Library, WIRES File (discussing efforts to privatize).

19. *Czechoslovak Draft 'Small Privatisation' Law*, in U.S. DEPT. OF COM. NAT'L TECH. INFO. SERV., CENTRAL AND EASTERN EUROPEAN LEGAL TEXTS, (Nov. 7, 1990), available in LEXIS, World Library, EELEG File.

20. *Id.* Under the republic structure of the former Czech and Slovak Federal Republic [hereinafter CSFR], each republic had parallel agencies which then fell under the jurisdiction of a federal agency. *Id.*

21. *Another Law for Crucial Economic Reform Passed*, CTK Nat'l News Wire, Feb. 20, 1992, available in LEXIS, Nexis Library, WIRES File [hereinafter *Another Law*].

this system of public auctions.<sup>22</sup>

A plan for privatizing larger companies was created by the "large privatization" law of February 27, 1991,<sup>23</sup> which had jurisdiction over approximately 4000 firms.<sup>24</sup> Although firm managers were asked to submit plans for the privatization of their own enterprises, the republic and federal Privatization Ministries retained the final say with regard to which plans were enacted.<sup>25</sup>

Most large firms were privatized through a coupon voucher method authored by the Federal Ministry of Finance and administered at the republic level by the Czech and Slovak Privatization Ministries.<sup>26</sup> The plan was an effort to transfer ownership of large enterprises to a wide array of Czechoslovak citizens and to provide the widest possible dispersion of assets. Voucher coupon booklets containing points for bidding on shares in state firms and costing the equivalent of about one week's salary went on sale on October 1, 1991.<sup>27</sup> Approximately 8.5 million of the country's 15 million eligible citizens participated in the program.<sup>28</sup>

Initially, the government's plan engendered little public response, perhaps because most Czechoslovaks had no experience evaluating stocks and playing the market. Public interest greatly increased, however, when a number of private investment funds offered to redeem vouchers at a price ten to fifty times higher than their cost.<sup>29</sup> The 437 investment funds soon attained control of 75% of all coupons; the twelve biggest funds gained "40% of the vouchers distributed for the first wave of privatization."<sup>30</sup> The response to the funds thus led to an unexpected concentration of privatized assets, and, as a result, concern about anticom-

---

22. *International Congress on Investment in Czechoslovakia Opens*, CTK Nat'l News Wire, Feb. 20, 1992, available in LEXIS, Nexis Library, WIRES File.

23. See *Another Law*, *supra* note 21.

24. See Bruce A. Mann, *Privatization in the Czech Republic*, 48 *BUS. LAW.* 963 (May 1993) (discussing privatization of larger companies).

25. *Another Law*, *supra* note 21.

26. *Ministry Reports Results of Coupon Privatization*, CTK Nat'l News Wire, June 26, 1992; see B.G., *Voucher Privatization Bidding Starts May 18*, *PRAGUE POST*, Apr. 1992, at 1, available in LEXIS, Nexis Library, WIRES File.

27. John C. Coffee Jr., *The Privatization of Eastern Europe*, *N.Y. L.J.*, July 23, 1993, *Corporate Update*, at 5.

28. *Czechoslovakia: Post Election Split Threatens Privatization Scheme*, Int'l Press Service, July 31, 1992, available in LEXIS, Nexis Library, WIRES File.

29. *Making It Work*, *supra* note 14, at 90.

30. *Id.*

petitive behavior. Addressing this fear, the Federal Assembly passed a Law on Investment Funds and Investment Companies, which prohibits a single fund from owning more than 20% of any company's stock.<sup>31</sup>

Some analysts predict that many of the funds will not survive. They suggest that funds that have invested in a large number of companies will find themselves overextended and unable to provide adequate guidance to the firms they control.<sup>32</sup> A number of the funds are already experiencing financial difficulty. Their problems are unlikely to improve before share-trading begins allowing the funds to raise money to meet their expenses.<sup>33</sup> Currently, however, trading is not expected to begin until a computerized system is developed.<sup>34</sup>

The first wave of coupon privatization, five rounds of which took place in the former CSFR from May 1992 to January 1993, involved property worth U.S.\$10 billion; almost 1500 firms were transferred to the public.<sup>35</sup> The leader of the country's economic reforms, former Finance Minister Vaclav Klaus, designated 1992 as the "year of privatization" in the CSFR. However, the country's division has derailed the progress of ownership transformation. Led by officials of the Movement for a Democratic Slovakia, Slovak legislators declared Slovak sovereignty on

---

31. See generally *Foreign Investors Access to Stock Markets Could be Limited*, FIN. TIMES, LTD., FIN. E. EUR., May 8, 1992, available in LEXIS, World Library, FINEUR File (discussing general implications of law).

32. See *Making It Work*, *supra* note 14, at 90 (discussing obstacles of investment funds and predicting slow privatization in Czech Republic).

33. *Id.* With the funds' chances of success so dismal, some analysts predict that foreign investors with greater capital and expertise, and banks will increase their roles in the newly privatized economy. *Id.*

The result, many believe, will be a financial structure for the Czech Republic that is like Germany's: banks will be owners, creditors, directors and advisers to big companies. The arrangement should suit a country where capital and managerial talent is scarce. Yet the system is unlikely to work as well as Germany's for a long time, if ever [due to, *inter alia*, Czech banks' lack of expertise].

*Id.* at 93.

34. *Id.*

35. *Ministry Reports Results of Coupon Privatization*, CTSK Nat'l News Wire, June 26, 1992, available in LEXIS, Nexis Library, WIRES File. Almost 35% of the total was paid for property in Slovakia; the rest was for property in the Czech Republic. Daily Report of April 19, 1993, CTK Wire Report, April 14, 1993, available in LEXIS, Nexis Library, WIRES File.

July 17, 1992.<sup>36</sup> Federal President Vaclav Havel resigned the same day.<sup>37</sup> On July 23, 1992, Klaus, now Prime Minister of the Czech Republic, agreed with Slovak leader Vladimir Meciar on a plan, effective January 1, 1993, to divide the country into two separate states.<sup>38</sup> The plan included a large number of treaties and agreements defining post-split relations between the Czech Republic and Slovakia,<sup>39</sup> yet, despite these attempts at a smooth transition, the division has resulted in a setback for privatization in the two republics.

### 1. Czech Republic

Considering it more important to privatize state property quickly than to finalize all the details of a market economy,<sup>40</sup> the government of the Czech Republic intends to proceed with the scheduled second wave of privatization. Privatization Minister Jiri Skalicky recently announced that this wave will take place at the end of 1993.<sup>41</sup> It is expected to involve property worth about U.S.\$17 billion<sup>42</sup> and some 2100 enterprises.<sup>43</sup> Most of the property will be privatized through direct sales to foreign investors.<sup>44</sup> Some property will be sold through the voucher method, with coupon books available for purchase in the summer of 1993.<sup>45</sup>

The Czech Coupon Privatization Center planned to start transferring to investors the Czech enterprise shares that they

36. Mary Battiata, *Havel Quits as Czechoslovak President*, WASH. POST, July 18, 1992, at A1.

37. *Id.*

38. See Mary Battiata, *Czech, Slovak Leaders Agree on Plan to Split Their Federation*, WASH. POST, July 24, 1992, at A30; Jiri Pehe, *Czech-Slovak Relations Deteriorate*, 2 RADIO FREE EUR./RL RES. REP., No. 18, Apr. 30, 1993, at 1.

39. See Pehe, *supra* note 38, at 1 (discussing treaties and agreements and lack of resolution of issues). Some of these agreements and treaties addressed the division of federal assets. *Id.* Many issues, however, were left unresolved. *Id.*

40. See *Making It Work*, *supra* note 14, at 93 (discussing privatization in Czech Republic).

41. Patrick Blum, *Choice of Markets As Czechs Distribute Shares*, Privatization Int'l, No. 57, June 1993 [hereinafter *Choice of Markets*], available in LEXIS, Nexis Library, WIRES File.

42. See *Second Coupon Privatization Wave Outlined*, translated in FBIS-EEU-93-084, May 4, 1993, at 5.

43. See *Choice of Markets*, *supra* note 41 (discussing second wave of privatization).

44. *Id.*

45. Skalicky: *Privatization Fastest in Czech Republic*, translated in FBIS-EEU-93-079, Apr. 27, 1993, at 21. Some delays in approving projects for privatization have been caused by "the poor state of property ownership records and insufficiently researched materials for environmental auditing." *Id.*

acquired during the first wave of coupon privatization in late May 1993.<sup>46</sup> With this decision, the government canceled its decision of March 17, 1993, to postpone distribution of shares to Slovak investors.<sup>47</sup>

Chairman of the Czech Fund of National Property, Tomas Jezek, acknowledged that distribution could be stalled by the difficulty in identifying whether shareholders are Czech or Slovak since the computer database used in managing the coupon scheme was created before the country split.<sup>48</sup>

## 2. Slovakia

Many Slovaks felt that their economic situation was ignored in the rush to sell off property.<sup>49</sup> Prime Minister Meciar has acknowledged these concerns by maintaining that, although the process of privatization is important, it must be aimed at ensuring growth and not at getting the highest possible prices for the privatized facilities.<sup>50</sup>

On April 22, 1993, Prime Minister Meciar reiterated his government's support for continuing the privatization process, although at a slower pace and with different methods than in the Czech Republic. In June 1993, Privatization Minister Lubomir Dolgos resigned and Prime Minister Meciar has since assumed direct control over privatization.<sup>51</sup> In the second wave of privatization, scheduled for late 1993, priority is to be given to the use of public tenders, public auctions, and direct sales, although some shares will be distributed through coupon privatization.<sup>52</sup> According to the former Slovak Privatization Minister Dolgos,

---

46. *Privatization Shares Distribution to Start*, translated in FBIS-EEU-93-093, May 17, 1993, at 9.

