STAFF APPRAISAL REPORT

POLAND

PRIVATIZATION AND RESTRUCTURING PROJECT

May 22, 1991

Indust-v and Finance Department
Countl. Department IV
Europe, Middle East and North Africa Region

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CURRENCY EQUIVALENTS

Currency Unit - Zloty (Zl)

AVERAGE EXCHANGE RATES
(Zlotys per US$)

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<td></td>
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<td>430</td>
<td>4000</td>
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WEIGHTS AND MEASURES

Metric System

ABBREVIATIONS

BRE - Export Development Bank
BGZ - Bank for Food Economy
BISE - Bank of Social and Economic Initiatives
BTT - Banking Telecommunication Society
CMEA - Council of Mutual Economic Assistance
DDSR - Deb. and Debt Service Reduction
EBRD - European Bank for Reconstruction and Development
EC - European Community
EIB - European Investment Bank
ETP - Economic Transformation Program
FIDL - Financial Institutions Development Loan
IDA - Industrial Development Agency
IEDL - Industrial Export Development Loan
LIB - Limited International Bidding
LIBID - London Interbank Bid Rate
LIBOR - London Interbank Offered Rate
NICA - Non Interest Current Account
MOF - Ministry of Finance
NBP - National Bank of Poland
PDB - Polish Development Bank
PKO BP - PKO State Savings Bank
PRP - Privatization and Restructuring Project

POLAND - FISCAL YEAR

January 1 - December 31
# POLAND

## PRIVATIZATION AND RESTRUCTURING PROJECT

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This report is based on the findings of the appraisal mission which visited Poland in March 1991. The mission comprised Mssrs./Mes. Y. Duvivier (task manager), H. Aghaee, D. Kocbav, U. Rao (EM4IF); A. Cordet-Dupouy (RHPOL); A. Ewing (EMTIE); and I. Lieberman (Consultant).

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POLAND

PRIVATIZATION AND RESTRUCTURING PROJECT

LOAN AND PROJECT SUMMARY

Borrower: Republic of Poland.


Amount: US$280 million equivalent.

Terms: Seventeen years, including a five-year grace period, at the Bank's standard variable interest rate.

On-lending Terms: The Government will administer directly the policy (US$75 million) and technical assistance (US$65 million) components, but will on-lend funds for restructuring/privatization investment component (US$140 million) to PDB, which in turn will channel these resources through participating banks to enterprises. On-lending by the Government to PDB will be denominated in US$ or in DM, at LIBOR or FIBOR plus one fourth of one percent (0.25%) with the Government assuming the cross-currency risk. On-lending by PDB to the participating banks, and by them to the final beneficiaries will be in US$ or in DM. PDB will lend to participating banks at LIBOR for US$ and FIBOR for DM plus 1.50%. Government and PDB spreads will be reviewed with the Bank semi-annually, to ensure adequacy and consistency with the cost of funds from other sources. Loans to the final beneficiaries will be at market rates determined by the participating banks. The loans will be for periods not exceeding 12 years with grace periods of up to 4 years. The final beneficiaries will assume the foreign exchange risk.

Project Objectives: The project's objectives are to provide support to Poland's efforts to develop and implement an effective enterprise privatization program, and implement restructuring across a major share of its industry, by: (i) assisting with the design of the necessary policies, the establishment and strengthening of the institutional framework, and the implementation of the privatization program; (ii) providing finance in ways which will mobilize additional resources for privatization, in support of the Government's objective of privatizing half of the State-owned assets within 3 years; and (iii) providing finance for enterprise restructuring programs in those cases where
investments are warranted and enterprises are private, or joint-stock or limited liability companies with a privatization strategy.

**Project Description:**

The scope of the proposed project includes:

(a) **Policy Component** (US$75 million) to support the Government's program for enterprise transformation and privatization, specifically, the implementation of the necessary policy and institutional conditions facilitating privatization. Up to US$50 million of this component could be used for a Debt and Debt Service Reduction (DDSR) plan meeting the requirements for Bank support.

(b) **Technical Assistance Component** (US$65 million), principally to support the key agencies involved in the privatization and restructuring process.

(c) **Investment Component** (US$140 million) for privatization/restructuring, which will be channelled through the Polish Development Bank, and through eligible banks to finance the direct foreign exchange investment costs, including physical improvements to production facilities, permanent working capital, interest during construction, licenses or other types of technology transfer, as well as software, technical assistance and training at the enterprise level.

**Benefits:**

The proposed project will yield major benefits to Poland in terms of establishing and applying the needed framework for effective transformation of enterprises, while directly supporting the privatization/corporatization of perhaps 10-15% of industrial enterprises. In addition, implementation of the Project will lead to: (i) improvements in enterprise management; (ii) economic benefits (related to returns on investment in the subprojects); (iii) convertible currency earnings derived from the increased availability of quality products both for exports and as substitute for imports; and (iv) environmental, institutional, social and demonstration benefits. It will also support efforts to stimulate private sector development and privatization in the on-going movement towards a mixed market economy. The Project, while not directly addressing the social cost of reform, will help in maintaining jobs in efficient enterprises and in reducing the overall loss of jobs in enterprises facing difficulties.
Risks:

(i) In the short term there could be delays in implementation associated with the scale and complexity of the privatization program, and the enterprises' willingness to privatize. The Government's limited implementation capability, the slow and difficult build-up of the new institutions and the lack of skills of managers may introduce some delays which would be minimized by the inclusion of the comprehensive technical assistance component. (ii) In the longer term, a risk that could adversely affect the indirect benefits of the project, stems from the ambitious program of adjustment and stabilization. While the Government's current plans are satisfactory, the major institutional and systemic reforms are unprecedented in Poland and may take longer than currently planned. The Bank's on-going economic and sector work dialogue will be important in helping to identify and overcome weaknesses in the implementation of the reform and to support the Government's overall industrial policy reform program. In addition, the technical assistance provided under the project to help develop the needed regulatory and institutional framework will reduce this risk. (iii) Finally, the lack of services and qualified consultants may slow the pace of the demonstration effect, but the design of the technical assistance component and the Bank's close supervision of the implementation will minimize this risk.

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<th>Project Cost:</th>
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<tr>
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<td>EC (for TA)</td>
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<td>Other institutions (for TA)</td>
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<tr>
<td>Total Financing Required</td>
<td>210</td>
<td>705</td>
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| Estimated                        |        |         |        |        |        |        |
|                                  | (US$ million) |        |        |        |        |        |
| Annual                          | 105    | 68      | 58     | 28     | 14     | 7      |
| Cumulative                      | 105    | 173     | 231    | 259    | 273    | 280    |

Economic Rate of Return: Not Applicable.
F I N A N C I A L D E C I S I O N  m a t e r i a l s

P O L A N D

PRIVATIZATION AND RESTRUCTURING PROJECT

I. INTRODUCTION

1.01 The far-reaching reform program now being implemented in Poland is designed to break the country out of a vicious circle of slow growth, inefficient investments and low productivity. Its main target is to stabilize the macro-economic situation, and to move the country rapidly towards an efficient market economy. Despite the pressure of the new economic environment, and initial attempts to adapt operations to the new conditions, many Polish enterprises are not capable of responding quickly and competitively. In some cases, the response until now has been largely negative, such as simply stopping production, closing down and sending workers home. Most enterprise managers, however, have come to realize the need to implement modern management techniques, to restructure and/or privatize their enterprises and to attract foreign partners.

1.02 Recognizing the difficulty of achieving an adequate supply response and efficiency gains in enterprises owned and operated in the public sector, the Government has decided that the preferred future for its 9,000 State-owned enterprises (SOEs) is privatization. It is targeting to have half of them transferred to private owners within three years. A program is being developed which will lead to rapid privatization of a large number of enterprises through a variety of alternative procedures, while at the same time assisting remaining viable SOEs to adjust effectively to the new market-oriented environment during the transition to eventual privatization. The Government is seeking Bank support for this program through this proposed Privatization and Restructuring Project.

1.03 The proposed project will further the process of privatization and restructuring by helping to establish the necessary framework and facilities through the creation and support of enabling institutions and instruments. In particular, the project aims at a catalytic role in this challenging transformation process by providing assistance and funds to help create an environment conducive to private (domestic and international) involvement in enterprise management. While the restructuring needs of Polish enterprises, especially in industry, are considerably greater than can be financed through a single operation, it is anticipated that this project will have a broad and decisive impact on the overall restructuring and privatization process through: (i) its support to the action program of the Government for enterprise transformation; (ii) its focus on the design and monitoring of the institutional framework for privatization and restructuring; and (iii) its financial support to specific enterprise restructuring.

1.04 To support the project, the Government is requesting a Bank loan of US$280 million equivalent. The loan would finance three integrally related components including: (i) a policy component for which US$75 million would be provided in support of specific policies essential to the Government's enterprise transformation program; (ii) a technical assistance component for which US$65 million equivalent would be provided to support privatization transactions as well as key institutional and training activities; and
(iii) an investment component of US$140 million equivalent which would provide loan financing for restructuring investments in privatized enterprises or enterprises in the privatization process. The proposed Bank loan will finance only a small part of the restructuring needs of Poland's industrial sector, but will have a greater impact by mobilizing and helping to direct cofinancing from bilateral donors and financing agencies, domestic and foreign private sources, the country's own specialized restructuring institutions, local commercial banks, and the enterprises themselves.

1.05 The proposed project was prepared and pre-appraised during missions in February, April/May, July, December 1990 and March 1991, which comprised staff of the Industry and Energy Divisions of both the Europe and Technical Departments of EMENA and consultants. A number of documents concerning the sector and the project are listed in Annex 1 and are available in the Project File.

II. THE PRIVATIZATION AND RESTRUCTURING PROGRAM

A. The Economic Environment

2.01 Poland's hyperinflation and severe external payments problems became untenable in the second half of 1989 and it became evident that a sharp break with the past was required. A comprehensive Economic Transformation Program (ETP) was therefore formulated at the end of 1989 and initiated at the beginning of 1990. A number of measures were agreed in the context of the IMF Stand-By Arrangement and the recent Bank Structural Adjustment Loan (Loan 3247-POL) in the areas of economic stabilization, macroeconomic policy and structural adjustment, including stringent financial and monetary policies, and wide-reaching reforms in the areas of fiscal policy, trade policy, competition and deregulation, enterprise sector, financial sector and social safety net.

2.02 Overall, the program has been successful. Hyperinflation has subsided, prices are freely determined, and most barriers to international trade have been removed. The program has also resulted in the following, somewhat unexpected, developments: a persistent inflation, a large trade surplus and reserve accumulation, a sharp drop in production, rapidly increasing unemployment, a large budgetary surplus, and a better than expected financial performance of enterprises. The rate of inflation has hovered around 4-5% per month since Fall 1990, as a result of the devaluation of the zloty at the end of 1989, the recurrent correction of administered prices and the wage indexation formula, the loosening of monetary and credit policy in the second half of 1990, the depreciation of the US dollar and the increase in international oil prices.

2.03 In response to these developments, the authorities loosened aggregate demand in the second half of 1990, and the pace in the last quarter indicated some unsustainable trends. In particular, net domestic assets of the banking system and wages surpassed the IMF Stand-By limits. The ETP was recently amplified and extended through the preparation of a Memorandum on
Economic Reform and Medium-Term Policies, which serves as a guide to its program of work. On the basis of this program, the Polish authorities agreed with the IMF on a three-year Extended Arrangement, complemented by access under the Compensatory and Contingency Financing Facility, which replaces the previous agreement which expired in March.

2.04 For the year 1990 as a whole, the external position of Poland improved markedly with respect to 1989. The trade surplus in convertible currency is estimated to be about US$2.2 billion (about 3.5% of GDP). This, together with private transfers and interest receipts, resulted in reserve accumulation of about US$4.3 billion, with the level of gross reserves at the year-end 1990 amounting to US$6.5 billion. A generous rescheduling of Paris Club debt obligations also strengthened the balance of payments position. The trade surplus for the year is due to a very strong performance of convertible currency exports, which increased by some 35% in real terms with respect to 1989. Imports increased by 6.1% in real terms for the year as a whole, with the rebound concentrated in the last two months of 1990. Poland is expected to face severe problems with the balance of payments in 1991, due to a sharp reduction in exports to the CMEA because of the virtual collapse of the Soviet markets and the curtailment of the CMEA trade arrangements. The balance of payments will also be affected by higher energy import prices (an additional US$1.5 billion) due principally to the shift to international prices. As a result, the trade balance is projected to worsen, moving into a small deficit. Based on the recent agreement with the Paris Club for Debt and Debt Service Reduction (DDSR) of about 50%, plus possible DDSR with commercial banks and the contribution of funds from other sources (including proposed quick-disbursing funds from the Bank), Poland should essentially be able to finance its balance of payments needs for the decade. An analysis of Poland's balance of payments prospects is provided in the President's Report for the proposed parallel Financial Institutions Development Loan (Report P-5535-POL).

2.05 The surplus of the consolidated State budget is estimated to be approximately 2.5% of 1990 GDP. This represents an extraordinary turnaround: the stabilization program called for a balanced budget (compared with a 7.4% of GDP deficit in 1989). The surplus continued throughout most of the year and thus dampened the increase in domestic credit. However, the Government borrowed from the banking system in November and December. GDP in 1990 dropped by an estimated 12% with respect to 1989. In particular, in 1990, industrial socialized sector production is estimated to have dropped by 25% whereas private sector production increased by 8.5%. During January-February 1991, there was a further 3.2% drop in production sold of the enterprise sector as a whole, compared to the same period in 1990. The greatest fall in production occurred in the electro-machinery sector (which accounts for 20% of all enterprise sector revenues), minerals and metallurgy. Only the food processing industry and the wood and paper industry recorded an increase of production sold during the first two months of 1991 compared to 1990.
Unemployment has continued to grow at a rate of 100,000 per month and reached 1.26 million (7% of the total work force) by end-February 1991 1/.

2.06 There is a general consensus that 1991 will be a difficult year for the Polish economy. The favorable circumstances and outcomes of 1990 are unlikely to be repeated and the full consequences of reform measures introduced in 1990 should begin to bite. On the domestic front, stabilization must be consolidated and an effort will be needed to carry out conservative monetary and fiscal policies. Additionally, important steps must be taken for the restructuring of the economy. Large-scale privatization of the enterprise sector will begin, which together with restructuring and further stabilization will likely lead to modest output recovery but higher unemployment. The expected GDP growth of 2.5% in 1991 — in part due to carry over from 1990. On the external front, Poland will face substantially higher energy prices and a severely depressed CMEA market. Moreover, the relative appreciation of the zloty will reduce the attractiveness of exports with respect to 1990.

B. The Industrial Sector

1. Structure

2.07 Poland has over 9,000 state-owned enterprises, of which 65% are in industry, and the remainder in the service, infrastructure, and agriculture sectors. The industrial sector 2/ has been the leading sector of the economy since 1960. Currently, it contributes about 44% of Poland's net material product, and employs 23% of the country's labor force. Total assets are estimated at about US$39 billion and total sales for 1990 have reached about US$63 billion. Socialized industrial enterprises, i.e. state-owned enterprises and cooperatives, produce about 90% of industrial net production and contribute about 60% of Poland's exports. Industrial state enterprises are generally large in size and capital intensive, and concentrate on the production of iron and steel, engineering and metal products, transport and farm equipment, chemicals and chemical-based goods.

2.08 Private sector activity in industry is limited but growing, and includes already a few sizable firms as well as numerous small firms in addition to artisan and household operations, employing about 10% of the industrial work force. Despite its relative size, private industry has shown

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1/ A complete description of the current situation with respect to employment is contained in the report Poland: Employment Promotion and Services for a Market Economy, Sector Memorandum, World Bank, February, 1991.

2/ The Polish classification of industry differs from the ISIC as it includes fuel and power (coal, coke, crude petroleum, petroleum refining, natural gas, electric and thermal power, etc.) within the industrial sector. To assess the performance of Polish industry according to the more usual classification, these activities have been excluded from the analyses wherever possible.
remarkable dynamism and, since the early 1980s, has consistently grown more rapidly than the socialized sector. Preliminary survey data for 1990 indicate that private production currently accounts for about 13% of industrial output, up from about 9% in 1989. Private operations are also increasing in other sectors, particularly in retail trade and services. In 1990 the number of private companies increased by 12,700 to about 22,800. The overall number of private businesses, including unincorporated ones, is now in excess of one million.

2. Impact of Past and Recent Policies on Performance

2.09 Serious inefficiencies persist within the industrial sector despite the macroeconomic success of the new stabilization and liberalization efforts. These inefficiencies are mainly due to the inherited industrial structure characterized by captive domestic markets, an indiscriminate flow of funds from the central government, and a heavy reliance on CMEA markets, especially sales of certain industrial products to the Soviet Union. Industrial performance in the past has also been constrained by systemic distortions such as in pricing, subsidies, taxation and wages. These distortions have historically limited the incentives for improving enterprise performance and constrained the mobility of resources to economic activities, thus maintaining existing shortages and impeding efficient growth.

2.10 The policy measures implemented at the beginning of 1990 correcting relative prices, imposing hard-budget constraints, setting interest rates that are positive in real terms, and increasing competition have put the enterprise sector under enormous stress. With higher (unsubsidized) prices of inputs, and limited scope for increasing output prices due to increasing international competition, many enterprises are facing sharp declines in their sales. In some cases (for example, where CMEA sales have stopped completely or in enterprises heavily dependent on the former east German market) enterprises are faced with a need to completely redirect their activity. The effects of the demise of the CMEA trade systems will be felt even more acutely in 1991 as Poland's former trading partners move to a free trading pattern based on convertible currencies. With the elimination of subsidies to producers in 1990, the increase in energy prices to international levels is having a severe impact on high energy consuming industries.

2.11 To some extent these negative factors have been offset by the sharp rise in exports to convertible currency countries, aided by trade liberalization and the devaluation of the złoty at the beginning of 1990. Other reasons why the effects of these negative factors have not yet fully been felt through numerous bankruptcies of enterprises are: (i) the minimal long-term debt of most enterprises, which was significantly reduced following hyperinflation; (ii) a temporary increase in inter-enterprise credit; and (iii) the cautious attitude adopted by many enterprises, drastically reducing purchases of inputs, drawing down on very large inventories and severely curtailing investments, in addition to personnel layoffs. However the hard-budget constraint is also beginning to take effect: 400 SOEs failed to make mandatory dividend payments (a tax levied on a portion of their equity
capital) to the State during 1990, which is a trigger for initiating special proceedings which in many cases will lead to liquidation.

C. The Privatization Program and Progress to Date

2.12 Privatization has been selected by the Government as the preferred mode for transforming SOEs, primarily because it will improve enterprise efficiency, and hence the efficiency of the Polish economy, by providing better incentives to capital, management and labor. The Government has gradually elaborated a privatization policy on the basis of extensive discussions with consultants and with the Bank Group, and in particular with the help of an initial technical assistance program developed by IFC. The Privatization Agency was first established (subsequently replaced by the Ministry of Ownership Changes) and the Privatization Law of SOEs was adopted in July 1990. The strategy and the details of the proposed privatization program were further elaborated and adopted by the Parliament in February, 1991. As noted above (para 1.02) the principal objective of this program is to transfer about one-half of the 9000 SOEs to private hands within three years, and to achieve a structure of ownership of the economy similar to that of EC countries within five years. Beside speed, other major concerns of the Government are transparency, fairness and compliance of the process with social justice. Recognizing the wide variation in the type and condition of enterprises to be transformed on the one hand, and of potential entrepreneurs on the other, as well as the current limited availability of Polish private capital and management skills, the program proposes and elaborates a multi-track approach to privatization (para. 2.14). The privatization program and its progress to date are detailed in Annex 2-1.

2.13 Considerable privatization of various types had already taken place before adoption of the new measures. The principal path to private or semi-private status to date had been to place part of the assets of an SOE into a joint venture with a local or foreign partner. In the two years since the enactment of the Law on Joint Ventures of December 1988, about 1,400 such joint ventures have been formed. Second, privatization has been accomplished by leasing all or part of the assets of an SOE to a private company, frequently formed by the management and employees of the SOE itself. Both of the preceding routes to privatization were largely initiated and managed by the enterprises themselves and in some cases led to some abuse. Third, some bankrupt enterprises have been liquidated and their assets sold to new, private owners. Fourth, in some cases where enterprises had already been incorporated as state-owned joint-stock companies, privatization has been


4/ The present program deals mainly with State-owned enterprises. Other state property includes State Budgetary Entities (such as Schools and Hospitals), Municipal Property, State Farms and partially or totally state-owned joint-stock corporations. For this property, as well as for some 13,000 cooperatives, specialized schemes are being developed.
effected through a capital increase subscribed by private institutions or persons. In addition to the Law on Joint Ventures, key legislation providing the legal framework for these activities includes the Law of the Economics of SOEs of September 1981, and its subsequent amendments and implementing decrees, including an important liquidation amendment in 1990; the Commercial Code of 1934, as amended at various occasions; the Bankruptcy Law as last amended in July 1990; and the Anti-Monopoly Act of February 1990.

2.14 Privatization of these types together with the rapid growth of new private sector activity has had a discernible effect on the economy. However, the Government recognizes that a more proactive approach will be required in order to achieve a much more rapid transformation of the economy. While the above roads to privatization are still possible, the new privatization law provides a comprehensive multitrack program comprising two principal routes: (i) the "commercialization" (i.e. corporatization) of an SOE through its conversion to a joint-stock company or limited liability company, with a view to subsequent sale or distribution of shares to private owners, either through "individual" privatization (public offering, trade sale or employees' buy-out, as described in para. 2.17) or through "mass privatization" (paras. 2.21-2.22); and (ii) "liquidation" (i.e. winding-up) of the SOE followed by the creation of a new private company to which some or all of the assets of the SOE are contributed, sold or leased. This latter method of privatization through the transfer of assets (rather than the sale of the enterprise as a going concern) has already attracted considerable interest. The various methods of privatization, together with the alternative routes for restructuring or winding-up of enterprises, are illustrated in Annex 2-2.

2.15 Decision-making on privatization is greatly hampered by the existing ownership/management structure of SOEs. While under their present form the SOEs are presumably owned by the State through a "founding organ", the various components of ownership rights (using the property, financial returns, disposing of the property etc.) are in fact held jointly but in a shifting and imprecise way among managers, workers and the State. In effect, the majority of SOEs are basically self-managed, either by a well-organized workers' council, or when these councils are not effectively organized, by enterprise managers who act with considerable independence, not only of the workers but of the state bureaucracy as well. While most decisions concerning the operation of an enterprise are made by the enterprise management, agreement must also be obtained from the workers' council of the enterprise. As workers and/or managers have gained the authority to control the enterprise but lack the clear title to the assets of the enterprise, they have considerable incentive to try to appropriate its income and to strip it from its assets. Under these circumstances it is not surprising that enterprises have had difficulty in facing up to some of the hard decisions which in many cases will be a necessary prelude to successful privatization.

2.16 The commercialization of the SOEs is therefore a crucial step towards actual privatization which will remove the problems arising from the currently muddled ownership structure of the enterprises. Through the
conversion of the enterprises into corporate form 5/, the property rights will be concentrated in a corporate board of directors appointed by the owners, initially the State and eventually the new private shareholders. The corresponding introduction of adequate corporate governance is of utmost importance, and should be effected as rapidly as possible to remove the state of uncertainty in which most SOEs presently operate.

2.17 In September 1990, the Government established a new Ministry of Ownership Changes (MoOC) to manage the privatization program. In the six months since its formation MoOC has assisted 107 enterprises with the first step of commercialization, while another 57 are under preparation or awaiting approval for this process. Even of the large commercialized companies have been privatized with the assistance of foreign investment banks, either through domestic public offerings (which includes a comprehensive process of valuation, preparation of a prospectus, and public offering of shares) or through direct (trade) sales to foreign investors. Another large company was privatized through a leveraged buy-out by employees. In the cases of the enterprises sold through public offerings or by trade sales, the employees were permitted to purchase up to 20% of the outstanding equity at the preferential price of 50% of the general offer price. Following the "liquidation" route, 143 small and medium enterprises have been privatized with the approval of MoOC (in most cases as part of a planned restructuring with identified buyers or lessors for the assets), while about 200 more have started the process or have expressed serious interest in this process.

Significant progress has also been achieved in the area of "small privatization", or privatization of small and medium-size retail and wholesale shops as well as services, mostly municipal property: by the end of March 1991, about 80% of retail trade, 40% of construction activities and 60% of road transportation services had been privatized, mostly through leases.

D. Constraints to More Rapid Progress

2.18 While progress has been significant, certain policy and institutional constraints must be addressed in order to achieve the much more rapid pace of transformation presently envisaged. Constraints related to the policy environment include: (i) the absence, until now, of a fully elaborated and implementable plan for privatization on a larger "mass" scale; (ii) a less than satisfactory environment for foreign investment (most foreign joint ventures had been relatively small and confined to the commercial and service sectors); (iii) problems of land ownership which inhibit real privatization in some cases, essentially in agriculture; (iv) the lack, until now, of clear guidelines and procedures for the transformation of the very large number of cooperatives; (v) the absence of a policy for dealing with property claims of former owners of nationalized assets now slated for privatization; and

5/ Incentives for SOEs to commercialize are significant: after commercialization, the transformed companies are exempt from paying the obligatory "dividend" tax of the SOEs; in addition, there is reduction of the tax on excessive wage increases. Privatized companies are fully exempt of this tax.
(vi) the lack of a clear industrial policy, which in some cases makes it difficult to assess the attractiveness of a particular privatization operation.

2.19 Equally important are the institutional constraints which have inhibited the pace of transformation: (i) the lack of institutional capacity to deal with the growing number of involuntary bankruptcies, and voluntary commercializations, privatization and liquidations; (ii) the occasional conflicting roles of the various agencies involved in the process; (iii) the slow (and expensive) individual process of the one-by-one privatization of medium and large enterprises being prepared by the MoOC; (iv) the inadequacy of the financial sector and the absence of supporting institutions required to effect ready transfers of ownership interest from one owner to another; (v) the absence to date of clear mechanisms and instruments to exercise the ownership rights of the "State Treasury" envisaged by the privatization law, which would provide clear ownership of state assets and enable the development of programs for their more effective management; and (vi) the lack of managerial and/or institutional capacity in many SOEs to turn them around and make them profitable and attractive for private investors.

2.20 The recently elaborated privatization program recognizes these constraints and, as detailed below, the Government is committed to taking steps to deal with them on a priority basis. The proposed Project is specifically designed to assist and support this undertaking. The Government has taken several critical preparatory steps for the program and is expected to undertake the follow-up actions during the next few months as detailed below.

E. Policies for More Rapid Privatization

2.21 The Government intends to continue with the currently-used methods of privatization discussed above. Individual privatization following existing procedures (valuation, preparation of a prospectus, bidding process) will be used for some large enterprises and in particular for those which develop their own privatization plan and/or require a major injection of foreign capital. However, as further elaborated below, the development of a new "mass" privatization program is a key element of the Government's strategy to accelerate the process of ownership transformation. For the 500 largest enterprises the Government is planning to use the "commercialization" route followed by individual or "mass" privatization. The smaller enterprises would essentially be privatized through the "liquidation" route.

1. Mass Privatization

2.22 In December 1990, the MoOC prepared a preliminary plan for mass privatization the key elements of which as presently envisaged are: (i) the distribution of "vouchers" to citizens which would be exchangeable for shares
in newly-created financial intermediaries or Privatization Funds 6/; and (ii) the establishment of a number of such Privatization Funds in the form of privately-managed mutual funds/active holding companies which would use the vouchers entrusted to them to bid for a majority of the shares of "commercialized" enterprises. These funds, managed with the help of foreign professional partners, would as controlling shareholder, manage or closely control the management of the enterprises for a certain number of years (and in some cases as long as necessary to complete the turn-around of the enterprises). This innovative concept (detailed in Annex 2-1) creates a market which would put a value on companies, gives the citizens some choice as to a Fund (as the Funds could propose different investment strategies and attract investors with different risk perceptions) and reduces the risk to investors through portfolio diversification. The concept of the Funds also has the advantage that they avoid a too large dilution of ownership while providing professional exercise of ownership rights. With technical assistance financed by the Bank and the British Know-how Fund, and with the help of the European Bank for Reconstruction and Development (EBRD), the Government has undertaken detailed studies to assess the costs and feasibility of the scheme, identify potential fund managers, and elaborate an implementation plan with a view to putting it into practice rapidly. EBRD has proposed to participate actively in the creation of one of the first funds.

2. Foreign Investment

2.23 To remove the current real or perceived barriers which constrain foreign investment in Poland, and to make Poland competitive in attracting such investment vis-a-vis other central European countries, the Government is in the process of replacing the law on joint ventures by a new law on foreign investment with a view to: (i) making a clear policy statement on the role of foreign investors in the Polish economy and eliminating the requirement of prior authorization of foreign investment by the Foreign Investment Agency (except in a limited number of sensitive activities); (ii) improving the incentive framework for foreign (and domestic) equity investment through such measures as accelerated depreciation, loss-carry forward stipulations under the tax law, and limited tax holidays; (iii) clarifying the way in which original investments, profits and earnings of foreign nationals employed by Polish and/or foreign companies can be fully repatriated without bureaucratic and other impediments; and (iv) removing inconsistencies between the different laws covering foreign investment (mainly the Privatization Law and the law on joint-ventures). In addition, the Government intends to promote direct foreign investments through a number of promotional actions and activities to be developed in the near future. The Government has submitted the draft of

6/ The preliminary plan envisages that citizens would receive an amount of vouchers corresponding to 30% of the shares of the selected enterprises; employees of the enterprises would be entitled to 10 to 20% of the enterprises' equity; the remaining shares would be held by institutional investors and by the State who would entrust them during a transitional period to the Privatization Funds to give them control of the enterprises.
the new law to Parliament and a promotional program has been developed by the Foreign Investment Agency to attract foreign investors.

3. **Privatization at the Local Level**

2.24 Most of the formal privatization activity to date has focussed on SOEs, in particular on those industrial enterprises of which the founding organ is the Ministry of Industry. This focus is appropriate first, because this is by far the biggest concentration of state-owned assets and second, this set of enterprises, because of size and (in some cases) performance, presents the most serious transformation problems. Significant privatization is occurring at the local level, however:

(a) At the level of the *wojewoda* which are the founding organ for about 4,500 enterprises (mostly small and medium sized enterprises), MoOC plans to decentralize the transformation process since a central approach to the privatization of such SOEs would be less efficient and slower. This decentralization will require major efforts of training and technical assistance, and the Government is requesting external assistance to design the necessary programs to achieve this.

(b) At the level of *municipal property*, there are also an estimated 20,000, predominantly local wholesale and retail trade entities, for which the founding organ is typically the municipal council. These are in the process of being privatized, at this time mostly through lease by individuals or small enterprises.

(c) In the case of the 13,000 *cooperatives* in Poland, which given their role in agriculture represent about 20% of GDP, there is no clear legal framework for full privatization. There have, nevertheless, been a significant number of "spontaneous" privatizations of cooperatives, which has been largely unregulated. The Government is presently working on a draft law in this area /1/ and is seeking external assistance for this purpose.

4. **Other Aspects**

2.25 The Government is also working to resolve other key aspects and issues which may slow down or hamper the privatization process. The issue of property claims on assets slated for privatization will be addressed through a selective plan of compensation of former owners of property (mostly small

/1/ In agriculture, the issues of clarification of ownership (through the liquidation process), the drafting of a new cooperative legislation and transitional regulations to facilitate the transformation of the current cooperatives into market-based, member-servicing cooperatives, are being discussed in the context of preparation of the proposed Agricultural Development Project.
businesses, farms and land) which had been nationalized in an abusive manner or without adequate compensation. The general principle is that, except for limited specific cases, property will not be returned but previous owners will receive compensation, not in cash but through bonds issued by the State and convertible into shares of privatized enterprises. This plan will be supported by appropriate legislation. By stating clearly that compensation but not restitution would be the rule, except in well-defined cases, this plan will remove a major cause of uncertainty which could slow down the privatization process of small businesses or in certain sectors.

2.26 Other issues are being addressed as the Government is elaborating detailed implementation plans for the various privatization schemes. For example, criteria and guidelines will be developed for a systematic selection and preparation of the enterprises to be privatized following each specific route (among others, individual privatization versus mass privatization, commercialization versus liquidation, immediate privatization or privatization following some restructuring etc.). The Government will also develop a coherent policy on environment-related contingent liabilities (clean-up costs) for new owners of privatized state-owned plants and other assets with potential environmental problems, and complete preparatory work for the conversions of external debt into equity of privatized companies.

F. Institutional Arrangements

2.27 The Ministry of Ownership Changes will be pivotal in the future programs of ownership transformation. Insofar as state-owned industrial enterprises are concerned, other key agencies are the Ministry of Industry (MoI) 8/, the Anti-Monopoly Commission, and to a lesser extent the Polish Development Bank and the Industrial Development Agency. Furthermore, the Foreign Investment Agency has a critical role in attracting foreign investments, for both greenfield projects and privatization.

2.28 An important deficiency in the institutional set-up is the absence to date of a comprehensive package of fully-defined mechanisms and instruments to exercise the ownership rights of the "State Treasury" on state assets. The Treasury is the designated owner of state assets (as specified for example by the Privatization Law) and can delegate such rights to other entities. At the present time, it is not quite clear how the State will manage its shares in commercialized companies, for example, what will be the rules for Board members appointed to oversee the State's interests in companies partially or wholly owned by the State. The manner by which the State will exercise its ownership rights will be of utmost importance in the privatization process as well as in critical cases of enterprises being restructured. The Government has initiated a large-scale program of selection and training of a pool of

8/ Or other founding organs with industrial enterprises, such as the Ministry of Physical Planning and Construction which controls many building materials industries, or the Ministry of Agriculture and Food Economy for agro-industries, or local wojewoda or municipal agencies for smaller industrial enterprises.
potential Board members who will initially represent the State's interest in the Boards of companies. To clarify their mandate, the Government will, before October 1991, elaborate policies and procedures to be followed by these Board members. The Government will also examine other mechanisms (such as holding companies) for management of the assets under State control, adopt them as needed and amend the legal framework accordingly.

2.29 The Government is now establishing a Stock Exchange and a Securities Commission to ensure a transparent, efficient and safe securities market. The French Stock Exchange Association and the American SEC, respectively, are advising in the design of these two institutions. The Warsaw Securities Exchange is being established as a joint stock company, with part of its capital partly owned by the State Treasury, and partly by market participants, and commenced limited operations in April 1991.

2.30 While in most cases, the respective roles of the various agencies is reasonably clear, in others there is some overlap in function. The Government will continue to work to identify those areas where conflict and inconsistency persists and make the necessary adjustments to eliminate these differences 9/. Despite this generally coherent design, all institutions lack the capacity to fulfill their mandate and the Government has elaborated an extensive program of technical assistance to rapidly strengthen their institutional capacity. The proposed project will provide direct support to this program.

G. Industrial Restructuring

2.31 The Government does not see itself as a major agent in the field of restructuring individual enterprises and will focus primarily on privatizing enterprises which can be privatized, and liquidating non-viable enterprises. Nevertheless, in view of the number of enterprises and the limited resources for privatization, it is clear that many enterprises will remain in Government hands for some time and that among this group will be potentially viable enterprises which may need some preliminary restructuring before they can be considered candidates for privatization. This is particularly true in the case of currently unprofitable enterprises, or enterprises which will soon become unprofitable because of drastic changes in the economic environment such as the loss of traditional CMEA markets.

2.32 The Government has established procedures whereby an analysis is undertaken of the prospects for the enterprise's future viability. In cases where there is clearly no future, the Bankruptcy Law and the Law on State Enterprises are utilized for an orderly process of liquidation. These laws empower the Government to intervene directly in enterprises incurring losses or not paying the compulsory dividends, suppress existing management

9/ Examples include: the stated intention of all five of the agencies to undertake subsector studies to guide their work; and the duplication of many functions in the Ministry of Industry and the Industrial Development Agency.
arrangements, and direct the enterprise to an ad-hoc Recovery Commission. This commission carries out, with expert help, a diagnosis of the enterprise's situation and recommends accordingly its liquidation, sale or restructuring. While a few liquidations of this type are taking place 10/, the lack of institutional capacity is impeding the pace of both the diagnosis of future viability and the liquidation process itself. The Ministry of Industry, for example, does not have the capability to deal with the 417 SOEs (out of the 1,200 industrial enterprises under its purview) which as of March 1991 were already experiencing some financial problems. The Government is seeking technical assistance in this area, to design and put in place appropriate mechanisms for dealing with the growing number of liquidations. Some non-viable enterprises have been 11/ sustained through inappropriate support loans which amount to indirect budgetary support. However the Government has reiterated its commitment not to subsidize directly or indirectly enterprises, and intends to develop a clearly articulated and transparent industrial policy, and a reorganized Ministry of Industry, itself restructured to implement this policy.

2.33 In some presently unprofitable enterprises, a diagnosis initiated by the Government or the enterprise, may show that with a greater or lesser degree of restructuring--financial and/or physical--the enterprise or some parts of the enterprise can be restored to profitability. In some such cases, a private buyer may still be interested in an acquisition of an enterprise--at a low price--if he sees the possibility for restructuring the enterprise by his own efforts to restore profitability. This type of individual privatization will be encouraged. The Government recognizes that in most cases the possibility of greater returns from the sale by undertaking the restructuring while the enterprise is still owned by the State will be far outweighed by the lack of state capacity to design and implement such restructuring.

2.34 For those enterprises which have good prospects for viability after restructuring, but for which there is no private interest in the enterprise prior to restructuring, the Government recognizes its responsibility to initiate restructuring to make them attractive enough for privatization. The Government intends to lend support to such restructuring only to enterprises that have already been commercialized.

2.35 A major aspect of the restructuring of the many integrated or other multi-plant enterprises is the break-up of the original enterprises into smaller individual enterprises. This process is initiated generally by a request of the enterprise to the founding organ, or sometimes by an action of the Anti-monopoly Commission which then works with the founding organ. The break-up aims at creating one or more profitable units by stripping off and subsequently liquidating unproductive assets and focussing each new enterprise on its core business. Mol and the Anti-monopoly Commission have inadequate

10/ In 1990, 22 such liquidations were completed.

11/ Through the former Industrial Restructuring Fund
capacity to handle this work and technical assistance is being sought as the pace of transformation accelerates and the pressure builds to proceed with break-ups in order to deliver an increasing stock of viable enterprises.

2.36 In most cases, restructuring actions to restore SOEs to profitability to facilitate subsequent privatization are being developed on a case-by-case basis. Such actions may include financial restructuring, reorganization, and physical restructuring including the sale of some assets or investments in others. The enterprise may seek the assistance of the new Industrial Development Agency (IDA—para 2.38) to prepare its restructuring plan.

2.37 For some groups of enterprises, the need for restructuring may be anticipated and in these cases MoI can provide early assistance to prepare for the necessary adjustment. Polluting industries are one such group, as are energy-intensive industries, which will soon run into major financial difficulties when the price of energy inputs is further increased to fully reflect international prices. There are also strategically important subsectors which warrant a subsectoral study to provide a backdrop against which individual enterprises (whether SOEs or private) can evaluate their restructuring and development proposals. MoI is already commissioning studies in the textiles, steel, components and packaging sectors, and will seek financial and technical assistance for further studies of this type in the future.

H. The Industrial Development Agency

2.38 Parliament has ratified an Act for the establishment of an Industrial Development Agency (IDA), as a joint stock company, by transforming the Industrial Restructuring Fund (IRF) which had previously been the restructuring arm of MoI. While the former IRF has been providing financial assistance to industrial enterprises (in the form of credits and equity investments), IDA's major role, as defined by its Statute, is to provide "advisory services and supporting analyses for SOEs in need of restructuring." IDA is thus basically a technical assistance agency for the preparation of restructuring programs of industrial enterprises and for the supervision of implementation of such programs.

2.39 The Chairman of IDA is a Deputy Minister of Industry. IDA's new senior management team, recently appointed, consisting of a President and two Vice Presidents, has prepared a document stating the "Overall Strategy, Operational Policies and Proposed Work Program for 1991/1992." It reconfirms IDA's basic role of providing advisory services for restructuring in contrast to the former IRF role of providing financial assistance.

2.40 Although the agency began to operate as IDA only on January 1, 1991, the precursor organization has actively participated in the preparation of enterprise restructuring plans, including the preliminary diagnoses of about 150 enterprises and the appointment of consultants to initiate detailed restructuring studies in 25 of them. The program for 1991/92 includes a further 150 diagnostic studies and 100 full restructuring studies. IDA's
needs in technical assistance to implement this program are substantial and will be addressed partly through this project.

2.41 The request for IDA assistance may be made by the enterprise, the founding organ, or by the Ministry of Finance or MoOC. Most of the ongoing studies have been financed through bilateral or multilateral grants at no charge to the enterprises. It is envisaged that in the future IDA will offer financing for consulting studies, requiring the enterprises to pay 20% up front, but will lend the balance of 80%. IDA will assist the enterprise management to select the consultants and supervise their work.