47. *Id.* This decision was made in reaction to the Slovak delay in former federal property division. *Id.*

48. See Pehe, *supra* note 38, at 2.

49. Robert Mclean & Laura Pitter, *Czechoslovakia: Post-Election Split Threatens Privatization Scheme* Int'l Press Serv., July 3, 1992, available in LEXIS, Nexis Library, WIRES File.

50. See *Meciar Outlines Republic's Policy in Speech*, translated in FBIS-EEU-93-038, Mar. 1, 1993, at 14.

51. *Slovak Parliament Backs Government Economic Programme*, The Reuter Asia-Pac. Bus. Rep., Apr. 26, 1993, available in LEXIS, Nexis Library, WIRES File; *Ex-Slovak Privatisation Minister Leaving Ruling Party*, The Reuter Eur. Bus. Rep., June 23, 1993, available in LEXIS, Nexis Library, REUTER File.

52. See *Ministers Outline Privatization Plans*, translated in FBIS-EEU-93-041, Mar. 4, 1993, at 12.

the coupon method has been pushed into the background because it is inefficient.<sup>53</sup> Former Minister Dolgos acknowledged the country's slow privatization pace.<sup>54</sup> He fears that government delay is likely to stall the second wave of privatization, during which property valued at over U.S.\$8 million is scheduled to be sold.<sup>55</sup>

## B. *Institutional Environment: Czech Republic and Slovakia*

### 1. Property Rights

Under the CSFR's socialist regime, state ownership enjoyed precedence over private ownership. In recent years, however, the constitution was amended to eliminate this division.<sup>56</sup> Similarly, the Civil Code of the CSFR, adopted in 1964, established a hierarchical definition of property rights.<sup>57</sup> Twelve amendments in 1992 did away with the hierarchical structure and "equalized the legal status of state and private property."<sup>58</sup> Before the country divided, a complete re-write of the Code was planned;<sup>59</sup> it is presently unclear whether the Czech Republic and Slovakia will proceed on their own to make the changes envisioned before the CSFR's breakup.

Even with revisions to the Civil Code, elimination of the state's monopoly on real property will be slow going. The restitution process has proven to be a significant obstacle.<sup>60</sup> Returning lands to their pre-communist period owners will transfer

---

53. See *Minister Discusses Privatization Problems*, translated in FBIS-EEU-93-038, Mar. 1, 1993, at 16.

54. *Slovak Privatization*, in 4 Eur. & Former Soviet Telecom Rep., May 1, 1993, No. 5, available in LEXIS, Nexis Library, WIRES File.

55. *Dolgos Dissatisfied with Second Privatization Wave*, translated in FBIS-EEU-93-073, Apr. 19, 1993, at 15.

56. See CHERYL W. GRAY ET AL., THE LEGAL FRAMEWORK FOR PRIVATE SECTOR ACTIVITY IN THE CZECH AND SLOVAK FEDERAL REPUBLIC 2-3 (Country Economics Dept., The World Bank, Policy Research Working Papers No. WPS 1051, Nov. 1992) [hereinafter LEGAL FRAMEWORK]. For example, the Constitutional Law on Fundamental Rights, adopted in January 1991, gives all people the right to own and inherit property and provides protection for all types of ownership rights. *Id.* at 3.

57. *Id.* at 3-4.

58. *Id.* at 4.

59. *Id.*

60. See *Minister Discusses Privatization Problems*, translated in FBIS-EEU-93-038, Mar. 1, 1993, at 18. The former Minister of Privatization, Lubomir Dolgos, noted that the Ministry of Privatization has received 2,000 unsettled restitution claims and, but for these, the Ministry would have progressed at least one-third further. *Id.*

ownership of only some state-owned lands. Other real property will still require privatization.<sup>61</sup>

## 2. Contract Law

Under the CSFR's socialist regime, freedom of contract was limited. Beginning in 1990, however, a number of legal reforms were directed at opening the system to increased private commercial transactions and treating them as equal to public transactions.<sup>62</sup> The new Czechoslovak Commercial Code and the revised Civil Code<sup>63</sup> eliminated the concept of contract conclusion based on commands "from above" and adopted, instead, a concept of property based on liberal economics.<sup>64</sup>

The Civil Code of 1964 was extensively amended in 1991 to equalize treatment of public and private transactions and to reinstate market concepts of contract law.<sup>65</sup> The new Commercial Code provides legal rules governing commercial contracts in such areas as commercial paper, secured transactions, and other financial agreements.<sup>66</sup>

The true test of these legal changes will arise in judicial interpretation of these Codes which will reflect the actual protections to be extended to private contractual agreements.

## 3. Entry and Exit Laws: Competition and Bankruptcy

The New Czecho-Slovak Competition Act was passed on January 30, 1991, and took effect March 31, 1991.<sup>67</sup> By preventing anti-competitive behavior, the law helps to ensure that the market remains accessible to entry by new participants.<sup>68</sup> The law sets up a Federal Competition Office and a competition author-

---

61. See LEGAL FRAMEWORK, *supra* note 56, at 4 (describing privatization and restitution laws which govern process by which property is returned to previous owners).

62. *Id.* at 18.

63. Pavel Kalensky, *Liberal Commercial Code*, FIN. TIMES BUS. L. BRIEF, Dec. 1991, at 10. The revised Civil Code came into effect on January 1, 1992 and governs commercial contracts. *Id.*

64. *Id.*

65. See LEGAL FRAMEWORK, *supra* note 56, at 19 (discussing 1991 amendments to Civil Code and objectives).

66. *Id.*; see Kalensky, *supra* note 63, at 10 (discussing Civil Code and provisions for financial agreements).

67. The New Czecho-Slovak Competition Act, No. 63, at 9 (Federal Competition Office, Bratislava, Czecho-Slovakia 1991) [hereinafter Competition Act].

68. See *id.* at 9.

ity in each of the republics.<sup>69</sup> Since the country divided, competition policy has been implemented by the Czech Office of Economic Competition and the Slovak Antimonopoly Office; the Federal Office no longer exists. The competition agencies are charged with preventing abuses of dominant position, overseeing mergers, and promoting competitive concerns in the privatization process.<sup>70</sup> Fostering a competitive philosophy is difficult, however, in a country where the mindset has been otherwise for so long. Unfortunately for the Czech and Slovak competition authorities, what are now considered illegal cartel agreements pursuant to the competition law used to be the norm.<sup>71</sup> Such cartel-like arrangements are common throughout the food processing industry and most professional groups.<sup>72</sup> The issue is whether the competition law is adequate to battle the long-standing tradition of extreme monopolization without a corresponding shift in attitudes.

Both the Czech and the Slovak competition authorities have the power to review and reject privatization plans. This disapproval may then be appealed to the government.<sup>73</sup> Foreign investors, who must work with the privatization ministry as well as the competition office of each republic have complained of the unclear review process where different groups "rarely speak with one voice" and have requested the development of transparent guidelines.<sup>74</sup> While guidelines have not been developed, the Czech Government has responded to this type of complaint noting that the Czech Office of Economic Competition ("CUHS") has approved mergers in less than the three month term permitted by law; has contributed to a flexible and speedy review process; and has helped eliminate differences of opinion between investors and the government.<sup>75</sup> A response to the Czech gov-

---

69. *Id.* at 31.

70. *Id.* at 31-32.