2.42 Upon completing the design of a restructuring program, IDA will review the work in consultation with its clients and help to decide on appropriate implementation actions. If the results of a study commissioned by IDA indicate little chance of successful restructuring, the enterprise will be liquidated and its assets sold off by a liquidator, appointed by the founding organ. Where restructuring is indicated, at the request of the enterprise or of the Government (as owner), or in some cases where IDA itself is a small shareholder, IDA will actively supervise the restructuring of an enterprise. At the present time, six enterprises are actively being restructured with technical assistance from IDA. Options for restructuring would include: (i) restructuring by existing management or by change of management; (ii) forming a joint venture with a suitable external company; (iii) management contracting with a foreign company; (iv) leasing of the enterprise’s assets; (v) selling partial ownership to a foreign company; and (vi) financial restructuring, as a prelude to partial or full privatization. IDA is developing a capacity for "financial engineering" for those enterprises which require financial reorganization as a part of their restructuring needs.

2.43 The Government has not allocated any funds to IDA in 1991, and has not indicated any plans for additional funding in the future. However, out of former IRF sources, IDA currently has available liquid resources of about $95 million equivalent. These may be used for providing financial assistance to restructuring enterprises which, on the basis of a detailed consultants' study, are considered to be viable. Such financial assistance may be in the form of bridging loans, loans convertible into equity or equity investments. However, as emphasized in IDA's Strategy document, financing of restructuring enterprises should be provided by the Polish banking and financial system and not by IDA. As indicated in its Strategy Document and as confirmed during negotiations, provision of such financial assistance by IDA would be an exceptional measure, to be provided only in the transitional period, until June 30, 1992.

2.44 IDA's existing financial portfolio will be transferred to financial institutions. Loans to enterprises will be sold or transferred to financial entities capable of managing credit risks (such as PDB and other banks) and IDA's equity investments in enterprises will be transferred to equity holding entities, such as independent companies, private funds, privatization funds or private equity holding companies in which IDA may have some equity participation. It was confirmed during negotiations that transfer of IDA's financial portfolio will be completed by June 30, 1992, on the basis
of a study with an implementation program which will be communicated to the Bank. If after this transfer, IDA continues to hold some shares in equity investment companies, it would ultimately sell these shares on the market as feasible.

2.45 IDA intends to support establishment of regional restructuring agencies (RRAs), which will provide assistance for the establishment of small businesses in regions affected by closure of non-viable enterprises. IDA may become a minority shareholder (in extreme cases up to 49%); the majority of the shares will be owned by the local authorities. So far, IDA has become a minority shareholder in four regional RRAs. In 1991/92 it intends to participate in ten additional RRAs. The RRAs will assist in the preparation of restructuring programs for relatively smaller enterprises, as well as promote the establishment of small and medium size enterprises, but will not engage in new lending activities.

2.46 Until now, a major constraint on IDA's operation has been the limited experience of its staff. Although IDA is now permitted to pay more attractive salaries than the civil service, it has to compete for professional staff against private companies, including foreign ones. To address this problem, IDA will hire external professionals for several key positions during the initial years of operation who, in addition to their operational responsibilities, will provide "on-the-job" training to young and less experienced Polish staff. The technical assistance component of the proposed project supports IDA by providing: (i) partial financing for restructuring studies of consultants' work within IDA; (ii) assistance in mobilizing TA grants from international donors such as the EC, the Japanese Grant Fund, and other sources; and (iii) training for IDA staff.

I. The Role of the Ministry of Industry

2.47 As Poland moves rapidly toward a market economy, and a large number of SOEs, previously controlled to a greater or lesser extent by the MoI, are privatized, it is appropriate that the Government re-evaluate the role that MoI should play focusing it toward supporting an enabling environment for the private sector. At the same time, it is important to determine how the Ministry should be restructured to undertake this supporting role. While the new policies have yet to be elaborated, it is clear that the overall objective of a new industrial policy will be to enhance the international competitiveness of Poland's industries and enterprises. The Government intends to play a role in shaping industrial policy, in a way similar to that of many west European countries. During negotiations, it was agreed that the Government would appoint a task force and commission a study with a view to establishing a coherent industrial policy for Poland and developing the appropriate structure for MoI to implement it (para 4.05). While drawing extensively on policies and structures in other market-oriented countries, the final recommendations will give full weight to the special conditions faced by the transitional nature of the Polish economy.
J. **Bank Group Strategy for Assistance to Enterprise Reform**

2.48 The Bank supports Poland's objectives to improve efficiency and productivity of the economy while upgrading socio-economic conditions, and this is being accomplished by supporting the market-oriented policies the Government has adopted to achieve these objectives. Specifically, the Bank is assisting the Government in implementing its program to: (i) reform the economic system; (ii) restructure the productive base; and (iii) improve creditworthiness. Regulatory measures and the institutional framework to support enterprise reforms have been agreed in the context of the ongoing SAL. In the industrial sector, the first project—Industrial Export Development project—is contributing to increasing convertible currency industrial exports, strengthening the role of the banking sector, and initiating the development of restructuring strategies.

2.49 Industrial sector work has identified and analyzed the constraints to the improvements of efficiency and competitiveness of the industrial sector, and the proposed Project will help promote and implement necessary changes in the industrial policy and restructuring strategies through continuous dialogue. To help expedite the privatization and restructuring of the SOEs, during the preparation of the proposed Project, some 25 SOEs were visited and diagnosed by Bank staff and terms of reference for further consultant assignments were prepared. In addition, the Bank, through the use of EC and Japanese grant funds, and other grant financing has assisted MoI to initiate industry studies in textiles, steel, and components subsectors and IDA to initiate sector/enterprise restructuring studies. Financing would be provided, under the proposed Project, for implementation of the consultants' recommendations, as well as additional enterprise and subsector studies. Finally, through continuous dialogue, the Bank staff has been able to assist the Polish Government in further elaborating and detailing its Privatization Program, and under the technical assistance component of the Project, explicitly address the need for the reorganization of the MoI and the establishment of a coherent industrial policy, as well as other institutional needs for the implementation of the Program.

2.50 The ongoing development of projects aimed at modernizing the financial sector, improving telecommunications and other key infrastructure sectors, and fostering the private sector through small and medium enterprise development, will support efforts to restructure Polish industry. The proposed Project, with a primary focus on privatization of SOEs, is expected to be the first in a series of such operations. The ongoing SAL includes provision of income support programs for workers displaced by restructuring,

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12/ Total commitments to-date on this project have exceeded US$100 million out of a total loan amount of US$260.

while the proposed employment promotion and services project would support specific programs of human resource development. The ongoing environment management project provides an umbrella framework for addressing environmental concerns, while a follow-up project would deal with major industrial polluters. Two proposed operations in the agriculture sector would deal with privatization and restructuring of the agro-industry and the State farm sector.

2.51 IFC has played an important complementary role in the reform of the Polish economy. IFC has assisted with the development of the regulatory framework for commercial banks and securities markets. In addition, IFC has promoted a joint venture commercial bank and is actively considering the establishment of a venture capital fund. It also plans to help establish other non-bank financial intermediaries such as leasing companies, mutual funds and insurance companies. IFC is also directly active in promoting Poland's privatization effort. It has advised the Government on the conceptual framework for privatization and on specific legislative initiatives, most recently, on amendments to the foreign investment and banking laws. IFC initiated a proposal, and helped secure EC funding for financing the organization/establishment of the Privatization Agency, which was later expanded into the MoOC. In addition, IFC is assisting in and undertaking individual privatization transactions. Furthermore, IFC has sponsored and is supporting the establishment of the Polish Business Advisory Service.

III. THE FINANCIAL INTERMEDIARIES

A. Current Status of the Financial Sector

3.01 The banking sector is principally comprised of the central bank, the National Bank of Poland (NBP), six specialized banks, nine commercial banks, a development bank, and some 60 private banks which have been established recently with private domestic or foreign participation (in addition to 12 representative offices of foreign banks). The specialized banks include Bank Handlowy (the foreign trade bank); Bank PeKaO S.A. (which manages foreign exchange deposits of households, savings and a portfolio of housing loans through an extensive branch network); BGZ (which is specialized in agricultural lending and serves as an apex institution for the cooperative banking system); and BRE (the export development bank).

3.02 The nine commercial banks were established in January 1989 out of the NBP, as part of an overall reform program for the financial sector, where NBP retained the typical central banking activities and transferred all its corporate lending activities to the commercial banks. In parallel, credit and interest rate policies were streamlined and significantly improved. Despite significant progress, however, the financial sector institutions continue to be characterized by limited autonomy, weak portfolios, lack of real competition, lack of real banking skills in a market economy and an ineffective institutional and legal framework.
B. Financial Sector Reform

3.03 Substantial restructuring of the financial sector and its policy framework is required for it to support and participate in a significant manner in Poland's privatization and industrial restructuring program. The requirements of the banking sector and some of these fundamental policy revisions are supported under a parallel World Bank Financial Institutions Development Loan. Key elements of this reform program are presented below:

(a) Strengthening Sectoral Financing. The Government has given priority to the rapid development of a national network of banks offering basic banking services, with the objectives of (i) continuing to establish viable new private banks; and (ii) strengthening, commercializing and privatizing the existing State-controlled banks to assist in their efforts to provide core banking services. The strengthening of the national bank network would also provide for the sectoral (housing, agriculture and industry) financing requirements previously undertaken through the centralized allocation process. In addition, a number of specialized financial institutions (e.g. PDB and IDA) have been established by the Government to accelerate the industrial restructuring and privatization program.

(b) Financial Policy Reform. A number of actions are intended to be taken to develop a coherent policy framework addressing the areas of (i) a closer monitoring of specialized credit programs; (ii) efficient management of the liquidity of the banking system; (iii) full liberalization of interest rates; and (iv) an improved foreign exchange management framework.

(c) Development of Banking Legislation. The Government is actively undertaking the process of harmonizing the Polish legal framework with that of the European Community. Reforms currently contemplated in the financial sector include (i) a comprehensive revision of the Banking Law and the Act on the Central Bank, including a further strengthening of prudential regulations; (ii) the introduction of a law on collateral security; (iii) the introduction of an enabling framework for the corporatization and privatization of banks; (iv) the development of legislation for ensuring the protection of depositors; and (v) the introduction of a legal framework for capital market activities.

(d) Institutional Strengthening of Banks. The institutional framework of the banking sector needs to be strengthened substantially in order to foster financial discipline in credit allocation and to discontinue support to inefficient industries. The institutional development program will involve (i) the development of bank institutional capabilities (through measures such as reclassifying bank portfolios, undertaking sound financial audits of the banks and training staff), and (ii) the financial restructuring of existing institutions, with a view to eventual privatization. A
key measure to promote institutional development is expected to be the development of "twinning" arrangements with reputable Western banks, to ensure the rapid transfer of banking know-how.

(e) Development of Financial Markets. With the objectives of further deepening the financial system, ensuring a more efficient mobilization of resources and broadening the sources of financing for the corporate sector, the Government is undertaking the development of the domestic financial markets. This would include supporting the establishment of privatization/investment funds, training of financial market participants and the establishment of the Stock Exchange and the Securities and Exchange Commission.

C. Financing for Privatization and Restructuring

3.04 A key element of financial sector reform is the provision of credit to finance enterprise operations and investment. While the enterprise sector is already important to Polish banks (enterprise credit to the banking system grew from 47% of banking system's total assets in 1989 to 59% by October 1990), there is a shortage of medium- and long-term finance for investments. The banks have traditionally relied on NBP refinance for this purpose but this has been reduced drastically. NBP has also been the channel for the intermediated World Bank operations in Poland.

1. The Polish Development Bank

3.05 To address the problem of investment financing and to further support the restructuring of the Polish economy while helping to refocus the role of NBP as a central bank, the Government decided to create a new financial institution. The Polish Development Bank (PDB) was established by the Council of Ministers in 1990, as a joint stock company, with equity participation of the Government (US$84 million equivalent) as the major shareholder, IDA (US$21 million), and three west European banks (Credit National of France, and Invest Kredit of Austria and IMI of Italy, US$2 million each). PDB is starting operations during the second quarter of 1991, under Polish banking regulation and supervision. PDB will act as the main apex institution for the provision of industrial development credits mobilized from external sources, including those of the World Bank, therefore releasing NBP of the organizational and administrative responsibilities related to such activities. An appraisal of PDB is contained in Annex 3-1.

3.06 As an autonomous institution, PDB's operations are guided by its Supervisory Board. The President has been appointed, an organizational structure is in place, and many of the staff have been recruited. Management is presently engaged in training staff, and has purchased hardware and software, prepared operating policies, and formulated a 3-year strategic plan.

3.07 With the mandate of facilitating and promoting privatization, restructuring and development of private sector, PDB will initially focus its operation on three "windows" providing financing, mostly through other intermediaries for: (i) restructuring of private and state-owned enterprises,
primarily those in the process of privatization; (ii) the development of new private small and medium enterprises; and (iii) minority equity investments in privatized or joint venture companies, altogether limited to 15% of PDB's capital. Later, PDB plans to engage in additional activities including leasing and other financial services.

3.08 Sources of funds in the first few years of operation will be capital, loans from external banks (including multilateral, regional and national banks), medium-term deposits and bonds in the Polish capital market, and possible loans from the Government. PDB's proposed operational procedures, and funding and lending policies are detailed in Annex 3-1, together with projected financial statements, confirming that key ratios and other indicators would be adequate.

3.09 PDB will act principally as a wholesale bank, channelling the majority of its lending to the final borrowers through eligible Polish commercial banks. However, since during the transition period of the financial system, commercial banks may be slow to engage in new activities, such as medium- and long-term lending (even if resources are provided by/through PDB), or introducing new monetary instruments, it has been anticipated that there will also be a need for limited direct lending operations by PDB. Direct lending by PDB will be limited to 15% of its total operations (and similarly direct lending out of the Bank resources proposed under the present loan would not exceed 15% of these resources) during the next three years. These commitments were confirmed in a Statement of Operating Policy, which was submitted to the Bank during negotiations.

3.10 In the medium term, when there will be less of need for an apex institution in Poland, PDB will evolve into a more conventional financial institution and is expected to further open its capital to private participation. By the end of 1993, PDB will undertake a review of its role in light of the progress achieved in the modernization and development of the financial sector in Poland, and will elaborate accordingly a plan on the appropriate reorientation of its activities. Such reorientation would be implemented after consulting with the international and bilateral institutions providing funding to PDB. By that time, PDB would prepare and start implementation of a program to increase private participation in its capital. Commitments on these matters are detailed in PDB's Statement of Operating Policy.

3.11 PDB may also be a channel for "special credits" from the Government, earmarked for specific uses, such as restructuring of enterprises in priority industrial subsectors. For such loans, PDB will serve as an agent of the Government for a fee and the loans would be given at Government risk and recorded below-the-line on PDB's balance sheet, with the funds provided through budgetary allocations 14/.

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14/ The mechanism described here is designed to ensure that such financial assistance by the Government does not prejudice the viability of the financial system.
2. **Polish Commercial and Specialized Banks**

3.12 The commercial and the specialized banks will play a major role in enterprise restructuring in the future. They have an inherent interest in promoting the enterprise restructuring process, since it will lead to a dynamic industrial environment with increased demand for credit and other banking services. Currently however, due to institutional weakness and tightening of long-term refinancing from NBP, these banks are not very active in granting medium- and long-term credits. The institutional strengthening programs initiated under the ongoing Industrial Exports Development Project, and envisaged under the proposed Financial Institutions Development Loan are addressing these problems and will enable the banking system to have a much more effective role in mobilization and allocation of medium- and long-term resources.

3.13 Seven Polish banks have already started implementation of recovery programs and are therefore eligible to on-lend Bank resources under existing loans. Further financial and institutional diagnostics programs conducted under the Financial Institutions Development Loan should enable the remaining commercial banks to become active participants in the enterprise sector reform in the near future. It is expected that new private banks would also play a role in providing financing for privatization, and private sector development. Eligibility criteria for participation of Polish banks as intermediaries in the proposed Project are detailed in para 5.12.

3. **Other Intermediaries**

3.14 Other institutions which could have an important role in financing industrial restructuring, include: (i) privately-managed *privatization funds* (para 2.22), which will be established to facilitate the proposed mass privatization program; (ii) future privately-managed *holding companies* which will actively manage and, where necessary, restructure the enterprises they hold; and (iii) *venture capital funds* and other funds providing equity or quasi-equity. The Polish-American Enterprise Fund already provides some equity financing and several other new funds are being set-up or proposed which would also play a role in providing equity or quasi-equity financing to enterprises.

IV. **THE PROJECT**

A. **Objectives and Scope of the Proposed Project**

4.01 Privatization and the responsible management of state assets have emerged as centerpiece of the Government's program to transform the Polish economy. The principal objective of the proposed project is to provide timely, responsive support to these efforts, and to strengthen the program while giving confidence to potential domestic and foreign investors.
4.02 More specifically, these objectives are being achieved by:
(i) assisting with the design of the necessary policies; (ii) supporting the establishment and strengthening of the institutional framework and the implementation of the privatization program, in support of the Government's objective of privatizing half of state-owned assets within three years; and (iii) providing finance for enterprise restructuring programs in those cases where investments are warranted and for enterprises which are already private, or which are under joint-stock or limited liability company form as a first step towards privatization.

B. Project Components

4.03 The proposed project, supported by a US$280 million Bank loan, includes three integrally related components:

(a) A policy component supporting the Government's privatization and restructuring program through a quick-disbursing tranche, which will secure the Government's commitment to: (i) implement the Privatization Program following Action Plans agreed with the Bank; (ii) adopt a sound approach for enterprise restructuring; and (iii) address a wider range of related issues, such as management of state assets and industrial policy, on a longer time period, as privatization and restructuring are being carried out. The proposed loan would provide US$75 million equivalent for the policy component. Up to US$50 million of this component could be used for a Debt and Debt Service Reduction (DDSR) plan meeting the requirements for Bank support.

(b) A technical assistance component which will support the various institutions which will assist in implementing the program. In particular, Bank-financed technical assistance would be provided to four of the key agencies involved in the restructuring and privatization process: the Ministry of Ownership Changes, the Ministry of Industry, the Polish Development Bank, and the Industrial Development Agency. Proposed Bank assistance of US$65 million under this component would be provided within the context of an integrated overall program, co-financed by the Government budget, as well as with the support of multilateral and bilateral institutions.

(c) A restructuring/privatization investment financing component which will provide sub-loans (channelled through and approved commercial banks) to privatized or privatizing enterprises. Such sub-loans would finance foreign exchange costs of needed organizational or physical improvements at the enterprise level. US$140 million equivalent of the proposed Bank loan would be allocated for this purpose.
C. Policy Component in Support of the Privatization and Restructuring Program

4.04 The evolving policy and mechanisms for the transformation of SOEs through commercialization, restructuring and privatization, have been described in detail in Chapter II of this report and are summarized in the matrix on the following page. Government commitments in this regard are detailed in a Letter of Policy for Privatization and Restructuring (Annex 4-1). The quick-disbursing part of the proposed loan is in support of this program. Many of the required policy actions have already been undertaken during the course of project preparation. Most recently, critical actions have included:

(a) preparation of an action plan for privatization, which has been agreed with the Bank, and includes criteria and mechanisms for selection of enterprises for specific privatization tracks, and a program for the establishment of regional offices of Ministry of Ownership Changes as well as guidelines on privatization for regional/municipal authorities; and

(b) establishment of an inter-ministerial task-force with guidelines for speedy decision of critical restructuring cases (large SOEs).

4.05 Given the considerable progress already achieved and the other undertakings proposed for the coming year, disbursement in a single tranche of US$75 million is proposed, with the completion of an implementation plan for the proposed program of mass privatization, based on careful feasibility studies, as condition of tranche release. Further progress in the privatization and restructuring program will be assured through dated covenants as follows:

(a) For privatization: (i) preparation of a plan for the application of debt-equity swaps in individual privatizations of enterprises (by December 31, 1991); and (ii) preparation of a statement of policy on environmental contingent liabilities for new owners of privatized SOEs (by December 31, 1991).

(b) For the management of state assets: (i) preparation of guidelines for directors representing the state in supervisory boards of fully or partly state-owned joint stock companies (by September 30, 1991); (ii) definition of appropriate mechanisms for defining and delegating responsibility for state ownership of enterprises by the "Treasury" (by December 31, 1991); and (iii) elaboration of incentives and other measures which will cause enterprises to commercialize (by December 31, 1991).
Key Steps of the Privatization and Restructuring Program

**Government Intent/Objectives**

**MACROECONOMIC PROGRAM**
Continue implementation of the Economic Transformation Program

**Privatization**
Adopt comprehensive Privatization Strategy (to privatize 50% of SOEs in three years, using multi-track approach).

Develop and execute detailed action plan for implementation of strategy including:
- mass privatization
- liquidation
- decentralization of privatization
- clarification/streamlining procedures
- plans for debt-equity swaps
- delineation of roles of and coordination between institutions.

Enact, update and harmonize policies and legislation (on cooperatives, land ownership, labor, taxes, commercial code, compensation for original owners, contingent liabilities, etc.)

Promote and attract Foreign Investment

**OWNERSHIP REFORM**
Define/Clarify State Ownership of assets and exercise ownership to improve SOE performance by:
- corporatizing (convert into joint stock companies) SOEs to introduce adequate corporate governance
- introducing mechanisms for effective management of State assets

**RESTRUCTURING**
Define clear policies and develop guidelines for restructuring of enterprises

Develop institutional capabilities for restructuring, and define roles of different agencies and their inter-relationship

Liquidate non-viable SOEs

**INDUSTRIAL POLICY**
Formulate a new industrial strategy and role for MoI to deal inter alia with structural changes arising from collapse of CMEA trade, non-subsidized energy prices, etc. and to support privatization and private sector development

**Salient Policy Commitments, Conditions, and Actions Supported under the Project TA**

Satisfactory progress in continuation of implementation of Economic Transformation Program

Approved in February 1991

Revision and harmonization of laws and regulations during 91-93 (supported by TA)

Program for debt-equity swaps and for contingent liabilities to be prepared (by December 31, 1991)

New law on foreign investment to be prepared and development and implementation of promotion program by Foreign Investment Agency over 91-93 (supported by TA)

Preparation of guidelines for Boards of Directors of SOEs (by September 30, 1991)

Definition of mechanisms for defining and exercising rights of state ownership (by December 31, 1991)

Elaboration and improvement of incentives to enterprises to commercialize (by December 31, 1991)

Clear definition of restructuring policy and mechanisms for dealing with important restructuring cases (satisfactory progress)

Build up restructuring capabilities of MoI, IDA, regional agencies (supported by TA)

Improvement of liquidation capabilities of MoI, and other agencies involved in liquidation process (supported by TA)

Completion of study of appropriate MoI role (supported by TA) (by December 31, 1991)

Restructuring of MoI (by June 30 1992)
(c) For development of a strategy for the Ministry of Industry:
(i) completion of preparation of a study, for presentation to the Bank by December 31, aimed at establishing a coherent strategy for industry which reflects immediate restructuring needs as well as long-term policy goals, and proposes an appropriate role and structure for MoI; and (ii) restructuring of the Ministry as required (by June 30, 1992).

4.06 Commitments with respect to the above actions were confirmed during negotiations and are contained in the Letter of Policy for Privatization and Restructuring.

D. The Technical Assistance Component

4.07 The main objective of this component is to provide expert assistance for the design and implementation of an effective policy and institutional framework for privatization and industrial restructuring in Poland. The technical and managerial capacity to handle a task of this magnitude does not exist in Poland. While considerable progress has been made in developing the concepts for programs of privatization and restructuring to effect the necessary transformation, the specialized nature of many aspects of the work, and the ambitious targets with respect to numbers of enterprises to be transformed, will require a substantial amount of foreign technical assistance. Elements of the proposed program of technical assistance, together with cost estimates, are detailed in Annex 4-2 and summarized in the following table.

| Table 4.1 - Technical Assistance for Privatization and Restructuring Project Estimated Cost and Preliminary Financing Plan (US$ million equivalent) |
|-----------------------------------------------|----------------|---|---|---|---|---|
| Item                                         | Budget | IBRD | EC | EBRD | Others | Total |
| Ministry of Ownership Changes                | 62     | 34   | 29 | -    | 16     | 141   |
| Ministry of Industry                         | 2      | 10   | 7  | -    | -      | 19    |
| Polish Development Bank                      | -      | 3    | -  | -    | -      | 3     |
| Industrial Development Agency                | 8      | 17   | 19 | -    | -      | 44    |
| Foreign Investment Agency                    | 8      | -    | 3  | 10   | -      | 21    |
| Anti-Monopoly Agency                         | -      | -    | 3  | -    | -      | 3     |
| Wojewoda Assistance                          | -      | -    | 7  | -    | -      | 7     |
| Technical Assistance Units                   | -      | 1    | 1  | -    | -      | 2     |
| Total Technical Assistance Program           | 80     | 65   | 69 | 10   | 16     | 240   |
4.08 In parallel with the magnitude of the task, the scope of the technical assistance requested by the Polish authorities and proposed for support under the project is unprecedented. Although the Government's commitment to the program is clearly demonstrated by its own budgetary allocation to the program, there remain questions about the implementation and absorption capacity on the Polish side. First, it must be noted that most (about two-thirds) of the technical assistance is directed to supporting the design and implementation of transactions at the level of individual enterprises with committed counterpart capacity. Second, the balance of the assistance proposed is directed to six different agencies (of which the Bank will be assisting four), each of which has carefully elaborated its specific requirements for training and counterpart support. Third, as further detailed below (para 4.10), a key component of the proposed assistance program is a procurement/coordination unit specifically designed to facilitate implementation. Finally, the technical assistance proposed and detailed in this report encompasses all of the assistance envisaged to support the massive privatization program over the next two years.

4.09 As can be seen from Table 4.1, the proposed Bank allocation of US$65 million for this component represents about 27% of the total estimated cost. Efforts are continuing to find additional grant financing and to reduce the proportion financed by the proposed Bank loan. Details on the entire technical assistance program are contained in Annex 4-2. Bank funds would be used as follows:

(a) In the Ministry of Ownership Changes, for (i) financing consultancy and other expenditures associated with individual privatization operations; (ii) a study of the feasibility of a mass privatization scheme; and (iii) training and institutional support, including the purchase of key office equipment;

(b) In the Ministry of Industry, for (i) support in elaborating an appropriate role for the Ministry in the context of the evolving structure of Polish industry, including a reorganization of the Ministry; (ii) studies and assistance for specialized restructuring activities including liquidation, the break-up of large enterprises, and the development of approaches for dealing with difficult restructuring cases which cannot readily be privatized (high energy users, major polluting industries, etc); and (iii) training and institutional support, including the purchase of key office equipment;

(c) The Polish Development Bank, for general support in establishing and starting up the bank as well as for training; and

(d) The Industrial Development Agency, primarily for financing restructuring/privatization studies in specific enterprises but also for general institutional support and training.
4.10 The effort required to manage the procurement and contractual arrangements for a program of assistance of this magnitude is considerable. It is thus envisaged that a special Technical Assistance Unit for this specific purpose would be set up in the Ministry of Finance. Other than providing review capability for Terms of Reference and short lists of consultant candidates, this unit would not have a major role in controlling the technical content of the assistance itself, but would act as a coordinating office for procuring and contracting World Bank-financed technical assistance services in response to requests from the implementing agencies. The European Community (EC) plans to provide similar assistance and this work will be coordinated between the two agencies.

4.11 In some cases, the necessary technical assistance services can be provided by individual experts working within the agencies concerned. In others, foreign firms (consulting firms, investment banks) will have to be engaged to undertake major specific pieces of work. Agreement on the content of the technical assistance program was confirmed during negotiations.

E. Restructuring/Privatization Investment Component

4.12 To address the immense challenge of restructuring a large number of (mainly) industrial enterprises, before or after privatization, a wide range of financial instruments channelled through different institutions will be required. Individually tailored financial packages will have to be developed for many enterprises to ensure the successful implementation of the respective restructuring plans and privatization. A variety of mechanisms and financial intermediaries are evolving to meet these needs, including the proposed investment component of the proposed project, which will provide loan funds for investments and for working capital required for the restructuring of eligible Polish enterprises.

4.13 Sub-loans from the proceeds of the proposed Bank loan would be made available through PDB and eligible Polish banks to eligible enterprises to finance viable restructuring projects. To be eligible for sub-loans, borrowing enterprises and their sub-projects must meet the following criteria:

- The borrowing enterprise must be in the form of a joint stock company, or limited liability company form;
- The enterprise must have initiated arrangements to undertake annual external audits of its operations according to auditing standards acceptable to the Bank, and to take any necessary actions as a result of such audits;
- The enterprise must have prepared and agreed to implement a strategic development plan and a restructuring program which demonstrates its long-term viability, deals with any outstanding environmental problems based on the recommendation of
environmental assessments (para. 4.19), and clearly identifies and quantifies the benefits of the proposed new investment 15/;

- If not already privatized, the strategic development plan must aim at eventual privatization;

- The financial and economic internal rates of return on any investments included in the restructuring program must be at least 15%;

- Financial projections must demonstrate that the borrowing enterprise will be able to recover/sustain a sound financial performance, with capacity to service adequately the additional debt incurred as a result of the restructuring program; and

- A complete financing plan for the proposed restructuring program must be in place, with adequate assurances in this regard from all financing agencies.

4.14 Agreement on these eligibility criteria for enterprises and their investments was confirmed during negotiations.

F. Project Cost and Financing Plan

4.15 The total cost of privatizing and restructuring Poland’s industrial sector will be far greater than the funds which would be mobilized under the present project. Table 4.2 shows an estimate of the total project cost associated with this specific operation.

<table>
<thead>
<tr>
<th>Table 4.2 - Privatization and Restructuring Project</th>
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</thead>
<tbody>
<tr>
<td><strong>Estimated Total Project Cost</strong></td>
</tr>
<tr>
<td>(US$ million equivalent)</td>
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<tr>
<td></td>
</tr>
<tr>
<td><strong>Amount</strong></td>
</tr>
<tr>
<td>Local</td>
</tr>
<tr>
<td>Policy Component</td>
</tr>
<tr>
<td>Technical Assistance Component</td>
</tr>
<tr>
<td>Investment Component</td>
</tr>
<tr>
<td>Total Financing Required</td>
</tr>
</tbody>
</table>

15/ Arrangements for providing assistance in preparing such plans and program will be made under the Technical Assistance component of the proposed loan.
4.16 This estimate has been developed on the following basis:

(a) The amount of the quick-disbursing part of the loan for the policy component is an amount considered appropriate to: (i) support the policy program; and (ii) deliver in combination with other instruments World Bank support to Poland's balance of payments;

(b) The estimate for technical assistance is the detailed estimate presented in Annex 4-2; and

(c) The estimate for the investment component is based on preliminary estimates of average investment needs for restructuring 60 enterprises, developed from a number of restructuring studies presently being prepared. The presence of a substantial pipeline of restructuring needs and viable projects has been confirmed in discussions with a number of the Polish banks which are expected to be financial intermediaries under the project.

4.17 World Bank financing would cover US$280 million equivalent or approximately 30% of the total cost (40% of the foreign exchange requirement) of the project. As discussed above, the EC, EBRD and others are expected to co-finance the technical assistance component, with the balance of foreign exchange requirements coming from private commercial sources as well as other multilateral and bilateral institutions (including possibly IFC, which is already participating in privatization transactions, and EBRD in a similar operation). The European Investment Bank is considering the provision of a line of credit of ECU40 million (US$55 million equivalent) through PDB to co-finance the investment component. Local cost financing would come from enterprises and local financial institutions such as commercial banks and specialized restructuring institutions. Based on current experience, it is assumed that on average, the enterprises themselves would be able to fund about one-half of the required local currency costs. The financing plan developed on this basis is presented in Table 4.3.

Table 4.3 - Privatization and Restructuring Project
Proposed Financing Plan
(US$ million equivalent)

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Local</td>
</tr>
<tr>
<td>IBRD</td>
<td></td>
</tr>
<tr>
<td>Government (for TA)</td>
<td>30</td>
</tr>
<tr>
<td>Enterprises/commercial/</td>
<td></td>
</tr>
<tr>
<td>institutional sources</td>
<td>180</td>
</tr>
<tr>
<td>EC (for TA)</td>
<td>-</td>
</tr>
<tr>
<td>Other institutions (for TA)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total Financing Required</strong></td>
<td><strong>210</strong></td>
</tr>
</tbody>
</table>
G. Environmental Impact

4.18 Environmental degradation is a serious problem in Poland. Air and water pollution, generated by urbanization, industrial activity, energy production, etc. has reached alarming levels. The Government is very conscious of the environmental issue, and while there is some strong environmental legislation, the Government lacks a clear strategy towards environmental protection and conservation. The Bank-assisted environment technical assistance project under implementation is providing support to the Ministry of Environmental Protection and Natural Resources to build-up the capability and means to elaborate, enforce or monitor suitable environmental protection policies and legislation.

4.19 Studies pinpoint the burning of coal, both for power production and in industry, as the major cause of air pollution. Industrial pollution is also one of the major contributors to the continuing deterioration of the country's lakes and rivers. Preparation of sub-projects thus includes an assessment not only of the environmental impact of the facilities to be installed in the various enterprises, but also of the existing operations of the enterprises concerned. The project has been screened in category B/C. PDB and the participating banks will ensure in their on-lending agreements that all enterprises which benefit from the proceeds of the loan will carry out an environmental assessment according to current Polish regulations and acceptable to the Bank, and build facilities and operate their plants, financed under the project, in accordance with environmental and safety standards satisfactory to the Bank. These measures were confirmed during negotiations.

V. PROJECT IMPLEMENTATION AND ON-LENDING ARRANGEMENTS

A. Project Organization and Implementation

5.01 With the main focus being to support the privatization program and the initiation of widespread industrial restructuring in Poland, care has been taken to design the project in such a way as to support the integration of the diverse agencies concerned with these activities, while at the same time building in sufficient flexibility to adapt the structure to the evolving situation.

5.02 Given the ambitious scope of the Government program involving a number of diverse institutions and enterprises, an appropriate organization within the Government will be needed in order for the work to be carried forward expeditiously. In order to ensure better coordination of policies and programs to implement privatization and restructuring, the Government of Poland is establishing an Inter-Ministerial Committee with the participation of the Ministries of Finance, Ownership Changes and Industry. In addition to its policy role, the Committee will establish guidelines for the use of Bank funds by the various beneficiaries of technical assistance. The
administration and procurement will be handled by the Technical Assistance Unit (para 4.10) to be established as an adjunct to the committee. The Inter-Ministerial Committee is already being formed. Terms of Reference for the Technical Assistance Unit have been prepared and are attached to Annex 4-2. During negotiations it was agreed that the establishment of this unit will be a condition of disbursement of the Technical Assistance component of the proposed loan.

B. Lending Arrangements

5.03 The proposed loan will be made to the Government for a period of 17 years, including 5 years of grace, at the Bank's standard variable interest rate. As detailed in the following paragraphs, the Government will administer directly the quick-disbursing and technical assistance components, but will on-lend funds for restructuring/privatization investments to PDB, which in turn will channel these resources to eligible beneficiaries and participating banks. Lending rates will be based on LIBOR or FIBOR plus appropriate margins to bring the rates to the final beneficiaries in line with market rates. On-lending by the Government to PDB will be denominated in US$ or DM, with the Government assuming the cross-currency risk between US$ or DM and the Bank's basket of currencies. To approximate the cost to PDB of funds from other sources, the Government will on-lend to PDB at rates of LIBOR + 0.25% (for US$) or FIBOR + 0.25% (for DM). On-lending by PDB to the participating banks, and by the participating banks to the final beneficiaries will also be in US$ or DM, the choice of currency between US$ and DM being left to the final beneficiaries who will thus assume the foreign exchange risk. PDB will on-lend at LIBOR + 1.50% (for US$) or FIBOR + 1.50% (for DM). PDB's spread will be reviewed every six months. In the few cases where PDB would lend directly (para. 3.09), the Government will on-lend to PDB at rates of LIBOR + 1.50% (for US$) or FIBOR + 1.50% (for DM). These on-lending arrangements were agreed during negotiations.

C. Policy Component

5.04 The US$75 million quick-disbursing component of the loan will be disbursed against general imports except for the usual small negative list of ineligible items such as arms and luxury products. Procurement under this component will follow the procedures established under the SAL. All contracts of US$5 million and above will be subject to International Competitive Bidding (ICB), using standardized bidding documents. All contracts below US$5 million will be awarded based on procurement procedures acceptable to the Bank including: (i) Polish public procedures where these are required and are acceptable to the Bank; or (ii) established commercial practice based on quotations from at least two countries; or (iii) for commodities, on the basis of evaluation and comparison of quotations obtained from more than one supplier. No Special Account will be needed. Statements of Expenditure will be used for contracts less than US$500,000 to facilitate disbursement; standard supervision and auditing requirements will apply.

5.05 A portion of this component will be made available to support an approved DDSR plan should the Government wish so. Up to US$50 million would
thereby be available upon agreement between the Bank and the Government on a DDSR program satisfactory to the Bank. Funds unused for DDSR support after June 30, 1992 could be reallocated for disbursements against general imports.

D. Technical Assistance Component

5.06 The technical assistance component will be managed by the Technical Assistance Unit which will be organized and staffed to the satisfaction of the Bank. Except as the Bank may otherwise agree, Bank resources for technical assistance will be made available only to the agencies and for the purposes elaborated in the agreed technical assistance program (Annex 4.2). The procurement of goods and services under this component will be according to Bank guidelines. Normally, for purchases of equipment, except for proprietary items, in order to ensure competitive prices, International Shopping Procedures will be followed, comparing price quotations from at least three suppliers, representing two eligible countries, and selecting the supplier offering the lowest evaluated offer. The procurement of consulting services will be according to the World Bank Guidelines for the Use of Consultants.

5.07 Where technical assistance is to be provided to Government or other agencies on a non-reimbursable basis, the proceeds of the Bank loan will be passed on as budget transfers to the ultimate beneficiaries. The detailed arrangements for channelling technical assistance funds from the Government to the ultimate beneficiaries were agreed to during negotiations.

E. Restructuring/Privatization Investment Component

1. The Apex Institution

5.08 PDB will act primarily as an apex institution making available Bank resources to support eligible enterprise restructuring programs (para 4.12), by on-lending Bank resources through eligible participating banks. As previously noted, however (para 3.09), PDB may also be engaged in a limited number of direct lending operations. In its role as an apex, PDB will be responsible for: (i) providing term credit to the participating banks for financing eligible sub-projects; (ii) assuring that the participating banks have the capacity to adequately judge the soundness of sub-projects they propose to finance; and (iii) monitoring the use of project funds and their repayment to the Bank. All funds for on-lending will be available on a first-come, first-served basis, without any allocation to specific participating banks or categories of enterprise.

5.09 To ensure sound and consistent assessments of investment projects by the participating banks, PDB will: (i) be responsible for preparing and disseminating standards and guidelines for appraisal and supervision reports; (ii) support dissemination of all aspects of the project cycle, particularly appraisal and the required technical, market, managerial, and financial analyses; (iii) review sub-project appraisals submitted by the banks, and participate in appraisals for those projects which would utilize more than US$2 million of Bank funds; and (iv) monitor the technical supervision
conducted by the banks of investments to be financed with Bank resources. Operating policies and procedures for the administration of the proceeds of the loan will be similar to those currently being used by NBP in the administration of the Bank-supported Industrial Export Development Project.

5.10 To handle all of these activities, PDB will have to appoint adequate numbers of suitably trained staff, supplemented as required (and envisaged under the technical assistance component) with foreign expertise pending the availability of suitable Polish candidates. During negotiations, assurances were provided concerning the adequacy of the initial staffing of PDB and concerning the maintaining of competent staff throughout the period of project implementation.

2. The Participating Banks

5.11 Any duly constituted Polish bank can become eligible for access to Bank resources under the project, provided it meets the appropriate eligibility criteria detailed below (para 5.12). The participating banks will: (i) identify restructuring investment projects; (ii) appraise restructuring investment sub-projects; (iii) administer their sub-loans; (iv) supervise sub-project performance; and (v) submit periodic reports on sub-project performance to PDB.

5.12 Within each participating bank, the credit department will prepare the appraisal and supervise all sub-projects financed through the respective institution. Each participating bank will appoint, within its credit department, a "project team" from among existing staff to perform these functions. Sub-loans to be presented for financing through the participating banks will be cleared by the respective Credit Committee.

5.13 The following eligibility criteria for participating banks were agreed to during negotiations. To participate in the project, a bank must:

(a) Be in good standing with the banking regulatory and supervision agency (NBP);

(b) Have sound financial policies, satisfactory to the Bank;

(c) Have established a Credit Committee as an advisory body to the bank's President on credit decisions. The Committee should include adequate, qualified staff and should review all investment projects and loans above the limit established for decision of branch managers, as well as all major supervision problems;

(d) Establish a technical unit, specialized in medium- and long-term project lending, properly staffed with at least one industrial engineer, one financial analyst, and one economist, and capable of undertaking project appraisal and supervision acceptable to the World Bank;
(e) Agree to undertake satisfactory external audits according to international auditing standards, and to take any necessary actions as a result of such audits; and

(f) Negotiate a Subsidiary Finance Agreement with PDB that reflects the acceptance of these conditions and include provision of periodic reports on portfolio financed by PDB, for reporting to the Bank.