71. See Milan Ruzicka, *New Rules Fail to Eliminate E. Europe Cartels*, J. OF COM., Dec. 14, 1992, at 1A.

72. *Id.*

73. The New Czecho-Slovak Competition Protection Act, art. 19(2), No. 63, at 41-42 (Federal Competition Office, Bratislava, Czecho-Slovakia 1991). This law was developed when Czechoslovakia was still one country and is still in effect although each republic foresees enactment of a new competition law. *Id.*

74. Daniel Arbess, *Survey of Privatisation in Eastern Europe*, FIN. TIMES, July 3, 1992, at 7.

75. See Ivo Bezecny, *Smooth Path to Czech Markets*, EUR., Oct. 22-25, 1992, at 35. In this same article Mr. Bezecny states that "[t]he basic philosophy of merger control is to

ernment noted that “[s]ince the end of September [1992, the CUHS] has been more thoroughly integrated into the decision-making process and has proved more successful than many people expected.”<sup>76</sup>

On April 22, 1993, the Czech Republic’s bankruptcy law came into effect after being delayed twice in 1992.<sup>77</sup> Observers predict that a wave of bankruptcies is imminent.<sup>78</sup> The new law is designed to prevent uncontrolled failures but to encourage closing persistent loss-making enterprises.<sup>79</sup> The law creates a settlement period of three to six months during which creditors and debtors may negotiate. A creditor’s failure to comply with statutory deadlines results in a waiver of claims.<sup>80</sup>

After several unsuccessful attempts, the Slovak government recently adopted an amendment to the country’s bankruptcy law.<sup>81</sup> The amended law is designed to give companies that cannot pay their debts the chance to negotiate bankruptcy

---

contribute to market structures and to prevent or eliminate those which would endanger economic competition.” *Id.*

76. Chris Pommery, *Clearcut Help for Sell-offs*, EUR., Oct. 22-25, 1992, at 35. Despite this favorable reply, Mr. Pommery also notes that the “full outlines of the government’s antimonopoly policy are . . . still being defined.” *Id.*

On the issue of trade liberalization, in a presentation given by the former CSFR Czech Premier, Vaclav Klaus spoke to the role of trade liberalization in creating a competitive marketplace. See *Klaus Presents Czech Government Policy*, translated in FBIS-EEU-92-135, July 14, 1992, at 10 [hereinafter *Klaus Presents Policy*]. He stated that “[t]he government will thoroughly promote the policy of the continuing liberalization of foreign trade, which is the most important condition for opening the Czech economy to foreign competition”. *Id.*

77. *Czech Bankruptcy Law Goes into Effect*, 2 RADIO FREE EUR./RL RES. REP., No. 18, Apr. 22, 1993, at 19 [hereinafter *Czech Bankruptcy Law*].

78. See Patrick Blum, *Czechoslovak Divorce Costs Both Sides Dear*, FIN. TIMES, Apr. 20, 1993, at 2. “According to conservative estimates, two-thirds of Czech industry is insolvent, including 80% of the country’s biggest and most important producers.” See *Czech Bankruptcy Law*, *supra* note 77, at 19 (discussing increasing insolvency in Czech Republic and bankruptcy law).

79. See Anthony Robinson, *Survey of Czech Republic, A Rich Diet of Adjustment*, FIN. TIMES, Mar. 24, 1993, at 2. The indebtedness of many state enterprises is partially addressed by the Consolidation Bank, which finances bad-debt write-offs with proceeds from privatization. See Patrick Blum, *Survey of Czech Republic, Changes Create Problems*, FIN. TIMES, Mar. 24, 1993, at 3 [hereinafter *Changes Create Problems*]; see also *Klaus Presents Policy*, *supra* note 76, at 10 (quoting Klaus stating that Czech government advocated “competition-driven management of loss-making, over-committed, and insolvent firms. Unfortunately, bankruptcies of nonviable firms cannot be avoided, because they are sometimes inevitable to make the economy healthier”). *Id.*

80. See *Czech Bankruptcy Law*, *supra* note 77, at 19. “[D]ebtors have 15 days to apply for a three month protection period and creditors have 30 days to file claims. . . .” *Id.*

81. See *Parliament Approves Amendment to Bankruptcy Law*, translated in FBIS-EEU-93-

terms with creditors and aims at restoring them to a sound financial basis.<sup>82</sup>

Fear that a large number of bankruptcies would be declared immediately may have contributed to the amendment's repeated failure to pass. According to Prime Minister Meciar, "seventy-three percent of industrial enterprises and over fifty percent of building enterprises demonstrate an inability [to pay their debts]."<sup>83</sup> A former economics minister has said that 900 of 2000 major Slovak enterprises are currently threatened by bankruptcy.<sup>84</sup>

#### 4. Securities Legislation

The outcry against investment funds during the CSFR coupon privatization process was so strong that the Federal Assembly hurriedly drafted a securities law to mollify the public. The law, passed on April 21, 1992, provides the legal basis for a securities exchange and defines the rules for participation.<sup>85</sup> It also establishes an oversight council and a dispute resolution mechanism.<sup>86</sup> Once shares of newly privatized firms are transferred, market participants will have legal protection from abuses by traders and institutional investors.

Authority for regulating the stock exchanges in Prague and Bratislava lies with the Czech and Slovak Finance Ministries. Western experts are currently aiding those officials in implementing the policies defined by the law. Until the trading of shares gets underway, it will be difficult to judge the efficacy of the law.

#### 5. Political Stability

The federal Czechoslovak government proved stable through June of 1992, paving the way for the successful passage

---

099, May 25, 1993, at 18 [hereinafter *Amendment to Bankruptcy Law*]; see also Meciar *Interviewed on Bankruptcy Law, Economy*, translated in FBIS-EEU-93-074, Apr. 20, 1993, at 16.

82. See *Amendment to Bankruptcy Law*, *supra* note 81, at 18 (discussing increasing insolvency in Czech Republic and bankruptcy law).

83. See *Meciar Stresses Restructuring Enterprises*, translated in FBIS-EEU-93-094, May 18, 1993, at 9.

84. Jan Obrman, *Internal Disputes Shake Slovak Government*, 2 RADIO FREE EUR./RL RES. REP., No. 14, Apr. 2, 1993, at 16.

85. *Law on Securities Market*, HOSPOCLARSKÉ NOVINSKY, May 13, 1992 (Czech.), reprinted in J.P.R.S.-EEU-92-079-5 54 (June 23, 1993) [hereinafter *Law on Securities Market*].

86. *Id.* at 57.

of key legislation and the implementation of the voucher bidding scheme. The country's division into separate states, however, has brought political and economic uncertainty and hindered privatization efforts in both countries.

Despite assurances from both governments that problems between them would be resolved, especially with regard to asset division, observers, including some government officials, have become increasingly pessimistic about their ability to compromise.<sup>87</sup>

Recent opinion polls show a high degree of public trust in the government of Prime Minister Vaclav Klaus and President Vaclav Havel,<sup>88</sup> their ruling coalition<sup>89</sup> has gained considerable public support since parliamentary elections were last held in June 1992.<sup>90</sup> The high approval rate may reflect the country's relatively healthy economy.<sup>91</sup> In contrast, the opposition has been plagued by internal disorganization and has consequently proven ineffective in challenging or checking government action.<sup>92</sup>

Slovakia lags significantly behind the Czech Republic in terms of economic progress. Many citizens and politicians want to slow the pace of reform until the economy can be stabilized. The continued poor performance of Slovakia's economy has caused the government's popularity to falter.<sup>93</sup>

Since the breakup of the CSFR, public support for Prime Minister Meciar and his ruling party, the Movement for a Democratic Slovakia ("MDS"), has dropped significantly,<sup>94</sup> despite

---

87. See Pehe, *supra* note 38, at 3 (discussing split of country into two states and resulting tensions).

88. See *Poll Shows Havel, Klaus Trusted by Majority*, translated in FBIS-EEU-93-099, May 25, 1993, at 12.

89. Jan Obrman, *Czech Opposition Parties in Disarray*, 2 RADIO FREE EUR./RL RES. REP., No. 16, Apr. 16, 1993, at 1. The coalition consists of Klaus' Civic Democratic Party, the Civic Democratic Alliance, the Christian Democratic Union-People's Party, and the Christian Democratic Party. *Id.*

90. *See id.*

91. See Dan De Luce, *Slovakia's Status New, But Old Issues Still Linger; Economy Flounders as Politicians Quarrel*, WASH. POST, Apr. 10, 1993, at A13 (stating that "[u]nemployment [in the Czech Republic] is running at less than [three] percent, while Slovakia's jobless rate stands at about 11 percent. After a precipitous two-year decline, Czech productivity is beginning to stabilize."). *Id.*

92. *See id.*

93. Obrman, *supra* note 84, at 16.

94. See De Luce, *supra* note 91, at A13. "Since the demise of the Czechoslovak

Meciar's efforts to strengthen his position.<sup>95</sup> Meciar has also lost leverage in the parliament. When the Slovak National Party pulled out of the government's informal coalition in March 1993, it left the MDS "two votes short of a majority in the 150-member parliament."<sup>96</sup> For the time being, the MDS has rejected the possibility of forming another coalition government.<sup>97</sup>

Against Meciar's wishes, Michal Kovac of the MDS was elected President of Slovakia in February 1993; he is widely considered to be opposed to Meciar. Although Kovac's position is largely ceremonial, analysts have wondered whether the increasingly popular President might step in and attempt to influence the direction of Meciar's government.<sup>98</sup>

The lack of unity within the ruling party threatens Slovakia's political stability. An illustration of this discord is Meciar's announcement that there will be no second round of coupon privatization; two of his ministers, however, maintain that the process will begin during the summer of 1993.<sup>99</sup> The government's disarray is further illustrated by the resignation of one minister and the ousting of another.<sup>100</sup> Several ministers have been dismissed or have chosen to resign, including Privatization Minister Dolgos. This has resulted in a growing public uncertainty about the government's reforms.<sup>101</sup>

### C. *Market Functions: Czech Republic and Slovakia*

#### 1. Information Flows

Information has not always been available to the investing public. There is difficulty in adequately assessing the true value of most Czechoslovak enterprises given the country's failure to use Generally Accepted Accounting Standards for many years.

---

state, support for Meciar's ruling party has dropped in Slovak opinion polls from 30 percent to 24 percent." *Id.*

95. See Obrman, *supra* note 84, at 13 (predicting future bankruptcies).

96. De Luce, *supra* note 91, at A13.

97. See Alexander Picha, *HZDS Rejects Call for Early Elections*, translated in FBIS-EEU-93-101, May 27, 1993, at 7.

98. See Obrman, *supra* note 84, at 17 (discussing relationship between Kovac and Meciar).

99. *Id.*

100. See Patrick Blum, *Slovak Leader Tightens Grip on His Party*, *FIN. TIMES*, Mar. 30, 1993, at 4.

101. See *id.*; see also Bernd Debusmann, *Czech-Slovak Gulf Widens*, Reuters, Sept. 5, 1993, available in LEXIS, Nexis Library, REUTER File.

The lack of such knowledge forced investors during the first wave of privatization to guess which firms might be profitable.<sup>102</sup> With the enormous number of firms being transferred to private hands, government officials had relatively little time to analyze privatization plans for individual firms.<sup>103</sup>

The Czechoslovak government, however, made efforts to respond to the widespread lack of information. The securities law of April 1992 includes provisions requiring the publication of financial data by stock issuers.<sup>104</sup> The law also requires price quotes to be published at the end of every business day by exchange traders.<sup>105</sup> The provisions of the securities law are a positive step toward promoting information dissemination.

## 2. Capital Markets

Before the country broke up, the CSFR pursued foreign investment to attract needed capital. Privatization officials designated approximately fifty firms for sale to foreign companies, and many others entered into joint ventures.<sup>106</sup> Firms such as Philip Morris, Dow Chemical, Coca-Cola, and K-mart initiated investments amounting to hundreds of millions of dollars.<sup>107</sup> The government has signed an investment treaty with the United States.<sup>108</sup> The country also passed tax legislation enabling foreign corporations to repatriate a portion of the profits that they make in the country.<sup>109</sup> The CSFR's commitment to reform, as well as its relative stability, proved attractive to investors.

Although foreign investors could not invest directly in coupon privatization, they have been able to buy shares on the secondary market. By the end of 1992, shares worth almost

---

102. See Charles T. Powers, *Czechoslovaks Start Bidding For a Piece of State Firms*, L.A. TIMES, May 19, 1992, at A4.

103. *Id.*

104. *Law on Securities Market*, *supra* note 85, pt. 4, § 23.

105. *Id.* pt. 5, § 25.

106. See Peter Martin, *Privatization Stirs Controversy*, REP. ON E. EUR., Oct. 4, 1991, at 7.

107. See Robert C. Toth, *K-mart Buys Up a Dozen Department Stores in Czechoslovakia*, L.A. TIMES, May 8, 1992, at D12.

108. Donnie Radcliffe & Roxanne Roberts, *Vaclav Havel, Getting Down to Business: At the White House Dinner, Czechoslovak's Labor of Love*, WASH. POST, Oct. 23, 1991, at B1.

109. Vaclav Klaus, *Remarks at Overseas Private Investment Corporation Conference on Investment in Czechoslovakia*, Fed. News Service, Mar. 4, 1992, available in LEXIS, Nexis Library, WIRES File.

U.S.\$260 million and property worth almost U.S.\$150 million had been sold to foreign investors.

#### a. Czech Republic

Before the CSFR disintegrated, the Czech Republic, with its central location, skilled labor force, and low wages, received close to 90% of the foreign investment coming into the country.<sup>110</sup> The country's breakup does not appear to have significantly deterred the influx of capital: according to the Czech National Bank, direct foreign investment in the Czech Republic in the first quarter of 1993 amounted to U.S.\$302 million, an increase of almost 31% over the same period last year.<sup>111</sup> Currently, Germany holds the number one foreign investment position, accounting for 32.2%, and the United States for 29.5%.<sup>112</sup> Minor tax advantages are available for foreign investors. Prime Minister Klaus' policy, however, is national, and advances equal treatment for foreign investors; he maintains that the country is attractive for investment without added incentives.<sup>113</sup>

Although a number of foreign investment privatizations have been proposed, inefficient government administration has led to costly delays.<sup>114</sup> With the success of the coupon privatization program, however, foreign investors can avoid the burdensome official privatization process and buy shares or companies directly from shareholders or from the electronic stock market.<sup>115</sup> The anticipated restructuring and development of the country's industrial and infrastructural sectors present prime op-

---

110. See Anthony Robinson, *Survey of Czech Republic, Ready To Go It Alone*, FIN. TIMES, Mar. 24, 1993, at 1 [hereinafter *Ready To Go It Alone*]; see also, Patrick Blum, *Survey of Czech Republic, Ideal Base for Exporters*, FIN. TIMES, Mar. 24, 1993, at 3 [hereinafter *Ideal Base*].

111. See Hana Piskova, *First Quarter Foreign Investment Figures*, HOSPODARSKE NOVINY, May 13, 1993, at 11, translated in FBIS-EEU-93-094, May 18, 1993, at 8.

112. *Id.*

113. See *Ideal Base*, *supra* note 110, at 3 (discussing foreign investment).

114. *Id.* Foreign investment plans have been discarded for a number of reasons. In March 1993, Mercedes-Benz abandoned its plans for a joint venture with the Avia truck company because the Czechoslovak split made access to Eastern Europe more difficult. See Blum, *supra* note 78, at 2 (discussing foreign investment). "Several other large investments have either fallen through (Dow Chemicals), are being revised downwards (Siemens) or are locked in endless negotiations (Iveco/Fiat)." *Id.*

115. See Robinson, *supra* note 79, at 2 (discussing Consolidation Bank's attempts to reduce indebtedness by using proceeds from privatization).

portunities for foreign investment.<sup>116</sup> The Czech Government recently approved the placement of U.S. management into the Tatra Koprivnice joint stock company, a car and truck producer.<sup>117</sup> Although this firm is presently in financial trouble, it was privatized via the voucher system. The receptivity of the Czechs to foreign investment is exemplified by this transfer: management will assume a key decision-making role rather than an advisory one in Tatra's eleven-member Board of Directors.<sup>118</sup> The breakup of the CSFR led to a great reduction of trade between the Czechs and the Slovaks. Traditionally, 25% of all Czech exports went to Slovakia, and 40% of all Slovak exports were shipped to the Czech Republic; experts predict inter-Republic trade could fall by 30% to 40% in 1993.<sup>119</sup> With the initiation of various new border and commerce laws between the two countries, each nation was forced to pursue alternate markets to maintain their trade equilibrium. Prior to the disintegration, in 1992, 70% of Czech and Slovak exports were destined for the West, but further increases will be difficult as typical exports like steel and textiles are subject to increasing Western protectionism.<sup>120</sup> On the whole, however, the Czech Republic has fared quite well following the break up. For example, overall growth of capital invested in the form of foreign direct investment into the Czech Republic reached 53.7 billion korunas (U.S.\$1.868 billion).<sup>121</sup>

#### b. Slovakia

Slovakia no longer receives the subsidies it was accustomed to getting from the Czech Republic.<sup>122</sup> According to representatives from Western Banks, foreign currency reserves in the Slovak National Bank have fallen to "unacceptably low levels."<sup>123</sup> The country is in need of capital, but its political instability

---

116. *See id.*

117. *See U.S. Management Stake in Tatra Approved*, PRAGUE CTK, Apr. 28, 1993, translated in FBIS-EEU-93-084, May 4, 1993, at 4.

118. *Id.*

119. *See Blum, supra* note 78, at 2 (discussing insolvency in Czech Republic).

120. *Id.*

121. *See id.*

122. *See Robinson, supra* note 79, at 2 (discussing Consolidation Bank's attempts to reduce indebtedness by using proceeds from privatization).

123. Dan De Luce, *Slovakia's Status New, But Old Issues Linger; Economy Lingers as Politicians Quarrel*, WASH. POST, Apr. 10, 1993, at A13.

threatens foreign investment.<sup>124</sup>

According to Former Privatization Minister Dolgos, the Slovak government has been taking affirmative steps to attract foreign capital. For example, in February 1993, the government hosted an international investors' conference on doing business in independent Slovakia.<sup>125</sup> At that conference, Slovak officials emphasized that domestic and foreign parties would be given equal consideration in the privatization process.<sup>126</sup> Furthermore, the country recently introduced major tax incentives for foreign investment.<sup>127</sup> Similarly, enterprises worth U.S.\$490 million have been earmarked for sale to foreign investors.<sup>128</sup>

### 3. Financial Intermediaries

On December 20, 1991, the Czechoslovak Federal Assembly passed legislation creating the State Bank and establishing regulations for private banks.<sup>129</sup> Several banks were sold during the first round of coupon privatization; others merged with foreign banks, gaining needed capital in the process. Many foreign banks have branches in the CSFR, and most investment banking is handled by them. The framework for a good banking system is now present: commercial banks, investment banks, and a central bank all have a legal presence in the country.<sup>130</sup>

Twin stock exchanges linked by computer were established in the republic capitals, Prague and Bratislava, to trade part of the shares; the remainder were to be traded over-the-counter by investment banks.<sup>131</sup>

---

124. See Jan Obrman, *Internal Disputes Shake Slovak Government*, 2 RADIO FREE EUR./RL RES. REP., No. 14, Apr. 2, 1993, at 17.