3. **On-lending Arrangements for Investment Financing**

5.14 A number of legal agreements will be required in order to set out the respective obligations of the various entities, and to regulate the flow of funds from PDB to the beneficiaries. Formal loan documents associated with the proposed Bank loan include a **Loan Agreement** between the Bank and the Government and a **Project Agreement** between the Bank and PDB. An **On-lending Agreement** between the Government and PDB will be a condition of disbursement of the investment component. In addition, the conclusion of **Subsidiary Financing Agreements** between PDB and the participating banks will be a condition of participation of those institutions in the project. Finally, **Sub-loan Agreements** between the banks and enterprises must be of a form and content satisfactory to the Bank. These arrangements were confirmed during negotiations.

5.15 PDB will make available Bank resources to enterprises with eligible sub-projects by on-lending Bank resources to the selected participating banks for re-lending to enterprises. Grace periods and repayment schedules will be flexible to suit the case-by-case requirements of the individual enterprise operation but except as the Bank may otherwise agree, in no case will the grace period exceed 4 years nor the term of a sub-loan exceed 12 years. Repayments by the banks to PDB will match the repayment schedules of the borrowing enterprise. Should the final sub-borrower prepay all or part of the sub-loan prior to maturity, the participating bank will immediately repay the sum received to PDB. In case of arrears in principal repayment, or in payment of interest on any due date from a sub-borrower, the participating bank will nevertheless be liable for payment on the due date and will then be responsible for making appropriate arrangements to get the account current from the enterprise concerned.

5.16 Maximum **sub-loan size** and maximum amount of financing for eligible enterprises will be US$10 million equivalent, except as the Bank may otherwise agree. An initial free limit for sub-loans by banks has been set at US$1 million for PDB review and at US$2 million for Bank review. The first three appraisals undertaken by each participating bank will be submitted for prior Bank review, irrespective of sub-loan size.

5.17 During negotiations, PDB confirmed that it will establish a rollover fund with resources generated by repayments of all sub-loans under the Project. Resources from the rollover Fund will be available to PDB for financing additional sub-projects which meet the eligibility requirements.
4. Procurement

5.18 Procurement procedures will be the responsibility of the enterprises who, as commercialized or privatized companies, are expected to follow good commercial practice. For equipment contracts of up to $2 million, the purchaser will follow good commercial practices comparing price quotations received from at least two suppliers, representing at least two eligible countries. The respective goods and directly-related services will be purchased from the supplier offering the lowest evaluated price. Determination of this lowest evaluated price may take into account such relevant factors as efficiency, time of delivery, availability of maintenance facilities and spare parts. For packages above US$2 million, International Competitive Bidding will be followed. For proprietary items, direct contracting or Limited International Bidding may be appropriate. Where the proceeds of the World Bank loan are to be used to finance consulting services, these should be procured according to the World Bank Guidelines for the Use of Consultants. Each appraisal report or summary will describe how the enterprise proposes to procure goods and services.

F. Allocation of Bank Loan and Disbursements

5.19 The technical assistance component of the proposed Bank loan will cover up to 100% of: (i) foreign exchange expenditures (CIF) for directly imported goods as well as 100% of the eligible ex-factory cost of locally produced goods; (ii) foreign and local expenditures for consultant services; and (iii) foreign exchange expenditures for training.

5.20 To facilitate disbursements for technical assistance, a Special Account will be established and maintained in US dollars in a bank acceptable to the Bank, and on terms and conditions acceptable to the Bank, with an authorized allocation of US$3 million covering an estimated four months' expenditures. Applications for replenishment of the account will be submitted quarterly. These arrangements were confirmed during negotiations.

5.21 The investment component of the proposed Bank loan will cover up to 100% of: (i) foreign exchange expenditures (CIF) for directly imported goods, as well as up to 100% of the eligible ex-factory costs of locally produced goods; (ii) foreign and local expenditures for engineering, financial planning, consultant services, computerization for development of management systems; (iii) foreign expenditures for technology transfer, quality improvements including the cost of licenses and other payments for specialized technology and associated equipment of a proprietary nature; (iv) foreign exchange expenditures for training, and for visits abroad by local staff for engineering, procurement, marketing, technology transfer and training; and (v) foreign exchange expenditures for interest during construction; and (vi) 100% of foreign and local expenditures for consultant services.

5.22 To facilitate disbursements for the investment component, a Special Account will be established and maintained in US$ in a bank acceptable to the Bank, and on terms and conditions acceptable to the Bank, with an authorized allocation of US$15 million covering an estimated four months
expenditures. Applications for replenishment of the account will be submitted quarterly, or sooner after one-third of the funds have been disbursed. These arrangements were confirmed during negotiations.

5.23 The estimated disbursement schedule for the Project, along with disbursement profiles of other Bank-financed industrial projects in the EMENA Region, and elsewhere, is contained in Annex 5-1. The expected disbursement of the loan is based primarily on EMENA experience with similar operations, adjusted for the expected impact of the quick-disbursing component. Disbursements for the expenses under the loan will be made against full documentation for contracts equal to or above US$500,000, and against statements of expenditure for contracts below US$500,000.

5.24 The proposed closing date for the loan, is June 30, 1998.

G. Auditing and Reporting Requirements

5.25 All project accounts, the Special Accounts, the Statements of Expenditure, and the financial statements of the project entities (participating banks and borrowing enterprises) will be audited at the end of each fiscal year by independent auditors acceptable to the Bank. Copies of the audit reports for the participating banks will be forwarded to the Bank within six months of the end of the reporting period; audit reports from borrowing enterprises will be retained by the concerned bank and made available to the Bank on request. Arrangements for auditing have been assessed. The training provided under previous projects as well as the establishment of Polish joint-ventures and subsidiaries by international auditors will ensure audits acceptable to the Bank. Agreements concerning auditing were confirmed during negotiations.

5.26 To enable the Bank to monitor the progress of project implementation, and to ensure conformity with project objectives, the Government and PDB will furnish the Bank with a series of reports detailing progress of their respective project components. In addition, the Government and PDB will prepare a Project Completion Report for the entire project six months after the completion of disbursements, covering all related activities during project implementation and describing the Project's costs and benefits. Reporting formats and schedules were finalized and agreed to during negotiations.

VI. BENEFITS AND RISKS

A. Benefits of the Project

6.01 The proposed project will yield major benefits to Poland by elaborating the policies for privatization, restructuring and the management of state assets and by designing and adjusting, when needed, the necessary framework for effective transformation of a substantial part of the country's state enterprise sector. While directly supporting the transformation of only perhaps 10-15% of industrial enterprises, the mechanisms developed and the
technical assistance put in place should ensure the continuing transformation of enterprises in line with national objectives. In addition, it should lead to: (i) improvements in enterprise management; (ii) economic benefits (related to returns on investment in the sub-projects); (iii) convertible currency earnings derived from the increased availability of quality products both for exports and to substitute for imports; and (iv) environmental, institutional, social and demonstration benefits, as described below. It will also support efforts to stimulate private sector development and privatization in the ongoing move towards a market economy.

6.02 The project will have a positive environmental impact through the rehabilitation and restructuring of enterprises which will enable the firms to use more efficient technologies and operations, thus decreasing their environment nuisances, as well as through addressing specific environmental problems. Sub-loan covenants will require that sub-projects not contribute to environmental or safety hazards, and that any facilities to be provided under the project be installed and operated with due consideration to safety and the environment (para 4.18). The project is thus introducing a concept which may lead to similar policies in the participating banks for future lending operations. Finally, by including as part of project preparation an assessment of the environmental impact of existing operations undertaking pre-identified restructuring, the project has helped to focus attention on potential methods for further improvement.

6.03 The project is expected to have major direct and indirect institutional benefits. In addition to the strengthening of existing institutions, in the medium term, the project will benefit the consulting sector as a whole through foreseeable spin-offs from PDB and IDA. This will complement the immediate benefit gained by Polish consultants working jointly with international consultants on the preparation of restructuring plans. In addition, the project is directly assisting the design and implementation of a coherent and supportive industrial policy in Poland.

6.04 Social benefits will also derive from the project. Although not addressing directly the social cost and the needed safety net associated with restructuring (this is being taken care of initially by the SAL, and more directly by other Bank projects under preparation), this project will help in maintaining jobs in efficient enterprises and in avoiding total loss of jobs in enterprises facing difficulties.

6.05 Finally, the project is expected to achieve an important demonstration effect among similar enterprises in Poland and to disseminate newly acquired experiences both at the enterprise and Government levels. High indirect benefits are therefore expected, both from the demonstration effect and the technical assistance, setting in motion the industry towards improved efficiency and an increased role of the private sector.
B. **Risks**

6.06 In the short term there could be delays in implementation associated with the scale, complexity, and unprecedented nature of the privatization program, and with the enterprises' willingness to privatize. The Government's limited implementation capability, the slow and difficult build-up of the new institutions, and the lack of skills of the enterprise managers may introduce some delays which would be minimized by the inclusion of the comprehensive technical assistance component. There might also be short-term market risks associated with stagnation and adjustment, and pace of revival of the market, but they will be minimized through sensitivity analyses and careful market analysis for the enterprises' sub-projects.

6.07 In the longer term, a risk that could adversely affect the indirect benefits of the project stems from the ambitious program of adjustment and stabilization that the Government is implementing. While the Government's current plans are satisfactory, the major institutional and systemic reforms are unprecedented in Poland and may take longer than currently planned. The Bank's on-going economic and sector work dialogue will be important in helping to identify and overcome weaknesses in implementation of the reform and to support the Government's overall industrial policy reform program.

6.08 Finally, the lack of services and qualified consultants may slow down the pace of the demonstration effect, but the design of the technical assistance component will minimize this risk.

**VII. AGREEMENTS AND RECOMMENDATION**

A. **Agreements**

7.01 During negotiations, the following agreements were reached:

1. **With the Government:**

   (a) On the Letter of Policy for Privatization and Restructuring (paras 4.05 and 4.06);

   (b) To elaborate for the implementation of the privatization program, by December 31, 1991: (i) a plan for application of debt-equity swaps in individual enterprise privatizations; and (ii) a statement on environmental contingent liabilities (para 4.05);

   (c) To define appropriate mechanisms for the management of state assets, including: (i) preparation of guidelines for supervisory boards, by September 30, 1991; (ii) definition of a plan to exercise the State's ownership function, by December 31, 1991; and (iii) development of further incentives to commercialize enterprises, by December 31, 1991. (para. 4.05)
(d) To prepare a study for presentation to the Bank by December 31, 1991, to establish a coherent strategy for industry which reflects immediate restructuring needs as well as long-term policy goals, and proposes an appropriate structure for the MoI. Implementation of the agreed recommendation on the structure of the Ministry should be completed no later than June 30, 1992 (para 4.05);

(e) On the interest rate and on-lending terms to PDB (para 5.03);

(f) On the technical assistance program (para 4.11) and the detailed arrangements for channeling technical assistance (para 5.06);

(g) To establish and maintain the proposed Special Accounts on terms and conditions acceptable to the Bank (paras 5.20 and 5.22);

(h) To ensure that all project accounts, the Special Account, the financial statements of PDB, the participating financial intermediaries and borrowing enterprises are audited at the end of each fiscal year by independent auditors acceptable to the bank (para 5.25); and

(i) To ensure that audited accounts and other reports are furnished to the Bank in a timely manner and that a comprehensive Project Completion Report will be prepared (para 5.26).

2. With the Polish Development Bank:

(a) On its Statement of Operating Policy, including a commitment to limit its total direct lending to enterprises during its first three years of operation to no more than 15% of its total lending and its direct lending out of Bank resources under the loan to no more than 15% of these resources (para 3.09);

(b) To ensure that enterprises and sub-projects which will benefit from the proceeds of the loan will meet established criteria aimed at achieving project objectives (paras 4.13 and 4.14);

(c) To ensure that all enterprises that will benefit from the proceeds of the loan will build and operate their plants in accordance with environmental and safety standards satisfactory to the Bank (para 4.19);

(d) On the on-lending arrangements to the participating banks (para 5.03);

(e) To appoint and retain the necessary staff (para 5.10);

(f) To select and enter into agreements with the participating banks in accordance with the criteria agreed with the Bank (para 5.13); and
(g) To establish and administer a rollover fund to recycle resources generated by repayments of sub-loans (para 5.17).

7.02 **Conditions of Disbursement**: The following would be conditions of disbursement:

(a) For the **technical assistance component**: the establishment of the Technical Assistance Unit (para 5.02); and

(b) For the **policy and investment financing components**: (i) The elaboration of the proposed program of mass privatization based on careful feasibility studies and detailed implementation plans (para 4.05); and additionally, for the **investment financing component**, (ii) the execution of the on-lending agreement between the Government and PDB (para 5.14).

B. **Recommendation**

7.03 Subject to above, the project is considered suitable for a Bank loan of US$280 million equivalent, for a period of 17 years, including five years of grace, at the Bank's standard variable interest rate.

May 22, 1991
POLAND - PRIVATIZATION AND RESTRUCTURING PROJECT

Selected Documents and Data Available in the Project File

A. The Industrial Sector


B. Project Reports and Studies


B.16 Regional Economy Restructuring Program for Lodz. Undated.


B.23 Foreign Investment in Poland in 1990.

C. **Selected Working Papers**

C.1 Terms of Reference for Mass Privatization Advisor

C.2 Terms of Reference for MoI Restructuring Study

POLAND - PRIVATIZATION AND RESTRUCTURING PROJECT

THE PRIVATIZATION PROGRAM

I. BACKGROUND

A. Introduction

1. With the objective of creating an efficient market economy, the Government of Poland in 1989 embarked upon a major program of transformation of state assets into private ownership. This is expected to result in a substantial improvement in enterprise efficiency by providing better incentives to labor, management and capital. Rapid privatization of state assets has been selected as the preferred mode of transformation, and central to this program has been the enactment of the "Privatization Law for State-Owned Enterprises" in July 1990 and the establishment in September 1990 of the Ministry of Ownership Changes (MoOC).

2. In view of the significant variations in the types of enterprises to be privatized on the one hand, and of potential sources of private ownership on the other, as well as the limited availability of Polish private capital and management skills, the Government has selected a "multi-track" approach to privatization. The privatization program, as envisaged, utilizes both the conventional methods of enterprise sale applied in the West, and more innovative methods of privatization which emphasize maximum possible participation on the part of Polish citizens.

B. Objectives of Privatization

3. The privatization program is based on the following objectives:

(a) move the economy from a centrally planned system to a competitive market system, which would encourage the creation of a profitable private sector;

(b) improve the performance of enterprises through a more efficient use of labor, capital and management skills;

(c) prevent possible distortions of the privatization process (for example, the sale of state assets to foreign investors at unduly low prices);

(d) reduce the size of the public sector and the burden on the public budget and administration;

(e) generate funds from the sale of enterprises or their shares;

(f) ensure a wide diffusion of ownership of privatized assets;

(g) provide an effective system of corporate governance; and
(h) commence the program of exchanging the external debt of the
country into the equity of the privatized enterprises.

4. The privatization program will transform Poland's ownership
structure to resemble that of Western Europe within five years, with
approximately half of the state-owned assets to be transferred into private
hands within the first three years. The Government intends to supervise the
process to ensure that it is fair, transparent and meets the requirements of
social justice.

C. Present Forms of Ownership

5. At present, there exist four forms of ownership in Poland: (a)
Treasury property, with state-owned enterprises and state budgetary entities,
such as schools and hospitals; (b) municipal property, with municipal-owned
enterprises and municipal budgetary entities; (c) property owned by
cooperatives and state farms; (d) private or semi-private property (joint
ventures between state-owned enterprises and private foreign or local
partners).

6. There are approximately 9,000 state-owned enterprises in the
"productive" sectors, approximately 4,500 of which are controlled by the 49
"wojewoda" (regional governments) in the country. The Government intends to
privatize the majority of the state-owned enterprises over the next five
years. The state budgetary entities are for the foreseeable future to remain
State property.

7. The municipalities control predominantly local wholesale and
retail trade enterprises (for which the founding organ is typically the Mayor
or the municipal council). These enterprises are in the process of being
privatized at this time principally through lease by individuals (usually
employees) or small enterprises. Municipal budgetary enterprises include
water treatment facilities and sewage plants, which are expected to be
privatized only to a very limited extent in the foreseeable future.

8. Cooperatives represent a major part of the economy, and contribute
almost 20% to GNP. They comprise a wide range of economic activity ranging
from agricultural and industrial production, wholesale and retail, to
religious, artistic and social groupings, all of which are controlled by
different laws. The privatization of cooperatives remains "spontaneous" at
this time and is not adequately regulated or legislated.

9. The private sector which has traditionally been strong in
agriculture (over 70% of arable land is privately owned), and in small artisan
manufacturing and retail trade, experienced a significant growth since the
adoption of the new policies. By end-1990, approximately 23,000 private
corporations were in operation, and 1,400 joint venture companies.

10. Under the classical central planning system, the functions of
enterprises were largely determined by the central plan, with the "founding
organ" (relevant Ministry or wojewoda) maintaining formal oversight of the
enterprise. With the reforms, commencing in 1981, the enterprises were granted increasing (and in the end almost total) operational and financial autonomy. While legally enterprises continue to be owned by the State, the responsibilities entrusted to the enterprise are exercised principally by the workers. This is typically accomplished through an assembly of the workers (similar to an annual shareholders meeting) and the Workers' Council, which is the governing body responsible for all decisions relating to the activities of the enterprise, including the right to appoint the management of the enterprise, or veto the Government's choice. In cases where the Council has been effectively organized, decision-making is controlled through the Council; in other cases, the managers of the enterprise have acted with considerable independence of the Council and the State.

11. As a result, the various ownership rights (use of property, financial returns and disposal of property, among others) are held jointly, but in a confused and shifting way among the managers, the workers and the State. This lack of clarity poses acute problems. A common example has been the situation where managers with decision-making autonomy, but no title to the assets they manage, tend to appropriate the income and strip the assets of the enterprise. With the increased freedom to set wages, particularly in an inflationary context, Workers' Councils have pressured managers to raise wages substantially. Also, in enterprises facing layoffs, the Councils can provide substantial support to workers, and as such, become a critical factor in the reform process.

D. Enterprise Segmentation

12. The multi-track approach to privatization adopted by the Government is in part based on the vast differences in the nature and size of the enterprises to be privatized. A systematic segmentation analysis of state-owned enterprises has been utilized as a means of providing insights into the modalities that are required to achieve a successful privatization program.

13. At the end of 1990, there were a total of 8,900 state-owned enterprises in the productive sector and 3,700 state-owned enterprises in the non-productive sector. Of the former group, approximately 35% were in the manufacturing and mining sector, 21% in the construction sector, 20% in the agriculture sector, 8% in the transportation sector and the remainder in other sectors. About 10% were municipal level enterprises. The non-productive sectors included, principally, housing, culture, finance and other service sectors. The state-owned sector comprised, in addition, approximately 13,000 cooperatives, principally in the manufacturing/mining, agriculture and housing sectors. Exhibit 1 contains the enterprises classified by sector for 1990.

14. As mentioned above, the private sector comprises approximately 23,000 enterprises, principally in the manufacturing/mining and agriculture sectors. In addition, there are about 1,400 joint ventures (with foreign investors) and 4,500 partially state-owned joint stock or limited liability companies.
15. In a study undertaken by the IFC in August 1990, the top approximately 500 state-owned enterprises were classified on the basis of sales and net income. The analysis used annualized figures from the first quarter of 1990. These represented 6% of the state-owned enterprises in the productive sector (medium-sized enterprises accounted for 25% and small for the remainder). In terms of sales and net income, however, these enterprises accounted for approximately 47% and 60%, respectively, of the state-owned productive sector. Total sales for the state-owned sector were about US$66 billion and net income, US$10 billion. Using net income as a proxy for efficiency, the study found that of the 500 enterprises, 32% were "good" (net income/sales greater than 20%), 40% "average" (net income/sales between 10% and 20%), 20% "poor" (net income/sales between 5% and 10%) and 8% "very poor" (net income/sales less than 5%).

E. The Privatization Strategy for State-Owned Enterprises

16. The privatization strategy adopted by the Government envisages a multi-track approach comprising separate privatization paths for the various categories of enterprises, often with a simultaneous use of different techniques of privatization within a category. In practice, this implies matching privatization instruments or techniques, on the one hand, with large, medium and small enterprises which perform either well or poorly, on the other. Enterprises are differentiated principally on the basis of their (a) size (large enterprises require a diversified ownership structure, whereas in most cases, small and medium enterprises can be sold in whole or substantial parts to a single acquiror); (b) economic and financial viability (viable companies would then be distinguished as to their immediate salability or need for prior restructuring); and (c) ownership (whether state-owned enterprises or under the jurisdiction of local authorities). Exhibit 2 presents a diagrammatic representation of the privatization process.

17. The Privatization Law envisages two main alternative tracks to privatization: i) "commercialization" or corporatization of an state-owned enterprise, to be followed by transfer of their capital to private owners; and ii) the "liquidation" route with the dissolution of an enterprise and the privatization of its assets. In general, state-owned enterprises which are deemed to be in "viable" financial and structural condition are prepared for eventual privatization through "commercialization", or the transformation from a state-owned enterprise to a state-owned corporation (either a joint stock or limited liability company) under the governance of the Commercial Code. Enterprises which are deemed "unviable" either financially or in terms of size are typically privatized through the "liquidation" route, that is, through a "winding-up" of the enterprise and the subsequent sale or lease in whole or in part.

18. Notwithstanding Article 5.3 of the Privatization Law, which allows the MoOC to "refuse transformation of a state-owned enterprise to a company due to "financial or economic conditions of the enterprise or important national interest", it is the Government's primary goal to privatize state-owned and other public enterprises as soon as possible.
1. Privatization Through Commercialization

19. The first step of the privatization process is commercialization, the transformation of a state-owned enterprise into a joint stock or limited liability company (single-holder corporation of the State). This is intended to (a) provide a clear decision-making and control structure; (b) adjust the legal status of state-owned enterprises to the requirements of potential foreign corporate partners; (c) create a pressure for market-oriented restructuring; and (d) prepare the enterprise for privatization. Commercialization is a vital step towards privatization, and is considered a priority in the privatization process by the Government, as it effectively concentrates the ownership rights of the enterprise in a corporate Board of Directors appointed by the owners or the State. It is a step in the introduction of sound corporate governance of enterprises, and as such is considered a priority by the Government for enterprises which will remain under State ownership for some time. Exhibit 3 presents the diagrammatic representation of the privatization process through the commercialization route.

20. The Privatization Law envisages that commercialization be initiated by either the enterprise or its founding organ (in agreement with the management and Workers Council), or be imposed from above by the Prime Minister, upon a motion of the MoOC. Immediately after commercialization, a Supervisory Council (Board of Directors) is appointed to the new joint stock company. The Supervisory Council is comprised of two-thirds of the candidates being appointed by the MoOC and one-third by the old Workers' Council. The training of candidates for the Supervisory Councils has commenced and the MoOC is expecting to train about 40 to 60 candidates per month. After commercialization, enterprises are exempt from paying the obligatory "dividend" tax and 20% of the excess wage tax ("popiwek"). The dividend tax is a tax levied on a portion of the capital of the enterprise and is based on the current refinancing rate of the NBP. The excess wage tax is levied on the portion of the wage increase which is above the allowable wage increases (the latter are typically based on, but lower than, the increase in inflation).

21. With a view to an effective implementation of the privatization program, the MoOC, while emphasizing the principle of voluntary commercialization, has also established a number of criteria for enterprise selection. These criteria include: (a) the size of the state-owned enterprise in terms of its annual turnover, number of employees and the absence of a monopolistic position; (b) historical and anticipated financial and operational performance of the state-owned enterprise; (c) transparent legal situation, specifically with respect to the ownership of land and buildings and the absence of an artificial multi-plant structure; (d) the interest of potential domestic and foreign investors in the state-owned

'Until the equity has been totally or partly transferred to private shareholders, at which time a new Council is appointed, with the Directors selected by the shareholders's meeting as per the Code of Commerce.
enterprise; and (e) good interpersonal relations within the enterprise between the management, workers and unions so as to minimize the tensions caused by privatization. This procedure will ensure that commercialization, in addition to changing the legal status of an enterprise, is also the catalyst for the restructuring program and will set the limits necessary for an economically viable program.

22. Following commercialization, the next step (according to the Law, theoretically within two years) is privatization which envisages two alternative methods: (a) individual or "customized" privatization, and (b) mass privatization.

23. (a) Individual Privatization. Individual privatization along traditional lines, using public offerings or direct (trade) sales to domestic and foreign investors, is more appropriate for the larger and more viable enterprises. The latter group includes the top 500 enterprises in the country.

24. In the case of public offerings, each enterprise will be evaluated independently by specialist firms and potential acquirors will be provided with the prospectus specifying asset valuation, historical financial data and the program for the enterprise's operations in the future. The prospectus will comply in full with the disclosure regulations of the Securities and Exchange Commission. The share issues will provide a basis for the development of a securities market, particularly, stock trading. It is also expected that the conversion of external debt into equity of privatized enterprises will commence. The operational experience gained in the five pilot privatizations (detailed in paragraph 93) is expected to provide significant guidance and insight into the process.

25. According to the Privatization Law, employees of state-owned enterprises are entitled to purchase up to 20% of the total amount of shares on a preferential basis, that is, at 50% of the offering price, and retain the right to purchase more shares on generally available terms. However, the total value of discounts given must not exceed the product of the average salary per employee in the enterprise and the number of employees purchasing shares.

26. A proposal which is currently under discussion envisages a free distribution of 10% of the shares to employees, instead of the purchase of shares on preferential terms described above. The shares will be provided to employees immediately after the enterprise is converted to a joint stock company. The share distribution to employees within the company is left to criteria to be established by the Workers' Council and management of each company. Consideration will be given to develop a general framework for all enterprises, which would ensure that the scheme provides an incentive to enhance employee performance.

27. The MoOC also prepares the sale of large enterprises through a direct sale to large domestic or foreign investors. This can be accomplished either through (a) a private sale to a single or several investors, or (b) a
full-scale domestic or international tender. The Government's strategy with respect to foreign investment is described in greater detail below (paragraph 50).

28. The group of small-and medium-sized enterprises comprises approximately 25,000 enterprises in construction, transport, distribution, tourism and other sectors. The number of these enterprises has been gradually increasing as a result of the steady break-up of multi-plant enterprises into smaller firms. The break-up decision is typically taken either by the founding organs, at the request of the enterprises themselves or on the initiative of the Anti-Monopoly Commission.

29. The privatization of small and medium-sized enterprises will, as in the case of the larger enterprises, transform the enterprise into a single-holder corporation of the State, offer the shares of this corporation to employees (employee buyouts), investors (typically private individuals), groups of private individuals and private domestic and foreign firms. The process may be initiated either by the enterprise concerned, by a potential buyer with an offer to purchase a major block of shares, the founding organ or the MoOC.

30. The acquisition of shares can be facilitated by special credit programs and by the possibility for individuals to convert State bonds, with a certain discount, into shares of privatized enterprises. Other arrangements include payment for shares in installments and the acceptance of privatized enterprises' bonds as a form of payment (only in the case of corporations in good financial condition). In cases where the enterprise's organizational and marketing condition warrants external management contracting, the MoOC may contract a domestic or foreign firm to manage the corporation.

31. For the privatization of small and medium-sized enterprises, the Government has selected, within statutory limits, a more decentralized approach to this process. In the first half of 1991, regional offices of the MoOC will be established in 11 voivodships. Each regional office will have responsibility for 3 to 5 voivodships, and will support the Plenipotentiary in charge of privatization in the voivodships' administration as well as the municipal administrations. At the initial stage of decentralization, the regional offices will have responsibility only for the preparation of the enterprises for privatization. It is anticipated, however, that in time the regional offices could also undertake the decision to privatize. The operational capacity of the regional MoOC offices will be further augmented by the following:

- An industry/sector approach to privatization, where interministerial teams are being appointed to draft restructuring/privatization programs for each industry.

- Closer cooperation with organizations involved in promoting the privatization effort at both the local and national levels.
32. Despite the initiative to decentralize, overall control of the privatization process will be maintained by the MoOC through the application of uniform criteria and principles of decision-making, the establishment of the regional offices and training of their staff.

33. (b) Mass Privatization. In view of the absence of adequate domestic capital resources and the relatively short time period allocated for the privatization process, the Government adopted mass privatization as a method to accelerate the process. The mass privatization scheme envisions privatization through specific methods including: (a) offering shares to employees on preferential terms; (b) free distribution of vouchers to Polish citizens; and (c) allocation of shares to pension funds and other financial intermediaries. The Government is undertaking substantial preparatory work in the first half of 1991 to enable the actual mass privatization to take place in the second half of 1991. The preparatory work includes:

- screening the largest enterprises to select those which are appropriate for mass privatization (a minimum of 100 enterprises);
- specifying the details of the voucher distribution operation, in cooperation with foreign experts selected under competitive procedures;
- verifying potential Polish institutional investors such as commercial banks, insurance agencies and pension funds;
- assessing the macro-economic consequences of mass privatization; and
- conducting a public information campaign regarding the mass privatization program.

34. Shares to Employees on Preferential Terms. As described above, employees will be permitted to purchase 20% of the shares of the privatized enterprise at a 50% discount, or alternatively, will receive 10% of the shares in a free distribution.

35. The principal issue that is raised here is one of the valuation of the shares provided to employees. Although the Privatization Law provides for the valuation of an enterprise prior to any disposal of shares, the mass privatization effort, through the voucher scheme (described below), would by definition establish a value for the shares only after trading commences. This could result in a share valuation below face value and create significant perception and credibility problems for employees.
36. **The Voucher Scheme and Privatization Funds.** The Privatization Law specifies the free distribution of "vouchers" to all Polish citizens, which will be exchangeable for shares in newly-created financial intermediaries. The latter would be established in the form of "Privatization Funds", holding companies or mutual funds, which would use the vouchers entrusted to them to bid against each other for the shares of commercialized enterprises. They will also, as controlling shareholders, manage or closely control the management of these enterprises during their turn-around or at least for a certain number of years. These funds would be managed by a managing firm with a foreign professional partner. The current proposal envisages the establishment of ten such Privatization Funds, each holding shares in about 20 privatized enterprises. The vouchers are intended to comprise 30% of the total shares of the privatized enterprises, and are expected to have a nominal value of not less than Zl 1 million. An international consulting firm has been hired by the Government to study the various issues related to the voucher scheme such as transferability, tradeability, physical vouchers versus book entry system, face value on the vouchers and the nature of the funds/holding companies that will hold the vouchers. The logistics and administrative costs of the scheme are also being investigated to confirm whether the voucher system is feasible or not as currently proposed.

37. One of the major issues related to the voucher scheme that is being investigated at present is that of the precise nature of the Privatization Funds that would hold and add value to the vouchers entrusted to them by the citizens. The Privatization Funds should take the form of holding companies which would play a more proactive role in acquiring, restructuring and reselling companies, than of closed end mutual funds, where the investment manager plays the passive role of holding and managing the shares. The Privatization Funds are a means of reducing investment risk, providing expert portfolio management and providing effective control of enterprise restructuring and management. A key issue in the implementation of the Funds is to acquire the capital necessary for their initial operation. The Government is seeking to mobilize domestic sources of capital such as private capital, domestic banks, insurance agencies, pension funds and trade unions, and to encourage foreign investors to participate in the creation of such institutions. Other issues include the means of providing adequate incentives to the Fund manager, the length of time shares should be retained in the portfolio, appropriate conditions under which the shares can be sold and the taxes that the Funds will be liable for (at present, the marginal tax rate is 40% and the withholding tax rate is 30%, which results in a very high blended rate). It would be useful to structure the Funds as pass-through vehicles for tax purposes, so as to increase the incentives for investors in the Funds. A study to develop the objectives, terms of reference and invitations to bid, for alternative fund schemes, is being prepared with the help of experienced investment bankers.

38. **Distribution of Shares to Banks, Insurance Agencies and Pension Funds.** The privatization program had initially envisaged the distribution of 10% of shares to the nine state-owned commercial banks. However, given that this may lead to distortions by placing emphasis on an activity within the banks which they cannot handle in the light of their constrained resources, it
was suggested that the shares be placed in an employee stock option plan, for example. Another 20% of the shares will be allocated to the state pension fund, ZUS.

39. The mass privatization program envisages an eventual distribution of the shares of privatized enterprises between the different parties as follows: (a) 30% to the Privatization Funds; (b) 10% to employees; (c) 20% to the State pension fund; and (d) in some cases, 30% to large private domestic or foreign investors. The State will hold the remaining shares of each privatized enterprise (the "golden" share), and entrust them to the Privatization Funds, to give them control of the enterprise.

40. The mass privatization program will be handled by a department within the MoOC, comprising people who will play the role of liaisons between the MoOC and the foreign firms. A Steering Committee, to which the Bank is being associated, has been established to coordinate with other ministries, foreign advisors and experts on all the aspects of the program. The Government recently selected a foreign investment bank to be the lead manager/advisor for the program, who will also be the formal representative of the Government. A foreign consulting firm will be appointed to prepare the information memoranda for the firms to be privatized.

2. Liquidation or Winding-Up

41. A state-owned enterprise may also be privatized through liquidation or winding up by its founding organ, on its own initiative or at initiative of the workers council, with the approval of the MoOC. Three forms of privatization are permitted by the Privatization Law: (a) sale of all or part of the assets of the liquidated enterprise to a new company, joint stock or limited liability company created (for example) by the employees of the former state-owned enterprise; (b) contribution of assets to such a company; and (c) lease of assets (regular or involving an eventual transfer of property rights) to such a company. In the case of enterprises which have been broken up due to technological, regional or monopoly reasons, these forms of liquidation may be used jointly. Exhibit 4 presents the diagrammatic representation of the privatization through liquidation.

42. A liquidated enterprise may therefore be sold in whole or in part to a private domestic or foreign acquirer, or its assets may be contributed to a domestic or foreign owned corporation. The access to privatized enterprises' assets will not be restricted by practices such as naming the acquirer in advance, but the founding organ, in its capacity as representative of the State, will set the minimum price for the disposal of the enterprise.

43. Leasing is generally recommended for smaller firms, and has proven to be the most popular method of privatization through liquidation. The wound up enterprise is typically leased to the employees of the enterprise, upon the employees contributing a minimum share capital equivalent to a least 20% of the capital of the former enterprise (Article 38 of the Privatization Law), for a pre-set annual fee. The fee is calculated on the basis of the value of the asset plus an interest rate equivalent to 75% of the current refinancing
rate of the National Bank of Poland. Eventual purchase of the leased assets is a possibility and is contractually negotiable at the end of the lease period. Asset valuation has historically been performed on the basis of the discounted cash flow of the enterprise. However, it has been found that managers with the objective of purchasing the enterprise have tended to contain the operations of the enterprise in order to reduce cash flow and therefore obtain a lower asset valuation/purchase price. As a solution to this problem, the current proposal for the valuation methodology for enterprises is one of the market value of assets plus goodwill, if any.

According to the Commercial Code, employees are required to pay in only 25% of their contribution to the equity of a privatized enterprise. In this sense, leasing may be considered to be equivalent to an installment sale in that the employees are initially liable for only a portion of the share capital of the new corporation, and retain the flexibility to pay in the remainder over a specified time period.

3. Possible Risks

Although the privatization strategy has been given considerable support and technical assistance to ensure its successful execution, there exist a number of possible risks which, if realized, could create significant problems of implementation. These include:

(a) An inadequate "inventory" of enterprises to be privatized (through commercialization), which would occur as a result of an insufficient number of state-owned enterprises being commercialized;

(b) Workers' resistance to the overall privatization effort caused by the unemployment (at least initial) resulting from the restructuring and privatization of enterprises;

(c) Rejection by Polish citizens of the substantial foreign involvement (caused not only by foreign direct investment but also the mass privatization program, when enterprises would be controlled by foreign-managed Privatization Funds) in the country's industrial assets; and

(d) The privatization process becoming overly " politicized" (due for example to the upcoming Parliamentary elections), and therefore ineffective.

F. Regional Privatization

The bulk of the privatization effort so far has focussed on state-owned enterprises. The focus is legitimate inasmuch as, firstly, this is the largest concentration of state-owned assets, and secondly, due to their size and performance, some of the enterprises present significant transformation problems. There are a large number of enterprises, however, which are owned by the local authorities, which include:
(a) at the level of the wojewoda, which is the founding organ for many small and medium-sized enterprises, there are approximately 4,500 public enterprises which have to be privatized;

(b) at the municipal level, there were approximately 100,000 businesses, mostly shops and other small businesses, plus wholesale and retail trade enterprises where the founding organ is typically the mayor or the municipal council. These have been substantially privatized, principally through lease by employees or small private companies ("small privatization", paragraph 84); and

(c) at the level of the 13,000 cooperatives, privatization has been hindered due to the absence of a clear legal framework. There have, however, been a significant number of "spontaneous" or largely unregulated privatizations. The specific issues related to the privatization of cooperative enterprises are discussed in paragraph 89.

47. In general, the founding organs of regional enterprises are the "gminas" or townships. There are approximately 2,200 gminas in Poland. The responsible department is the "Office of the Plenipotentiary for Self-Government", which reports directly to the Prime Minister. Although decisions on the privatization of the regional enterprises are taken by the gminas, the MoOC plays an advisory role in the process. Specifically, the MoOC will (a) execute privatization initiatives from the gminas; (b) provide various forms of consulting and training on privatization; and (c) monitor the course of privatization.

48. Significant progress has been achieved in the area of "small privatization", that is, the privatization of the approximately 100,000 small and medium-sized retail and wholesale shops (paragraph 84). Small privatization essentially involves the establishment of corporations by employees (or under employee stock ownership plans), by means of leasing the assets of the enterprise, on the basis of a contractually agreed lease rent. In the majority of cases, employees possess pre-emptive rights and preferential terms for leasing the outlet. In some areas, however, the gmina authorities, in the interests of profiting from the lease rent, have conducted auctions of the property resulting in uneconomically high rent rates. The Government is taking measures to contain this practice so as to further promote the small privatization process.

49. With a view to standardizing and simplifying the privatization process at the regional level, the Government supported the establishment of an institute to provide appropriate advise to the gminas. The institute has prepared a manual on regional privatization which contains a general interpretation of the Privatization Law as well as more specific guidelines for privatization at the regional level. The institute is also expected to monitor the progress of the regional privatization effort.
G. Foreign Investment

50. To date, foreign investment, typically through joint ventures, has been a major route to privatization. With the role of foreign investment growing as a key element of the overall privatization effort, the Government is revising the Foreign Investment Law to "expedite the creation of a market economy in Poland and to assure more attractive legal, fiscal and economic conditions for foreign investment." The new Law will not only eliminates the minimum investment amount and the rule that foreign equity participation above 10% requires the approval of the Foreign Investment Agency, but also provide a number of tax and other incentives including: (a) repatriation of a 100% of after-tax profits and capital invested (previously, the Law limited the amount of profit and capital that could be repatriated); (b) guaranteed compensation of all losses as a result of expropriation or a similar event; (c) customs exemption for in-kind contributions to capital; (d) three-year loss carry forward; and (d) accelerated depreciation. A newly-revised Land Law also allows foreigners to own land in Poland, subject to the authorization of the Ministry of Interior.

51. In addition, the Government also intends to actively promote foreign investment into Poland through the Foreign Investment Agency. To date, the inflow of foreign investment has not been of a size or character that would contribute significantly to Polish economic growth. Although there have been approximately 2,800 joint ventures approved at the end of 1990, the average foreign equity investment has been relatively small (US$140,000), and typically in commercial operations and component manufacturers. Any increase in the type and size of foreign investment would require a major promotional effort.

H. Legal Framework

52. Although much of the legal framework required for the privatization program is already in place, the Government is developing key additional legislation to ensure an efficient implementation of the privatization effort, and ensure the effective functioning of the private sector in the future.

53. The fundamental legislation underlying the privatization program is the "Privatization Law for State-Owned Enterprises" (1990), which initiates, processes and monitors the overall privatization of SOEs. Other key legislation includes (a) the "Anti-Monopoly Act (1990), which establishes an independent Anti-Monopoly Office and provides for the break-up of large monopolistic SOEs and cooperatives prior to privatization; (b) the "Law of Economics of State-Owned Enterprises" (1981), as amended in 1987, 1989, and 1990, and its implementing decrees, which governs state-owned enterprises; (c) the "Commercial Code" (1934), as amended on various occasions, which governs the joint stock and limited liability companies which cannot immediately be privatized; and (d) the "Bankruptcy Law" (1987), which governs the bankruptcy and subsequent liquidation of joint stock and limited liability companies.
54. A key legislation which permits privatization through the infusion of foreign capital is the draft "Foreign Investment Law" (1991), which replaces the "Law on Joint Ventures" (1988), as mentioned above. The former Law on Joint Ventures established the independent Foreign Investment Agency (FIA) and governed all joint ventures between state-owned enterprises and foreign investors. Previous inconsistencies between this law and the Privatization Law have been solved in the new draft, which is currently being considered by Parliament.