125. See *Minister Discusses Privatization Problems*, translated in FBIS-EEU-93-038, Mar. 1, 1993, at 17.

126. See *Minister Outlines Privatization Plans*, translated in FBIS-EEU-93-041, Mar. 4, 1993, at 13.

127. See Blum, *supra* note 78, at 2 (discussing tax incentives to reduce insolvency in Czech Republic).

128. See *Minister Kubecka Outlines Economic Measures*, FBIS-EEU-93-095, May 19, 1993, at 12.

129. Act of Dec. 20, 1991 on Banks (Czech and Slovak Fed. Rep.) (English translation on file with the *Fordham International Law Journal*).

130. *Changes Create Problems*, *supra* note 79, at 3.

131. John Mastrini, *Prague and Bratislava Exchanges Await Action*, Reuter Asia-Pacific Bus. Rep., Apr. 28, 1993, available in LEXIS, Nexis Library, WIRES File.

### a. Czech Republic

The Czech banking market has been expanding rapidly; approximately seventy Czech and foreign institutions are currently operating.<sup>132</sup> The Czech Republic has made great strides in revolutionizing its banking industry. It has created three different types of banks. First, the recently renamed Czech National Bank (previously the Central Bank) has been made responsible for future currency development, and is wholly separate from commercial banking activity. The second group consists of banks which originated as state-owned intermediaries but later broke off to become quasi-privatized, allowing some power to remain with the state through substantial, but not majority, stakes in the bank. Small, entirely privatized banks comprise the third group, many of which developed from domestic sources, such as Agrobanka Praha and its associated regional networks.<sup>133</sup> Under the Communist regime, the banking system was burdened by a huge number of bad debts, many of which resulted from loans to state companies on government orders.<sup>134</sup> To give the banks a fresh start, the Czech government allowed them to transfer their bad loans to the Consolidation Bank, which was expressly created for this purpose.<sup>135</sup>

To further spur economic growth and expedite the privatization process, the Czech Republic also founded the Ceskomoravska Guarantee and Development Bank, which assumes loan guarantees for new clients and provides some state support to high risk entrepreneurs to insure the much needed credit they desperately seek.<sup>136</sup>

### b. Slovakia

According to Peter Mihok, Chairman of the Slovak Chamber of Commerce and Industry, Slovak banks have been unable

---

132. *Changes Create Problems*, *supra* note 79, at 3.

133. *See Banks Quickly Adapt*, FIN. TIMES, THE CZECH REPUBLIC, Jan. 11, 1993 [hereinafter *Banks Adapt Quickly*].

134. *Changes Create Problems*, *supra* note 79, at 3.

135. *See id.* "The hope is that the Consolidation Bank will be able to get some of the loans repaid, and sell some of the bad debt on the market. The rest will have to be repaid by the National Property Fund, an institution established to handle the privatization process . . . ." *Id.* "[T]he Consolidation Banks- [are] special institutions under the administration of the Ministry of Finance, which, in turn, oversees long-term redemption." *Banks Adapt Quickly*, *supra* note 133.

136. *See Banks Adapt Quickly*, *supra* note 133 (discussing Consolidation Bank).

to issue credit since October of 1992.<sup>137</sup> The banks have no funds to loan; even if they did, interest rates would be between 24% and 26%.<sup>138</sup> The Slovak Foreign Ministry initiated its push for private investment by guaranteeing "up to 75% of commercial bank credits, plus grants covering up to 75% of interest payments . . . ."<sup>139</sup> This push followed efforts by the Slovenska Zarucna Banka (Slovak Guarantee Bank), which has traditionally aided small and medium sized businesses engaged in foreign and domestic tourism and travel. In 1992, Slovenska Zarucna Banka guaranteed 289.4 million korunas of credits, supported green credits (a framework which guarantees 538.3 million korunas for 316 agricultural groups), and provided grants within development programs devised by the government of Slovakia.<sup>140</sup>

### III. *POLAND*

The Polish privatization program has been characterized by changes in policy and shifts in emphasis. The political divisions that have plagued Poland since the overthrow of the Communists have stymied privatization reforms.

#### A. *Privatization Laws*

The Sejm, the Polish Parliament, passed Poland's first privatization law on July 13, 1990.<sup>141</sup> It established plans for converting all state-owned enterprises into joint-stock companies owned entirely by the State Treasury. Privatization was to occur in two fashions: sale of stock to third parties and liquidation. The law called for economic analyses to be performed on enterprises sold through stock offerings, and it included provisions on preferential treatment for employees buying shares, payment of outstanding financial obligations, and repatriation of foreign capital. It also called for the distribution of "privatization coupons" to all Polish citizens free of charge, which could then be

---

137. See *No Credit Available From Banks Since October*, FBIS-EEU-93-046, Mar. 11, 1993, at 18-19.

138. See *id.* at 19.

139. See *Increase in Illegal Border Crossings Noted*, translated in FBIS-EEU-93-095, May 19, 1993, at 12.

140. *Id.*

141. See *Law on Privatization of State Enterprises*, RZECZPOSPOLITA, July 23, 1990, at 3-4.

exchanged for shares.<sup>142</sup> Liquidation simply meant dissolving unprofitable companies and selling or leasing their valuable assets to third parties. Workers' councils received permission to appeal any decision to liquidate. Another law passed on the same date created the Ministry for Ownership Transformation (or Privatization Ministry) to oversee the conversion and sale of Polish firms.

Unlike the Czechoslovak privatization laws, the Polish law contained few specifics. It identified general objectives for the program but contained few details on the execution of the plan. In December of 1990 the Polish government issued a document outlining its strategy for privatization.<sup>143</sup> It split Polish companies into two categories: 500 large enterprises and 5500 small-to-medium-sized enterprises.<sup>144</sup> The plan envisioned substantial growth in the latter category as large firms were fragmented into individual components. The Polish strategy document reiterated that sale of shares and liquidation were the two available methods for privatizing firms. In addition, unlike the Czechoslovak plan, which recognized the utility of selling small companies in their entirety, the Polish plan left open the option of selling shares of these enterprises to various parties. Because the companies are small, the value of their stock is very low and having to report to a diverse body of owners hampers the ability of managers to conduct business.

The Polish plan envisioned the creation of investment funds to aid in the distribution of shares to Polish citizens. The initial plan called for 30% of each company's stock to be given to the public through these funds.<sup>145</sup> Another 20% would go to pension plans, also managed by investment funds.<sup>146</sup> Ten percent would be reserved for half-price sale to company workers and another 10% would be sold to banks.<sup>147</sup> The remaining 30% would remain with the Treasury, which could sell the shares to foreign investors or other Polish companies.<sup>148</sup> Western manag-

---

142. *Id.*

143. U.S. DEPT. OF COM. NAT'L TECH. INFO. SERV., CENTRAL AND EASTERN EUROPE LEGAL TEXTS, *Polish Government Program for Privatization of the Polish Economy*, 43 (Dec. 1990) [hereinafter *Polish Government Program*].

144. *Id.* at 45.

145. *Id.* at 46.

146. *Id.*

147. *Id.* at 47.

148. See *Polish Government Program*, *supra* note 143, at 47.

ers were to be recruited to run the investment funds.

Privatization stalled in the first half of 1991. Disputes between management and workers, political upheavals, and the general weakness of the Polish economy all combined to hamper the pace of selling enterprises to private parties. By June 1991, the Treasury had sold only thirteen companies.<sup>149</sup> The Privatization Ministry, in an effort to refocus privatization reforms, unveiled a new mass privatization plan on June 27, 1991.<sup>150</sup> The plan called for the establishment of five to twenty National Management Funds ("NMFs") to run Polish businesses and distribute shares to the people.<sup>151</sup> NMFs would control 60% of each Polish enterprise, with employees getting 10% of the shares and the government holding on to 30%.<sup>152</sup> Each firm would be assigned a "lead fund," which would receive 33% of the company's stock.<sup>153</sup> Lead funds would be responsible for the management of enterprises and for preparing annual financial statements. The remaining 27% of "fund stock" would be distributed among the other NMFs.<sup>154</sup> Polish citizens would then receive vouchers giving them a stake in the NMFs.<sup>155</sup>

The Privatization Ministry originally planned for 400 firms to participate in the initial execution of the mass privatization scheme.<sup>156</sup> However, this number was slashed to 204 in the wake of political turmoil at the end of 1991.<sup>157</sup> Prime Minister Jan Krzysztof Bielecki's party fared very poorly in October elections, and Bielecki was replaced later in the year by Jan Olszewski.<sup>158</sup> With a new prime minister came a new government and a new privatization minister. Privatization slowed considerably as the Olszewski government concentrated on consolidating its power. By the end of 1991, Poland had privatized fewer than

---

149. See Steve Lohr, *Poland to Privatize Industry by Giving Stake to All Adults*, N.Y. TIMES, June 28, 1991, at A1.

150. *Id.*

151. See *supra* notes 145-48 and accompanying text (discussing Polish privatization plan).

152. *Id.*

153. *Id.*

154. *Id.*; see Lohr, *supra* note 149, at A1.