55. To support the process of enterprise reform and privatization, the Government introduced or modified a number of laws with a view to providing the legislative basis for a free market economy. The "Law on Financial Management of State Enterprises" (1989) reinforces financial discipline on enterprises by imposing budget constraints and making compulsory "dividend" payments (based on a portion of the share capital of the enterprise) and providing for a periodic revaluation of assets. The "State Enterprise Law" was amended in 1990, and allowed the founding organ, in close collaboration with the Ministry of Finance, to compel a non-performing enterprise into restructuring/liquidation or ultimate bankruptcy, suppress the Workers Council management system, and turn the enterprise over to a "Recovery Commission".

56. The liquidation amendment of Article 25(1) of the Privatization Law is being used extensively to privatize state-owned enterprises, for reasons including: (a) financial insolvency; (b) techno/economic reasons e.g. environmental liabilities; (c) an unfeasible and inefficient corporate structure. In addition, amendments were made to the "Law on Bankruptcy" in December 1989, in which all enterprises, state-owned and otherwise, are equally subject to normal bankruptcy procedures.

57. The Government also amended the "Land Law" in December 1990 to address the issue of the ownership of land and other assets by both domestic and foreign investors. The principal revisions included the following: (a) foreigners are permitted to acquire privately-held land. In the case of state-owned land, foreigners are permitted access to the land through the mechanism of a perpetual (99 year) lease. This lease is transferable and can therefore be utilized as collateral; (b) privatized state-owned enterprises will be permitted to acquire both state-owned and privately-held land; and (c) Polish citizens will be permitted to own multiple real estate assets and will be allowed unlimited and unconditional access to agricultural land.

I. Institutional Framework

58. The key institutions influencing the privatization process are (a) the MoOC, and (b) the "founding organ", that is, the relevant Ministry or local authority at the wojewoda or the municipal level. Under the Privatization Law, the privatization of state-owned enterprises is entirely under the direction of the MoOC. The principal functions of the MoOC are to initiate, monitor and control the process of privatizing state-owned enterprises. It is also called upon to provide legal and operational assistance in the privatization of enterprises at the municipal and cooperative level. For some enterprises which were recently created as joint-
stock companies with shares held directly or indirectly (through existing SOEs) by the Sta., and as such are not administratively and legally state-owned enterprises, the responsible parties are the founding organs, which may be one of the 49 wojewoda or one of the other Ministries. The founding organs are responsible for initiating enterprise privatization and the preparation of an enterprise for privatization (in terms of breaking up large enterprises and liquidating unviable enterprises) at the regional level.

59. Supporting institutions include the Foreign Investment Agency (FIA), which becomes involved when foreign participation is envisaged, and the Anti-Monopoly Commission, which is responsible for initiating the break-up of monopolistic enterprises. The FIA was created to take primary responsibility for the overall management of foreign direct investment into Poland. Its principal responsibilities include promotional and informational activities to attract foreign investors to Poland, evaluation of applications for joint ventures and monitoring the activities of the joint ventures after they have been approved. The latter responsibility would considerably reduced under the new foreign investment law.

60. The Anti-Monopoly Commission was created in April 1990 and is responsible for containing monopolistic practices in the economy and for monitoring and breaking up, if necessary, large and potentially monopolistic enterprises. A monopolistic enterprise is defined as one having a "dominant market position", that is, greater than 30% of the market. In 1990, the Commission reviewed 1500 cases of potential monopoly, of which 200 were deemed monopolistic and 200 deemed as requiring substantial restructuring. Enterprise break-up can be initiated either by the owner, after a review by the Commission, or by the Commission itself.

61. The financial sector is a key sector which requires further development for the success of the privatization program. A specialized financial institution, the Polish Development Bank (PDB) has been established as a key institution to also assist in financing the overall privatization and restructuring effort. The new Industrial Development Agency (IDA) is essentially providing technical assistance to restructuring enterprises. Both have been established as joint stock companies with appointed Boards to ensure autonomy from the Government. The PDB will provide medium and long-term financing for restructuring through a network of financial intermediaries.

62. The development of a transparent and efficient capital market is a key element of the institutional framework required for the success of the privatization program. The Stock Exchange, which is being established with French technical assistance and is modeled on the Lyon stock exchange, is expected to provide a complete and modern system of quotation, execution, settlement and custody for the secondary market of shares issued in past and future public offerings of privatized enterprises. Although initially the Stock Exchange was established under the auspices of the Government, the Government's role will be temporary and confined to start-up. With the emergence of brokerage houses, the control and ownership of the Stock Exchange is expected to pass into private ownership.
63. The regulation and supervision of the capital market is contained in the securities law, the "Bill on Public Trading and Trust Funds", which was approved by Parliament in March 1991, and is implemented by the Securities and Exchange Commission (SEC). The Bill provides a general legal framework for the creation of the SEC and determines the conditions for the admittance of securities for public trading and the principles governing the conduct of such trading. The SEC, to be established as a new State administrative entity, will be responsible for the public trading in securities, providing educational and information services for investors and developing a comprehensive educational/training program for stockbrokers and SEC employees. It is envisaged that the stock market will be operational by June 1991, with limited trading in the shares of the five privatized enterprises to commence in April 1991.

64. An important element in the mass privatization effort is the emergence and development of the Privatization Funds as the intermediary institutions which will be engaged in holding the vouchers of the Polish citizens and creating value in the shares of the privatized enterprises. The Government intends to provide substantial support for the establishment of these institutions.

65. The training of Board members, managers and capital market participants is crucial to the implementation and sustenance of the privatization effort. The MoOC has already embarked on the recruitment and training of Directors to the Supervisory Boards of the commercialized enterprises. The objective is to train approximately 1500-2000 Directors by end 1991. In addition to the Banking Institute which provides training programs for bank employees, the MoOC has also established a training institute, the School of Finance and Management, which offers training programs at various levels for Directors, managers and stockbrokers. The training programs cover all relevant areas of finance and management.

J. Specific Sectoral Developments

66. Although the privatization program is generally aimed at all sectors of the economy, the bulk of the effort, to date, has been directed at the manufacturing sector. This is to an extent justified, in light of the concentration of state-owned enterprises in the manufacturing sector. However, there exist a large number of state-owned and public enterprises in the other sectors which require a more "customized" program of privatization to take into account the specific characteristics and problems of each sector. The principal sectors are discussed below. The Government is also currently in the process of preparing specific sectoral studies (that is, sector-wide studies comprising the dynamics of each sector and the enterprises within that sector) with a view to undertaking "cluster" privatizations. Cluster privatizations essentially would involve preparing a group of small and medium-sized enterprises for privatization within individual sectors, with the objective of eventually privatizing them simultaneously or sequentially.

67. Agriculture. The agricultural sector is comprised of agricultural marketing and processing enterprises and cooperatives as well as state-owned
farms. The Government intends that the privatization of this sector be done selectively, in light of the type of enterprise and its importance to the economy. In this context, the MoOC requested bids for the preparation of sub-sector studies which are intended to be utilized as a basis for the privatization of enterprises in these sub-sectors. Issues specific to agro-enterprises which have relevance to privatization include:

- The restructuring and demonopolization of large enterprises to define a "package" of industrial units that is economically viable, and which will take into account special factors such as (a) health, environment or technological constraints; (b) access to raw material supply in relation to processing capacity; and (c) complementary activities within a sub-sector or between different sub-sectors.

- Separating all non-commercial activities from the commercial activities. The non-commercial activities should then be transferred to the appropriate public administration.

- Infrastructure development such as the development of a wholesale market network for livestock and fresh produce, handling facilities for sea and rail transportation and access to effective communication systems.

68. The issues of the state-owned farm sector and the development of an overall national land policy are crucial for the restructuring and eventual privatization of the agricultural sector. The Government appears committed to expediting the restructuring and privatization of the state-owned farms and ancillary state-owned farm lands. A draft law exists which seeks the transfer of state-owned farm assets to joint stock companies. The development and implementation of the 2200 farms representing 25% of Poland's agricultural land would commence formally after passage of this law. At present, state-owned farms are under severe financial pressure as a result of high leverage, but are not formally bankrupt due to their managers undertaking methods such as asset stripping, unrealistic inventory valuations and other creative accounting procedures to maintain a semblance of profitability. Insolvency on the part of a large number of state-owned farms will result in an acute liquidity crisis in the rural sector. In some sub-sectors (export crops, for example), state-owned farms make a significant contribution to national output. The approach to privatization has to be selective so as to minimize any negative effects on forward linkages (foreign exchange earnings) or backward linkages (input supply).

69. Privatization criteria would therefore have to be developed to prioritize efforts to (a) inventory land, buildings and equipment on these farms; (b) assess the financial prospects; and (c) determine which state-owned farms should be divided and sold to private farmers, which should be leased and which should remain State property.
70. To date, a national land policy for agricultural land has not been developed. Proposals have been made to the Government to develop a policy focussed on an improvement in the functioning of the private sector land market, redefinition of the National Land Fund (PFZ) and the development of legal and financial instruments to foster an improved private land market. Measures under development include intensification of the land consolidation effort, initiation of legal instruments for easier land transfers and provision of support for the purchase of released state-owned farmland.

71. **Banking.** The financial sector is principally comprised of the central bank, the National Bank of Poland (NBP), six specialized banks, nine commercial banks, a development bank and some 60 newly-established private banks. The specialized banks include Bank Handlowy (the foreign trade bank); Bank PeKaO S.A. (which managed foreign exchange deposits of households, savings and a portfolio of housing loans through an extensive branch network); BGZ (which is specialized in agricultural lending and serves as an apex institution for the cooperative banking system); and BRE (the export development bank). The nine commercial banks were established in January 1989 out of the NBP, where NBP retained the typical central banking activities and transferred all its corporate lending activities to the commercial banks.

72. In view of the general lack of autonomy and accountability and the need to revise the corporate governance and structure of the state-owned commercial banks, the Government submitted a program for the transformation of the commercial banks into joint stock companies to the Economic Sub-Committee of the Council of Ministers, which was approved in March 1991. The subsequent privatization of two commercial banks is intended to be accomplished in 1991, with the remaining seven to be privatized subsequently. The selection of the two banks to be privatized will be based on their degree of maturity. The issues which may complicate the privatizations are essentially the uncertainty regarding the quality of the banks' portfolios, the problems of valuation and the poor quality of financial information on the banks.

73. **Culture.** The state-owned enterprises under the jurisdiction of the Ministry of Culture were considered to be candidates for relatively rapid privatization. These enterprises are in the areas of retail and wholesale publishing, musical instrument manufacture, printing, music and entertainment. The process of privatization included separate methodologies for each sub-sector. The principal issue was one of breaking up large enterprises into smaller and more viable enterprises. For example, the music sub-sector is dominated by Polskie Nagrania, a phonograph manufacturing enterprise, and the wholesale publishing is dominated by Dom Książki, a book publishing enterprise. In the area of publishing, all the newspapers in the country were managed under a single large state-owned enterprise, RSW. RSW was broken up into several smaller enterprises, which were subsequently individually privatized. The majority of the newly-created enterprises were purchased by employee-owned or supported private Polish companies.

74. The printing and musical instrument manufacturing enterprises are expected to be privatized through the liquidation method. The specific issue in the case of these enterprises was one of assets, particularly property, and
the proper compensation to be granted to previous owners. The enterprises in the film sector are expected to be privatized after being broken up into smaller units.

75. **Energy/Mining.** In 1990, the energy sector contributed approximately 10% to GDP and employed over 500,000 persons. During the 1980s, the energy sector suffered from inadequate levels of investment, maintenance and attention to environment aspects. The sharp economic contraction in the past few years, in addition, resulted in capacities being generally larger than demand. The sector is dominated by coal, which in 1990 accounted for over 95% of primary energy production and over 75% of primary energy use. Oil production is negligible and accounts for only about 1% of primary energy use. Natural gas production has been more significant, accounting for over 3% of primary energy production. Electricity production accounts for over 55% of primary energy use.

76. In general, the energy sector has an important strategic significance and is characterized by a strong monopolistic structure. The sector can be broken up in terms of (a) the exploration and exploitation of primary energy resources; (b) production of energy products; (c) transmission; and (d) distribution and final sale of energy products. These activities could be fully integrated as in the case of the gas industry, or kept separate. In early 1990, the Government split the electricity board into one transmission grid and several generating companies. The coal mining sector, comprised of 68 independent coal mines and the Hard Coal Agency, is expected to be restructured into 10-15 independent joint stock companies with the Hard Coal Agency playing the role of a "transitional" holding company for those mines which are to be closed down. The restructuring studies, prepared under the auspices of the World Bank, are being discussed by the relevant Ministries. The Government is also presently in the process of considering alternative structures for other energy sub-sectors. The emerging structure would influence the privatization process and the scope for joint ventures.

77. Other key issues in the energy sector which would have an impact on privatization/restructuring include: (a) the shortage of qualified management; (b) the shortage of domestic capital (in light of the highly capital intensive nature of the sector); and (c) a comprehensive legal and regulatory framework. The Government, through the Department of Energy, is presently in the process of formulating a new Energy Law, and is studying a privatization proposal submitted to them by a consortium of consultants.

78. **Foreign Trade.** The foreign trade sector is comprised of state-owned enterprises and joint stock or limited liability companies. The state-owned enterprises account for about 20% of total exports. Approximately 30% of the state-owned enterprises were "spontaneously" privatized prior to the formal implementation of the present privatization program. There are presently 72 foreign trade enterprises, of which 26 are state-owned and 46 are joint stock or limited liability companies. Shareholders of partially state-owned foreign trade enterprises are typically industrial groups, mostly suppliers to the trade enterprises.
79. The action plan for the privatization of state-owned foreign trade enterprises has been prepared by the Ministry of Foreign Economic Relations, the founding organ for these enterprises. The privatization program has been approved by the MoOC and is expected to be implemented after approval by the Council of Ministers. Issues that are specific to foreign trade enterprises which affect the privatization process include: (a) the need to restructure and break up a number of enterprises; (b) the high valuations that will be attributable to some of the enterprises owing to their vast marketing and information networks, and in some cases, high profitability; and (c) the capital accumulated by the majority of the enterprises which may be utilized in other areas of the economy. The privatization program does not cover, however, the joint stock or limited liability companies in this sector. A large number of these companies are substantially owned by the State, and require to be privatized.

80. The privatization program for this sector envisages different strategies depending on the specific characteristics of each enterprise, its financial position and its long-term strategy for development. The basic privatization methodologies are expected to be trade sales to domestic or foreign investors or secondary share offerings. It is also envisaged that the employees will participate significantly in the overall process. The following steps are envisaged: (a) an economic/financial analysis of the enterprise, including a valuation, plan for restructuring and plan for privatization; (b) a legal analysis, including particularly the issues of property ownership; (c) submission to the Council for Privatization (which is comprised of representatives of the founding Ministry, MoOC, other ministries, foreign trade units, consulting firms and academicians) for verification; (d) submission to the founding Ministry and MoOC for approval; and (e) commercialization and privatization.

81. Housing Construction. There are four major "agents" in the housing sector: cooperatives, municipalities, enterprises and private households. Cooperative housing is the principal source of new supply, and accounts for approximately 50% of new housing. State housing comprises two types, enterprises and municipality housing, and accounts for about 30% of new housing. The remainder is provided by private housing, most of which is constructed in smaller cities and villages.

82. The housing sector in Poland has been deteriorating steadily over the past several years, particularly since 1989. Factors such as a rationing of resources away from the sector and generally misguided sector policies led to high housing prices, expensive Government subsidies and declining sector productivity. The number of households exceeds the number of dwellings by about 10%, the highest in Eastern Europe, and the market price of an average dwelling is about 20 times the average annual household income. In addition, productivity is low, with the average time required to complete a new housing unit is between two and five years, compared to one year in Western Europe.

83. Despite these problems, however, the Government now perceives the sector as an important participant in stimulating investment in the economy. This requires a new regulatory framework and the restructuring of the building
materials and construction industries. The principal issues in the sector which would also have relevance to any privatization effort in the sector are the following:

(a) The institutional and legal framework, which is undergoing major changes aimed at stimulating the private housing sector. Revisions of major laws including the "Civil Code", the "Housing Act", the "Spatial Planning Act", the "Land Use and Expropriation Act", the "Cooperative Act" and the "Construction Act" are under consideration. In addition, two new laws, the "Local Autonomy Law" and the "Communal Property Law" are being prepared, which if adopted would allow local authorities greater responsibility over the ownership and management of housing stock and related infrastructure.

(b) Land development and infrastructure. There are three main constraints contributing to the inefficiency in the use of developed land for housing: (i) uncertainty over land tenure, where state land to be transferred to local authorities and land attributed to cooperatives is in uncertain legal status; (ii) an over-restrictive regulatory environment; and (iii) a lack of financial resources for infrastructure development. The immensely inefficient use of infrastructure and urban land, due to excessive control of land use, poor land allocation practices and a shortage of construction materials have constrained the sector.

(c) The construction industry, which is dominated by large monopolistic kombinats, which operate substantially below capacity, are capital intensive and have high fixed costs. During periods of economic slowdown (as in 1989), these enterprises cannot reduce their high fixed costs and a high proportion (reportedly over 70%) faced closure. These enterprises have to be broken up in an optimal manner and the newly created enterprises must be structured so as to increase flexibility and reduce costs.

(d) A need to broaden the sources of funding (away from Government subsidies) by mobilizing private savings and attracting new forms of institutional savings through a network of financial intermediaries, in order to solve the problems of inadequate construction and mortgage financing.

(e) A need to reorganize the housing cooperatives into smaller units, concentrating on specific tasks such as building, maintenance and individual ownership.

(f) To define a program to include the completion of the unfinished stock of housing, the sale of the majority of the
public rental housing and the introduction of new techniques and principles for managing remaining public housing stock.

84. **Retail and Wholesale Trade.** The retail and wholesale trade sector essentially comprises approximately 100,000 small and medium-sized shops, located all over the country. As of the end of 1990, approximately 80% of these had been privatized ("small privatization"), including 400 pharmacies.

85. **Transportation.** The enterprises in the transportation sector are very diversified, implying specific problems which would have to be addressed in the privatization strategy. The principal sub-sectors are railway transport, air transport, including airports, road transport (trucking and passenger services) and shipping enterprises, including ports. Apart from the road transport and airline sub-sectors, the privatization in the other core sub-sectors (that is, not including ancillary services such as repair and spare parts, which may be fully privatized) is expected to be largely confined to commercialization and restructuring. LOT, the national airline company, is currently seeking a private buyer for 40% of its equity. In addition, to the purely transport-oriented sub-sectors, the transportation sector as a whole also comprises a large network of industrial non-transport enterprises, some of which are in the process of being privatized.

86. In the road transport sub-sector, PKS was the principal enterprise for the transport of both passengers and freight. Prior to its reorganization, PKS was comprised of four enterprises, KPKS, the large state motor transport company, and a further three enterprises, the PKPS enterprises. In 1990, PKS was divided up into 227 constituent operating entities, to operate as independent firms. Of these, 27 specialized in passenger transport, 31 in road haulage and the remainder were engaged in both activities. The passenger transport units and mixed units were retained under the supervision of the Ministry of Transport and the road haulage units, were placed under the relevant wojewoda.

87. The road transport sub-sector has proved to be particularly amenable to small scale enterprise and as such, privatization has been proceeding through the growth of a private truck fleet (approximately 70% of the road haulage fleet is under private ownership). However, outright privatization has not been completed to date, although some 100 public transport enterprises have been earmarked for small or medium-scale privatization, essentially through sale as going concerns or leasing. In addition, industrial enterprises with in-house transport divisions have transformed these divisions into independent subsidiaries, formed as limited liability companies.

K. **Other Issues**

88. There exist a number of other issues which have arisen as a result of the experience gained in the privatization effort, which have to be addressed in order to ensure a smooth privatization process. The three principal issues are: (a) the transformation of cooperative ownership; (b)
reprivatization; and (c) the macroeconomic effects of the overall privatization effort.

1. Cooperative Ownership

89. The cooperative sector is not only highly diverse (housing cooperatives, labor cooperatives, dairy cooperatives, horticulture cooperatives, agricultural production cooperatives, cooperatives for the disabled and cooperative banks, among others) but also holds a substantial volume of assets in the rural areas. The major issue regarding cooperatives is the largely unclear ownership structure, which arises particularly when the cooperative is to be transformed or liquidated. According to the "Cooperative Law" (1982), cooperatives were essentially regarded as service institutions which performed economic functions for social purposes. Cooperatives were not regarded as profit-making entities.

90. In January 1990, the Parliament amended the Cooperative Law with a view to restructuring and democratizing the cooperative sector. The amendments were to (a) elect new member and cooperative representatives, and (b) liquidate all cooperative unions at the regional and national levels. These amendments created substantial confusion as a result of their complexity, inadequate design poor implementation and the absence of an adequate regulatory structure. In particular, the amendments did not allow the establishment of new cooperative unions before July 1991 to avoid the risk of the old structure resurfacing. As a result, there are presently a number of primary cooperatives in Poland without adequate guidance or support, in terms of management, training of staff or the establishment of regular internal control procedures.