155. *Id.*

156. *Id.*; see Michael S. Lelyveld, *Polish Privatization to Continue Despite Political Uncertainties*, J. OF COM., Nov. 26, 1991, at A12.

157. See *id.*

158. See Christopher Bobinski, *Polish Coalition Talks Hit*, FIN. TIMES, Dec. 16, 1991, at 2.

thirty enterprises.<sup>159</sup>

Privatization regained momentum in March of 1992, when the government announced plans to speed up the privatization process.<sup>160</sup> The new program called for up to 600 companies to be privatized by the end of 1992 through the mass privatization scheme developed by the previous government.<sup>161</sup>

Less than two weeks after the announcement to speed up the process, the Polish government announced that the entire program was in danger of insolvency.<sup>162</sup> To generate capital, the Polish government began offering Polish companies for sale to foreign investors. The *Financial Times* ran an advertisement promoting the sale of 80% shares in twenty Polish companies.<sup>163</sup> Meanwhile, the mass privatization plan was put on hold yet again. Only seven joint stock companies were privatized by mid-1992.<sup>164</sup> June of 1992 was a month of political chaos in Poland as the Olszewski government fell, and a government led by Waldemar Pawlak never gained acceptance. Finally, on July 8, Hanna Suchocka was named as Poland's new prime minister.<sup>165</sup> This upheaval brought privatization to a halt as Polish leaders were sidetracked while they attempted to form a lasting government.

The push for privatization soon resumed under Prime Minister Hanna Suchocka and Privatization Minister Janusz Lewandowski. With the support of the Coalition, a current union of Polish Political Parties banded together to back the Mass Privatization Program. Privatization was brought to the floor of the Sejm for a vote where it was narrowly defeated on March 19, 1993.<sup>166</sup> This setback was in major part due to the break in ranks by Coalition members belonging to the Christian National

---

159. See Lelyveld, *supra* note 156, at A12 (presenting statistics on privatization).

160. *Polish Government Speeds Up Privatization Program; Western Experts to Play Key Role*, 2 EBRD WATCH, No. 8, Mar. 2, 1992, at 4.

161. *Id.*

162. See *Money Could Run Out*, FIN. TIMES, FIN. E. EUR., Mar. 19, 1992, available in LEXIS, World Library, FINEUR File.

163. *Capital Privatization: Who's the Boss?*, RZECZPOLPOLITA, No. 109, May 9, 1992, at 1.

164. *Last Six Months of Privatization Assessed*, translated in FBIS-EEU-92-131, July 8, 1992, at 20.

165. See *Walesa Accepts Suchocka Candidacy, Cabinet*, translated in FBIS-EEU-92-132, July 9, 1992, at 24.

166. See Louisa Vinton, *Polish Coalition Digests Privatization Defeat*, 2 SUPPLEMENT TO THE RADIO FREE EUR./RL RES. REP., No. 14, Mar. 22, 1993, at 10.

Union who voted against the legislation for fear that it provided foreigners with too great an opportunity to acquire stock and gain control of many vital Polish companies. Gambling on the stability of the coalition government, Privatization Minister Janusz Lewandowski threatened to resign if the legislation was not passed upon resubmission.<sup>167</sup>

The legislation underwent modification, resulting in a two stage, "pilot-like" privatization program. The first stage now consists of a pilot process in which national investment funds will assume control of 200 firms already prepared for the privatization process.<sup>168</sup> Most of these shares will be disbursed to pensioners and public servants who lost benefits in 1991.<sup>169</sup> The second phase will include 600 giant, state-run businesses, whose shares will be made available to all adult citizens for 5% of the average monthly wage in Poland (down from 10%).<sup>170</sup> In addition, employees of the affected firms will receive 15% of the shares for free (up from 10%).<sup>171</sup>

Concurrently, President Lech Walesa espoused a privatization proposal put forth by a political group known as the Network. Under this plan, the government would distribute coupons<sup>172</sup> worth 300 million zlotys (U.S.\$18,750) to each citizen to be used to purchase shares of state assets to be sold off during the privatization process.<sup>173</sup> After the success of the Mass Privatization Program appeared likely, however, President Walesa lent his support to this package although he truly preferred a national referendum on the entire issue of privatization. With the new modifications, which were geared toward capturing pivotal Post-Communist Democratic Left Alliance votes, the privatization legislation was resubmitted to the Sejm. On April 30, 1993 the government-revised Mass Privatization Program was passed

167. *Lewandowski Vows to Resign Unless Privatization Accepted*, FBIS-EEU-93-079, Apr. 27, 1993, at 31.

168. Christopher Babinski, *Polish Sell-Off Plans Revised*, FIN. TIMES, Mar. 24, 1993, at 3.

169. *See id.*; see also Louisa Vinton, *Polish Coalition Modifies Mass Privatization*, SUPPLEMENT TO THE RADIO FREE EUR./RL RES. REP., No. 14, Apr. 3, 1993, at 15 [hereinafter *Polish Coalition*].

170. *Minister Lewandowski Views Privatization Plans*, translated in FBIS-EEU-93-074, Apr. 20, 1993, at 24; *Polish Coalition*, *supra* note 169, at 15.

171. *Polish Coalition*, *supra* note 169, at 15.

172. *Id.* The coupons are actually low interest loans repayable in 20 years. *Id.*

173. *See* Louisa Vinton, *Builds Privatization Compromise*, SUPPLEMENT TO THE RADIO FREE EUR./RL RES. REP., No. 14, Mar. 29-Apr. 2, 1993, at 16.

by a wide margin with several amendments, most notably one "giving firms the right to refuse to take part in mass privatization."<sup>174</sup>

To smooth the path for this imminent privatization, new State Enterprise Laws are being pursued that would increase social safety nets for employees of state enterprises being privatized, give employees more say in the running of such firms, and allow enterprises to choose their method of privatization.<sup>175</sup>

Although the legislation must still be ratified by the Polish Senate and President, implementation of the Mass Privatization Program is underway with plans for the first stage being devised. This process will not be free of obstacles, as the public is still wary of giving control of Polish companies to foreign investors.<sup>176</sup>

General parliamentary elections were held on September 19, 1993 and were won by the Democratic Left Alliance and the Peasant Party.<sup>177</sup> Both parties have roots in the old Communist system. While President Walesa was hoping that the strides made in privatization will serve as an impetus to the people of Poland to "[m]aintain [their] support for the parties pledged to continue the reform which is now showing its first fruits,"<sup>178</sup> in

---

174. See Louisa Vinton, *Polish Mass Privatization Passes, at Last*, 2 RADIO FREE EUR./RL REP., No. 18, Apr. 26-30, 1993, at 9. This amendment allowed for firms targeted for privatization by the Ministry of Privatization to reject such offers, limiting the scope and impact of the original legislation. *Id.*

175. See *Sejm Reaction to State Enterprise Draft Laws, translated in FBIS-EEU-93-093*, May 17, 1993, at 22. Public support for privatization itself is still questionable. In 1989 and 1990, "spontaneous privatization" took place and several economic elites legally privatized their way to enormous wealth; this resulted in "public outcry and development of programs for state-controlled privatization." See Ben Slay, *Poland: The Role of Managers in Privatization*, 2 RADIO FREE EUR./RL RES. REP., No. 12, Mar. 19, 1993, at 52. The wish for managed privatization may indicate increased public support for the Mass Privatization Program. The public still retains certain reservations concerning foreign investment, but it appears they would favor regulated, state-run privatization to the "exploitative" privatization of the late 1980's. *Id.*

176. See *Walesa Orders Suspension of Szczecin Privatization, translated in FBIS-EEU-93-098*, May 24, 1993, at 17. This concern was displayed in the suspension of the Szczecin shipyard privatization by President Walesa due to worker protest. *Id.*

177. John Pomfret, *Former Communists Take Strong Lead in Polish Elections*, WASH. POST, Sept. 20, 1993, at A12.

178. See *Poland on a Detour*, FIN. TIMES, June 2, 1993, at 17. President Walesa viewed this as an opportunity to document the increased faith of the Polish public in economic reform and in the path toward a market system, developing after a period of a "Retreat to Tradition" immediately following the passage of the privatization legislation. See Stephen Engelberg, *Polish Vote, Clear Slap at Reform*, N.Y. TIMES, Oct. 29, 1991,

light of the recent results of September elections, reforms are expected to continue, but at a slower pace.

## B. *Institutional Environment: Poland*

### 1. Property Rights

Poland's real property rights reform has lagged behind legal reforms generally.<sup>179</sup> However, private ownership of land during the previous socialist regime was the rule rather than the exception,<sup>180</sup> thereby making the transformation to private ownership of land easier than in other former communist countries. Previously, ownership was divided into three types, listed here in descending order from most protected to least protected: (1) social ownership, which included ownership by the state, cooperatives, and social organizations; (2) personal property, which was property used for personal consumption, but not for production; (3) individual or private property or individual ownership of means of production.<sup>181</sup> These divisions were eliminated in the Polish Constitution of 1989 and the Civil Code of 1990, but have yet to be removed from other areas of law.<sup>182</sup>

Before state-owned property can be privatized, ownership of

---

at A3 (stating that former Communists enjoyed second highest contingency in Parliament).

179. CHERYL W. GRAY ET AL., *THE LEGAL FRAMEWORK FOR PRIVATE SECTOR DEVELOPMENT IN A TRANSITIONAL ECONOMY: THE CASE OF POLAND 2-9*, (Country Economics Dept., The World Bank, Policy Research Working Papers No. WPS 800, Nov. 1991).

180. *Id.*

181. *Id.* at 3.

Under Polish socialist law, "social ownership" — including ownership by the state, cooperatives, and social organizations — was the highest category of ownership and was protected by the Constitution and the Civil and Criminal Codes. Typically, such property included means of production, including, for example, land, mineral resources, and public utilities. In contrast, property used for personal consumption was individually owned and considered "personal property." Personal property could include, for example, one's dwelling house but not a rental house, which was considered a means of production. Finally, "individual — or private — property" was defined as the individual ownership of means of production, a residue of presocialist economic relationships founded on exploitation and expected to "wither away" over time. Individual property received less constitutional protection than social or personal property and was subject to heavy taxation and numerous limitations on use and transfer.

*Id.* (footnote omitted).

182. *Id.* at 3-4.

these lands<sup>183</sup> has to be clearly determined. In 1989, specific state agencies were identified as owners of land and state enterprises were permitted to become owners of the property upon which they were located. In 1990, local governments were re-established and the Act on Local Autonomy and its implementing regulations assigned local governments revenue rights and spending responsibilities for land which was transferred to them. This state property can now be alienated to private investors.<sup>184</sup>

Issues for complete privatization of real property still remain. Poland has been struggling with the issue of returning land that was expropriated by the former regime to its original owners. The transfer of land to local governments has been confusing; it is unclear who is the owner of some state lands. A registry of land ownership does not yet exist. Regulations on land use have yet to be developed and implemented. Foreign investors wishing to purchase land face certain domestic hostility.

## 2. Contract Law

Polish contract law is based on the Polish Civil Code of 1964 and subsequent amendments enacted in July 1990.<sup>185</sup> The Polish Civil Code of 1964 contained a distinction between contracts involving the state and those involving private individuals.<sup>186</sup> The goal of the 1990 amendments was to provide a uniform system of contract law; this goal has largely been achieved.<sup>187</sup> Overall, the Civil Code contains the core rules of contracting and reflects western practice.<sup>188</sup> Areas requiring updating include rules regulating commercial leases, franchises and factor leasing; commercial laws are contained in various codes and these may need unification or updating; the Civil Code will likely need to be harmonized with that of the European Community.<sup>189</sup> Issues in the area of contract law will depend upon Polish interpretation of contract provisions.

---

183. See GRAY, *supra* note 179, at 2 (stating that lands referred to included Warsaw, other urban land, state-enterprises land, and some agricultural land).

184. GRAY, *supra* note 179, at 4.

185. Ustawa z dnia 23 kwietnia 1964 r.- Kodeks Cywilny [Civil Code], *Ozłennik Ustawa* (1964), as amended, *Dziennik Ustawa* (1990).

186. GRAY, *supra* note 179, at 20.

187. *Id.*

188. *Id.* at 21.

189. See GRAY, *supra* note 179, at 22 (discussing need to update commercial laws).

### 3. Entry and Exit Laws: Competition and Bankruptcy

The Law on Counteracting Monopolistic Practices was passed on February 24, 1990<sup>190</sup> and the creation of the Polish Antimonopoly Office ("AMO") followed two months later. The Antimonopoly Act has two principal sections: prohibition of restrictive business practices and structural changes in the economy.<sup>191</sup>

The President of the AMO, Anna Fornalczyk, noted that the main role of her agency is the creation of competitive markets.<sup>192</sup> The agency does this by concentrating on demonopolization, working on privatization, and promoting trade liberalization.<sup>193</sup> In the area of demonopolization, the AMO takes into account efficiencies which might be gained from not breaking up the enterprise and weighs these against the lack of business culture in Poland generally.<sup>194</sup> Although efficiencies are part of the mix, the AMO considers "whether the benefits of putting more managers on the line, where they must learn to fend for themselves or fail, are outweighed by any efficiencies that may be lost [through] division."<sup>195</sup>

The AMO has also been involved in the privatization process. Formally, the AMO can veto any privatization proposal.<sup>196</sup> This power can often be too blunt an instrument to use in fine-tuning a privatization plan. As a result the AMO has been issuing conditional approvals to privatization plans.<sup>197</sup> One example of the success of the AMO in bringing competitive considerations to the privatization decision is in the restructuring of the Polish petroleum industry. The Office took the position that the industry should be restructured prior to privatization. By 1996,

190. Law of Feb. 24, 1990 on Counteracting Monopolistic Practices (Pol.) [hereinafter Law on Counteracting Monopolistic Practices] (English translation on file with the *Fordham International Law Journal*).

191. *Id.*

192. See Anna Fornalczyk, Remarks at the Fordham Corporate Law Institute Conference on International Law & Policy, Competition Policy During Transformation of a Centrally Planned Economy 7 (Oct. 23, 1992) [hereinafter Anna Fornalczyk].

193. See *id.* at 8-14.

194. See *id.* at 10.

195. *Id.*

196. *Id.* at 11.

197. See *id.* (stating that from 1990 through 1992, Antimonopoly Office disapproved privatization plans for only two firms, while it issued sixty conditional approvals).

refineries will be separated; the state-owned monopoly distribution firm will be permitted to own only 25% to 40% of refinery capacity and 40% of gas stations; foreign firms will be permitted to buy gas stations; and the AMO will be involved in determining which gas stations CPN may keep.<sup>198</sup>

The AMO also fights against trade protectionism by objecting strongly to privatization proposals which incorporate trade barriers which are not tied to "a specific, time-limited program to restructure the industry and then leave it to face competition in the world market."<sup>199</sup> In its role as competition advocate, the AMO has refused trade barriers on textiles and agricultural products.<sup>200</sup>

A bankruptcy law has been in existence in Poland since 1934 and was amended most recently in 1990.<sup>201</sup> It provides general procedures for liquidation and reorganization and is overseen by the tribunal of a local court.<sup>202</sup> An investigation may be initiated by the tribunal, the debtor, or a company's creditors on the grounds of non-payment of debt.<sup>203</sup> The case is accepted by the tribunal only on the condition that the firm's assets sufficiently cover procedural costs.<sup>204</sup> The tribunal reviews the value of the company's assets and the creditor's claims and then determines how the debts will be paid or whether the company will be liquidated.<sup>205</sup> In 1992, the law was amended again to provide equal conditions in applying bankruptcy law to private and to public enterprises and some of the restrictions on the transfer of assets of a bankrupt state enterprise were removed.<sup>206</sup>

Few bankruptcy proceedings have been heard pursuant to this law.<sup>207</sup> The legacy of the former state-owned dinosaurs has left most countries in Central and Eastern Europe with large

---

198. *See id.* at 12-13.

199. *Id.* at 13.

200. *Id.*

201. *See* GRAY, *supra* note 179, at 23 (discussing Polish bankruptcy law and amendments).

202. *Id.*

203. *Id.* at 23-24.

204. *Id.* at 24.

205. *Id.*

206. Telephone interview with Peter Ianachkov at World Bank (Wash., D.C. June 1993).

207. *See* CHERYL W. GRAY, *supra* note 179, at 24 (discussing ineffectiveness of bankruptcy proceedings).

numbers of bankrupt enterprises. These enterprises have a tradition of vertical and horizontal relationships through which they extend each other credit, or inter-enterprise debt. The existence of inter-enterprise debt keeps many creditors from imposing bankruptcy proceedings on their debtors for fear that the whole house of cards will tumble. The state must now determine how to liquidate these holdings while maintaining consumer confidence. Massive bankruptcies would surely undermine any attempts at buoying public faith in the economy during a difficult transition period. Despite the political pressures to avoid bankruptcy, a liquidation law is necessary where a voucher scheme or a joint venture is not workable. It can also fill the vacuum for bankruptcy proceedings in the shorter term privatization process.

The privatization legislation of July 1990 allows for liquidation privatization. Pursuant to this procedure, insolvent firms can be declared bankrupt and their assets reallocated. Liquidation provides a convenient way of privatizing relatively healthy small and medium-sized firms.<sup>208</sup> Additionally, firms view the liquidation option as a viable one. In the fall of 1991, approximately twenty requests for liquidation arrived daily at the Ministry of Privatization and at the end of December 1992, almost 62% of the firms undergoing privatization were taking the liquidation route.<sup>209</sup>

#### 4. Securities Legislation

Poland has done a satisfactory job in developing a regulated and protected securities market. The Warsaw stock exchange, opened in 1991 and modeled after the Paris Bourse, was created

---

208. Ben Slay, *Poland: The Role of Managers in Privatization*, 2 *RADIO FREE EUR./RL RES. REP.*, No. 2, Mar. 19, 1993, at 53-54. Of 1,055 firms scheduled for liquidation privatization through February 1992, only 589 were classified as bankruptcies. *Id.*

209. *Id.* Almost 62% of the firms were actually 1,474 state enterprises of the 2,387 firms officially classified as undergoing privatization. *Id.* Of the 1,055 small and medium-sized state enterprises undergoing liquidation proceedings in February 1992, however, significant asset sales were registered in only 510 of these. *Id.*

Since 1990, 540 state sector businesses employing 180,000 people have been privatized, most by Poland's most popular privatization device, liquidation. Many of these privatized businesses were labor intensive rather than having high capital requirements. See Christopher Bobinski, *Much Lost Time Has To Be Made Up*, *FIN. TIMES*, July 7, 1992 (Special Supplement). As to the question of capital versus labor intensive, consider that 80% of all retail outlets in Poland have already undergone privatization, displaying the relative ease of labor intensive industries to participate in privatization. *Id.*

with the help of the French.<sup>210</sup> The Sejm has passed laws regulating investment funds and other financial intermediaries.<sup>211</sup> In addition, the Poles have created a Securities Commission, an oversight organization similar to the Securities and Exchange Commission in the United States.<sup>212</sup> Currently, there is little business for the exchange to conduct. With the impending ratification of the mass privatization legislation, however, the Polish securities market will play an important role in the privatization process of Polish industries. With the rise in activity, the Polish Securities Commission will need to guard against insider trading by developing laws specifically outlining appropriate and inappropriate behavior for the national investment funds as well as individual investors.

### 5. Political Stability

Since the first post-Communist government was elected in 1990, there have been five Polish prime ministers: Tadeusz Mazowiecki, Jan Krzysztof Bielecki, Jan Olszewski, Waldemar Pawlak, and Hanna Suchocka. There are currently twenty-nine political parties represented in the Sejm, requiring government creation through negotiation and coalitions.<sup>213</sup> A casualty of Polish political turmoil has been the pace of economic reform. The strict measures taken during the "shock therapy" era of reform in early 1990 had until recently been relaxed considerably due to public pressure. Upon the creation of the current seven-party coalition government, serious economic restructuring returned to the forefront. This rejuvenation of reform was made possible primarily through the stability provided by the Suchocka government. Prior to this, Poland had little continuity in its reform efforts, as political considerations had forced the resignations of individual ministers as well as entire governments; there had been no unified vision of where the program was going and how it should accomplish its goals. Privatization legislation proved to be a test of governmental support for eco-

---

210. See *Nascent Markets in Eastern Europe and Soviet Union Exchanges Proliferate, But Will They Lure Investors?*, BUS. INT'L MONEY REP., Jan. 20, 1992.

211. See *Polish Government Program*, *supra* note 143.

212. *Id.* In fact, the SEC currently administers a technical assistance program in Warsaw which advises the Securities Commission on points of law, investigation, and enforcement. *Id.*

213. Christopher Bobinski, *Polish Coalition Talks Hit*, FIN. TIMES, Dec. 16, 1991, at 2.

conomic reform; the public's support of these measures will be seen in the general parliamentary elections.

### C. *Market Functions: Poland*

#### 1. Information Flows

Information about plans for a company's restructuring, as well as its current financial condition, must be disseminated to labor, government, and investors.<sup>214</sup> Polish firms are becoming more involved in the actual negotiations that are conducted between the Ministry of Privatization and the foreign investors due, in part, to the new State Enterprise Laws aforementioned. This has served to alleviate the fears of many workers and managers who were unhappy that they were not involved in determining their companies' futures. Although Polish privatization has not reached a stage where the availability of corporate financial data is of paramount importance, upon ratification of the current legislation on privatization, this information will be of critical importance.

Bankruptcy law closely accompanies the privatization program, and the free flow of information from creditors to debtors is essential in order to assess risk and credit standing. Since creditors currently can only consult a company's registration at the Court of Registration in order to determine its financial situation, which is many times either unreliable or insufficient, this type of asymmetric information will lead to imminent conflict and problems.<sup>215</sup>

#### 2. Capital Markets

Poland, advertised as a haven for Western investment in 1990, has had a disappointing record in attracting foreign capital. Hungary, the Czech Republic, and Slovakia, which has a combined population smaller than Poland's, have each attracted more foreign investment than Poland.<sup>216</sup> A variety of factors

---

214. See John Darton, *Polish Parliament Rejects Bill to Privatize Industries*, N.Y. TIMES, Mar. 19, 1993, at A3 (stating that "[d]eputies who voted against the bill said they opposed the idea of foreigners having control over Polish companies, and many workers fear that privatization could cost them their jobs through layoffs").

215. See GRAY, *supra* note 179, at 25 (discussing inefficiency of Court of Registration).

216. Blaine Harden, *Sewing Up Success Against the Odds*, WASH. POST, Feb. 10, 1992, at A1, A22.

have contributed to the disappointingly low level of investment in Poland: the massive foreign debt, the devaluation of the zloty, and the chaotic political climate. Another reason is the attitude of the Poles themselves. Many citizens fear that massive foreign investment represents a significant threat to the Polish economy. Some politicians, including former Prime Minister Olszewski, have made statements hinting that Poland should not welcome outside investment so heartily.<sup>217</sup> Attitudes like Olszewski's have made some Western firms leery of investing in Poland, especially when Hungary and Czechoslovakia offered a viable alternative.

Some foreign investment has entered Poland. The first bank to be privatized was the Wielkopolski Bank Kredytowy ("WBK").<sup>218</sup> The European Bank for Reconstruction and Development invested U.S.\$10.6 million in exchange for a minority share of 28.5%.<sup>219</sup>

### 3. Financial Intermediaries

In April 1993, Poland's WBK became the first commercial financial institution in Eastern Europe to be privatized and sold to stockholders.<sup>220</sup> Shares of the bank were sold to Polish and foreign investors, including the European Bank for Reconstruction and Development, and are traded on the Warsaw Stock Exchange.<sup>221</sup>

This privatization is the first of nine bank sales that are to take place pursuant to the break up of the Polish National Bank into nine parts in 1989.<sup>222</sup> In preparation for the sale, Wielkopolski undertook a private bank philosophy and stopped lending to state-run firms and invested instead in Poland's entrepreneurs. Loans to private firms or individuals now comprise 45% of the bank's portfolio where previously 95% were to state enterprises.<sup>223</sup> The bank also undertook a depositor drive and now boasts of 250,000 depositors who are served by forty-four

---

217. See Blaine Harden, *The Art of a Deal in East Europe*, Poland, WASH. POST, Feb. 10, 1992, at A1 (discussing lack of receptiveness of Poles to foreign capital).

218. John Pomfret, *Bank Privatization to Put Poland in Forefront of Financial Reform*, WASH. POST, Apr. 7, 1993, at C3.

219. *Id.*

220. See *id.* (discussing beginning of privatization trend).

221. *Id.*

222. *Id.*

223. *Id.*

branches.<sup>224</sup>

Despite this development, Poland's banking system has been trying to overcome the Art-B scandal. The fall of 1991 brought revelations of a U.S.\$360 million fraud perpetrated by the Art-B financial company of Katowice.<sup>225</sup> The proprietors of this company developed a pyramid of savings accounts through a scheme made possible by Poland's lax banking laws and the inefficiency of commercial banks. The Bank of Poland, the nation's central bank, was forced to prop up Polish institutions bilked of large sums by Art-B.<sup>226</sup> The scandal illuminated the weakness of the Polish banking system. Legislation has been very lax and policies loosely monitored. Two top officials of the central bank were arrested for their negligence in the Art-B affair.<sup>227</sup> Three banks were supposed to be sold into private hands in 1992, but this sale was postponed until April of this year.<sup>228</sup>

In a recent interview, Minister of Justice Piatkowski was answering questions about the Art-B scandal and stated that banking practices from the previous regime have remained virtually unchanged. As a result,

opportunities for criminal malpractice in this sector are still undiminished. However, nowadays persons who are prosecuted for financial malpractice also include chairman and directors of the banks involved, not only the offenders who obtained loans from their banks by deceit.<sup>229</sup>

### CONCLUSION

After applying the eight criteria to each of the countries, one can conclude that the Czech Republic appears to be furthest along in establishing the institutional environment and market functions necessary to run a successful privatization program.

224. *Id.* But see Christopher Bobinski & Anthony Robinson, *Poland's Banking Privatization Given \$12.7m Injection*, *FIN. TIMES*, Apr. 7, 1993, at 28 (stating that Polish National Bank has only 41 branches).

225. Christopher Bobinski & Hugh Carnegy, *Poles Charged in Financial Scandal*, *FIN. TIMES*, Nov. 14, 1991, at 2.

226. *Id.*

227. *Id.*

228. See *BRE Sell-Off Delayed*, *FIN. TIMES LTD.*, *FIN. E. EUR.*, Apr. 24, 1992, available in LEXIS, World Library, FINEUR File (stating that Polish government was delaying first bank privatization).

229. See *New Minister of Justice Piatkowski Interviewed*, *FBIS-EEU-93-092*, May 14, 1993, at 9.

Poland has been plagued by political instability as has the newly-formed Slovakia whose leadership is unclear on the appropriate pace of privatization. It is too soon to judge which of these countries will have the most successful reform effort, but certainly all three are working towards creating the necessary framework.