91. The present legal status and diversity, therefore, could present significant obstacles to the process of initiating and implementing ownership transformation. Legislative changes should provide a legal basis for ownership changes, particularly for the transformation of cooperatives into corporations registered under the Commercial Code. In addition, legislation should adapt cooperatives to a market environment, while at the same time ensuring their autonomy and self-management. Specific legislative changes could include: (a) ascertaining that cooperatives would operate as business enterprises; (b) ensuring that only members own the cooperatives, and employees can become members only if there is no obvious conflict of interest; (c) ensuring that cooperatives are completely independent of the State; (d) ensuring that sufficient capital is provided by members; (e) ensuring adequate profit-sharing between members; (f) allowing for the transformation of cooperatives into share companies; and (g) rebuilding the regulatory structure that the 1990 amendments abolished.

2. Reprivatization

92. The issue of reprivatization is an important element in the overall privatization process. Prior nationalizations were very different in their scope and character, implying the need for a case-by-case approach to reprivatization. According to the proposed regulation, enterprises will be
Annex 2-1
Page 24

reprivatized only in cases where the previous nationalization was "abusive" or done with inadequate compensation. Except for a few specific cases, however, the general principle is that property will not be returned, but previous owners will receive adequate compensation. As of July 1945, there were approximately 30,000 businesses in Poland, of which about 11,000 were privately-owned. The balance consisted of state-owned, municipal and cooperative enterprises. Although the extent of reprivatization is yet to be determined, the Government, by March 1991, had received approximately 1,200 applications for compensation.

93. In March 1990, the Council of Ministers accepted a reprivatization program which covered: (a) smaller properties (e.g. mills, sawmills, breweries and brickworks) which were illegally and forcefully nationalized, and then legalized under a 1958 law; (b) other property nationalized under the 1946 law; (c) small farms which were nationalized, although agrarian reform at the time was to include only farms of over 50 hectares; and (d) Warsaw real estate nationalized by a 1945 decree. The Government intends to return the smaller properties in full to their previous owners. In the other three cases, former owners will receive capital bonds issued by the State, which will be convertible into shares of privatized enterprises.

3. Macroeconomic Effects

94. An assessment of the macroeconomic effects of the privatization process is difficult, and any quantitative forecasts are likely to be misleading in view of the presently transitional nature of the economy. A number of trends are discernible, however, which are included below:

(a) The free distribution of vouchers, and the eventual purchase of shares in privatized enterprises with these vouchers, will increase the private property of Polish citizens. In addition, dividends on shares will add to household incomes. Overall spending can therefore be expected to increase as a result, and savings to fall.

(b) There may be an impact on the Budget in that private enterprises are exempt from the obligatory "dividend" tax, a tax calculated on a portion of the share capital of state-owned enterprises and levied at a rate which is based on the refinancing rate of the National Bank of Poland. Realistically, however, the impact may be expected to be minimal, given the small proportion contributed by this tax to State revenues (in 1990, 7% was contributed by these payments).

(c) Privatization may be expected to improve investment efficiency and therefore, production growth in the economy. However, the increase in productivity may result in the rationalization of employment, and as a result, short-term unemployment. The Government should take steps to expand
the small and medium-scale private sector (which has a lower capital to labor ratio) to absorb the excess labor supply.

(d) Although an excessively high increase in overall demand is not expected, the Government should be prepared to take appropriate counter-inflationary measures.

II. ACHIEVEMENTS TO DATE

95. Until the enactment of the Privatization Law, privatization had been limited to "spontaneous" privatizations of state-owned enterprises, largely at the initiative of the employees and management of the enterprises. Since then, however, the Government has achieved substantial progress in the process of privatization, as delineated below.

A. Establishment of the MoOC and development of a Privatization Strategy

96. The MoOC was established, with assistance from bilateral sources (USAID, British Know-how Fund, France) and advice from the IFC, as the principal department of the Government with the mandate to initiate, control and monitor the privatization effort. Although at this time staffing is still inadequate (120 local staff and 40 foreign advisors) and significant technical assistance is continues to be needed, the MoOC has successfully developed a privatization strategy and has achieved substantial progress in its actual implementation.

B. Commercialization of Enterprises

97. A major effort has been made to initiate the voluntary commercialization of state-owned enterprises. As of the first quarter of 1991, 107 enterprises have been commercialized, of which 57 are slated for individual privatization.

C. Privatizations

98. In addition to the spontaneous privatizations of Universal, a foreign trade enterprise, and BIG Bank, a state-owned commercial bank, the individual privatizations of eight large enterprises has been accomplished, five by public offering, two by trade sales to foreign investors and one through an employee leveraged buyout. The pilot privatization through public offering of five enterprises, Exbud, Kabli, Prochnik, Krosno and Tonsai were completed in January 1990 with a reasonable degree of success. All five offerings were oversubscribed by between 7% and 20%. The premium of the issue price over the book value of the enterprises ranged between 70% and 150%. The offerings were principally targeted at the domestic market, although a limited foreign participation was permitted. In addition, two enterprises, Fampa and Polam Pila were sold to foreign companies, with 80% of Fampa being acquired by Beloit of Germany and 51% of Polam Pila by Philips of the Netherlands. The other enterprise, Zaklady Miesne, was purchased by the employees in a leveraged buyout, with equity being fully paid up and the debt to be paid off.
over five years. Total estimated proceeds from these privatizations was approximately US$43 million. Details on the privatizations are contained in Exhibit 5.

99. Preparations are also currently underway for a group of enterprises (including foreign trade enterprises) which are intended to be sold through domestic public offerings during the first half of 1991.

100. The Government has also made substantial progress in the development and preparation of the mass privatization program. In addition, 143 small and medium state-owned enterprises were privatized through the liquidation route. Of these, 48 were privatized through the sale of assets and 95 through either leasing or installment sale.

D. Other

101. The Government has made substantial progress in re-drafting the Foreign Investment Law to ensure a more conducive investment environment in Poland for foreign companies. In addition, the Stock Exchange has been established and expects to be formally opened in June. Also, the new Securities Law and Securities and Exchange Commission has been established. The Anti-Monopoly Commission has been established to prevent monopolistic activity.

102. A training institute has been established which has commenced the training of future supervisory board members, stockbrokers and Polish consultants in the areas of finance and management. A separate institute to assist in regional privatization has also been established, and has prepared a manual to assist regional authorities in the privatization of the enterprises under their jurisdiction.

III. NEXT STEPS

103. The Government intends to achieve the following in 1991:

- Finalize the legal framework in support of the privatization program: amend, revise or replace the Law on the Economics of State-Owned Enterprises, the Commercial Code, the Cooperatives Law and the bankruptcy regulations. Prepare new legislation for land ownership and privatization of cooperatives. Enact the law on reprivatization and the Foreign Investment Law.

- Develop the criteria and clear mechanisms for the selection of enterprises for privatization through various routes (individual privatization versus mass privatization) and accelerate the pace of privatization through (a) the commercialization of an additional 1,000 enterprises at the national level and 1,700 enterprises at the municipal level, to achieve an adequate pipeline of enterprises for
subsequent privatization. Approximately 40-60 enterprises are expected to be privatized under this method during the course of the year (15 through public offerings, 15-20 by sale to Polish investors and 5-10 by sale to foreign companies). These enterprises will be selected from among the 500 largest state-owned enterprises; and (c) the continuation of the process of privatization through the liquidation route. Approximately 50-60 enterprises per month are expected to be privatized in this manner.

- Review existing incentives and elaborate/implement as needed new incentives or other measures to cause state-owned enterprises to commercialize voluntarily.

- Complete the necessary preparatory work and commence the conversions of external debt into the equity of privatized enterprises.

- Finalize the program for mass privatization. As presently envisaged, this would include the establishment of a minimum of five Privatization Funds and the elaboration of a program for the free distribution of vouchers. It is expected that the program will actually be implemented in the last quarter of 1991.

- Finalize and commence implementation of the sectoral privatization programs e.g. commercial banks, insurance agencies, cooperatives, foreign trade companies (the privatization program for foreign trade enterprises must be expanded to include the partially state-owned joint stock and limited liability companies also in existence in the sector. Some of these are substantially state-owned and have to be privatized.) and agriculture, among others. It is expected that at least two commercial banks and one insurance agency will be privatized in 1991.

- Further support and accelerate the process of regional privatization, by bolstering the capabilities of the regional and local authorities. Develop the plans for decentralization of the privatization effort and the establishment of regional offices of the MoOC.

- Develop a program for the transformation of the cooperative sector towards private ownership, while ensuring their full autonomy and self-management.

- Substantially increase the focus of the Foreign Investment Agency towards promotion.

- Establish an inter-ministerial task force to monitor the overall progress of privatization/restructuring and take
active measures to ensure that it continues rapidly and efficiently. This would include a re-definition of the organization structure of the two principal Ministries, MoOC and the Ministry of Industry, in the overall process, and clarification of their respective roles, especially in marginal cases of state-owned enterprises requiring restructuring.

Define a policy on contingent liabilities related to environment for new owners of privatized enterprises or former state-owned enterprises' assets, and develop a clear methodology for "sensitive" cases.
### ENTERPRISES CLASSIFIED BY SECTOR
(as of December 1990)

#### PRODUCTIVE SECTOR

<table>
<thead>
<tr>
<th>Sector</th>
<th>State-owned Enterprises</th>
<th>Co-operative Enterprises</th>
<th>Total</th>
<th>State (1)</th>
<th>Joint-venture</th>
<th>Private</th>
<th>Non-profit Foundations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing/Mining</td>
<td>3,107</td>
<td>2,411</td>
<td>5,518</td>
<td>951</td>
<td>853</td>
<td>6,416</td>
<td>20</td>
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<tr>
<td>Construction</td>
<td>1,620</td>
<td>732</td>
<td>2,552</td>
<td>722</td>
<td>71</td>
<td>5,711</td>
<td>21</td>
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<tr>
<td>Agriculture</td>
<td>1,733</td>
<td>4,244</td>
<td>5,977</td>
<td>135</td>
<td>48</td>
<td>245</td>
<td>2</td>
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<tr>
<td>Forestry</td>
<td>58</td>
<td>—</td>
<td>58</td>
<td>7</td>
<td>4</td>
<td>33</td>
<td>—</td>
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<tr>
<td>Transport</td>
<td>741</td>
<td>187</td>
<td>928</td>
<td>76</td>
<td>67</td>
<td>319</td>
<td>—</td>
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<tr>
<td>Communication</td>
<td>96</td>
<td>—</td>
<td>96</td>
<td>6</td>
<td>5</td>
<td>1,767</td>
<td>28</td>
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<tr>
<td>Municipal Enterprises (2)</td>
<td>887</td>
<td>64</td>
<td>951</td>
<td>35</td>
<td>6</td>
<td>139</td>
<td>8</td>
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<tr>
<td>Other</td>
<td>420</td>
<td>454</td>
<td>874</td>
<td>1,728</td>
<td>258</td>
<td>5,699</td>
<td>38</td>
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<td><strong>Sub-total</strong></td>
<td>8,862</td>
<td>8,092</td>
<td>16,954</td>
<td>3,659</td>
<td>1,312</td>
<td>19,789</td>
<td>117</td>
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</table>

#### NON-PRODUCTIVE SECTOR

<table>
<thead>
<tr>
<th>Sector</th>
<th>State-owned Enterprises</th>
<th>Co-operative Enterprises</th>
<th>Total</th>
<th>State (1)</th>
<th>Joint-venture</th>
<th>Private</th>
<th>Non-profit Foundations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing</td>
<td>220</td>
<td>4,491</td>
<td>4,711</td>
<td>14</td>
<td>1</td>
<td>34</td>
<td>1</td>
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<td>Science</td>
<td>28</td>
<td>19</td>
<td>47</td>
<td>60</td>
<td>8</td>
<td>91</td>
<td>1</td>
</tr>
<tr>
<td>Education</td>
<td>47</td>
<td>12</td>
<td>59</td>
<td>14</td>
<td>1</td>
<td>133</td>
<td>5</td>
</tr>
<tr>
<td>Culture</td>
<td>28</td>
<td>32</td>
<td>60</td>
<td>20</td>
<td>15</td>
<td>210</td>
<td>9</td>
</tr>
<tr>
<td>Health</td>
<td>52</td>
<td>53</td>
<td>105</td>
<td>9</td>
<td>6</td>
<td>117</td>
<td>2</td>
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<tr>
<td>Sports</td>
<td>167</td>
<td>15</td>
<td>182</td>
<td>80</td>
<td>33</td>
<td>356</td>
<td>20</td>
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<tr>
<td>Finance</td>
<td>2,914</td>
<td>5</td>
<td>2,919</td>
<td>55</td>
<td>8</td>
<td>46</td>
<td>—</td>
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<tr>
<td>Other</td>
<td>273</td>
<td>281</td>
<td>554</td>
<td>541</td>
<td>61</td>
<td>2,039</td>
<td>19</td>
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<tr>
<td><strong>Sub-total</strong></td>
<td>3,729</td>
<td>4,908</td>
<td>8,637</td>
<td>783</td>
<td>133</td>
<td>3,026</td>
<td>57</td>
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<tr>
<td><strong>TOTAL</strong></td>
<td>12,581</td>
<td>13,000</td>
<td>25,591</td>
<td>4,452</td>
<td>1,445</td>
<td>22,815</td>
<td>174</td>
</tr>
</tbody>
</table>

(1) Joint stock companies which are partially state-owned. These are differentiated from state-owned enterprises, where the State is a 100% owner, and the legal structure is different from that of a joint stock or limited liability company.

(2) Not including retail/wholesale shops.
Information gathering
Enterprise/founding organ conducts feasibility analyses of stock of enterprises

Initiation by Workers' Council/management/founding organ

Yes

No
Process continued by founding organ only

Preparatory team gives opinion to Workers' Council

Founding organ refers request to in-house preparatory team for opinion

Workers' Council sends second opinion

Preparatory team gives second opinion and sends documents to MoOC

MoOC examines privatization plan

Yes

No

Reasons for refusal presented and solution to problem

COMMERCIALIZATION

PRIVATEIZATION STRATEGY

Trade sale
Public offer
Mass prvn.
Employee buyout
Exhibit 4

PRIVATIZATION THROUGH LIQUIDATION

Information gathering
Enterprise/founding organ conducts feasibility analyses of stock of enterprises

Initiation by Workers' Council/management/founding organ

Yes

No
Process continued by founding organ only

Preparatory team gives opinion to Workers' Council

Founding organ refers request to in-house preparatory team for opinion

Workers' Council sends second opinion

Preparatory team gives second opinion and sends documents to MoOC

MoOC examines privatization plan

Yes

No

LIQUIDATION

Sale

Contribution of assets

Lease

Reasons for refusal presented and solution to problem
## LARGE PRIVATIZATIONS

### PRIVATIZATIONS TO DATE

1. **Domestic Public Offerings**

<table>
<thead>
<tr>
<th>Name/Industry</th>
<th>Total Shares Offered (mm)</th>
<th>Price per Share (US$)</th>
<th>Domestic Public Offering</th>
<th>Foreign Investors</th>
<th>Domestic Institutions</th>
<th>Employees</th>
<th>Management Board</th>
</tr>
</thead>
<tbody>
<tr>
<td>EXBUD S.A. Construction</td>
<td>1.0</td>
<td>11.20</td>
<td>450</td>
<td>175</td>
<td>0</td>
<td>200</td>
<td>175</td>
</tr>
<tr>
<td>SLASKA FABRYKA KABIL S.A. Furniture</td>
<td>1.0</td>
<td>7.00</td>
<td>700</td>
<td>100</td>
<td>0</td>
<td>200</td>
<td>0</td>
</tr>
<tr>
<td>PROCHNIN S.A. Garment manufacturing</td>
<td>1.5</td>
<td>5.00</td>
<td>855</td>
<td>90</td>
<td>255</td>
<td>300</td>
<td>0</td>
</tr>
<tr>
<td>KROSNO S.A. Glass manufacturing</td>
<td>2.2</td>
<td>6.50</td>
<td>1,100</td>
<td>44</td>
<td>616</td>
<td>440</td>
<td>0</td>
</tr>
<tr>
<td>TORNIL S.A. Audio equipment</td>
<td>1.5</td>
<td>8.00</td>
<td>450</td>
<td>450</td>
<td>270</td>
<td>300</td>
<td>0</td>
</tr>
</tbody>
</table>

2. **Leveraged Buy-outs**

**ZAKLADY MESNE INOWROCZAW**

Meat processing

- Equity owned by employees: $0.54 million
- 6,000 shares, fully paid up
- Debt: $2.48 million
- To be paid up over 6 years
- 2 year maturity, variable rate
- Total proceeds: $3.00 million

3. **Trade Sales**

**FAMPA S.A.**

Textile machinery

- Single Investor: Belgot 60% for $7.0 million
- Employees 20%

**POLAM PILA S.A.**

Lamps

- Single Investor: Philips 61% for $15.0 million
- Employees 20%
- Treasury 20%
POLAND - PRIVATIZATION AND RESTRUCTURING PROJECT

Processes of Transformation of State-owned Enterprises

Privatization - Restructuring - Liquidation

Stock of State-owned Enterprises

- Large enterprises
  - Viable units
  - Non-viable elements

- Viable enterprises
  - Develop enterprise strategy
    - Viable units
    - Non-viable elements
  - Bankrupt enterprises
    - Potentially viable
    - Evaluation by Recovery Commissions
      - Never viable

- Stock of State-owned Enterprises
  - Ent/Mol/AMC

- Stock of State-owned Enterprises
  - Ent/IDA

- Stock of State-owned Enterprises
  - Preliminary restructuring (if necessary)

- Stock of State-owned Enterprises
  - Convert to joint stock company
    - Ent/FIA

- Stock of State-owned Enterprises
  - Continue as state-owned enterprise
    - Ent

- Stock of State-owned Enterprises
  - Privatization through commercialization
    - Co/MoOC

- Stock of State-owned Enterprises
  - Individual privatization
    - Co/MoOC/PF

- Stock of State-owned Enterprises
  - "Mass" privatization
    - MoOC/PF

- Stock of State-owned Enterprises
  - Lease assets to private company
    - Ent

- Stock of State-owned Enterprises
  - Sale of assets to new company
    - Ent/IDA

- Stock of State-owned Enterprises
  - Liquidation
    - Form new company with some of assets

Key to responsible agencies:

Ent = Enterprise
Mol = Ministry of Industry (or other "Founding organ")
MoOC = Ministry of Ownership Changes
AMC = Anti-Monopoly Commission
RC = Recovery Commission
MoF = Ministry of Finance
IDA = Industrial Restructuring Agency
IB = Investment Bank
PF = Privatization Fund
FIA = Foreign Investment Agency
1. The Polish Development Bank (PDB) was established on the basis of the Council of Minister's decision of July 2, 1990. It was incorporated in October 1990. By its statute, PDB is an autonomous financial institution, set up as a Joint Stock Company. It is subject to regular banking regulation and supervision by the National Bank of Poland (NBP).

2. PDB was established to fill a major gap in the Polish financial system, which does not currently provide medium and long term (MLT) financing for investment or restructuring projects in the industrial sector, based on sound technical, economic and financial analysis. Nor does the system have national financial institutions to promote provision of term financing and venture capital to either small and medium enterprises (SME). PDB is designed to be basically an Apex bank for MLT lending to privatized or restructuring companies as well as to SMEs, using commercial and specialized banks as intermediaries. It is expected to play a catalytic role in guiding and assisting these banks in the provision of MLT financing. In the medium term, when there will be less of need for an apex institution in Poland, PDB will evolve into a more conventional financial institution and is expected to further open its capital to private participation. By the end of 1993, PDB will undertake a review of its role in light of the progress achieved in the modernization and development of the financial sector in Poland, and will elaborate accordingly a plan on the appropriate reorientation of its activities. Such reorientation would be implemented after consulting with the international and bilateral institutions providing funding to PDB. By that time, PDB would prepare and start implementation of a program to increase private participation in its capital.

3. PDB will provide financing to the manufacturing, industrial, agro-industrial, construction, tourism and mining sectors, and associated services including trade, transport and repair. PDB will generally not finance the development of agriculture or housing, for which other banks exist or are being established, nor will it normally finance basic infrastructure such as railways or power.

4. The shareholders have appointed a Supervisory Board (SB), chaired by Mr. Szomburg, a well known economist who was an adviser to Mr. Walesa prior to his election as President. Other SB members are Mr. Dabrowski, a prominent economist who served as deputy minister of finance; Mr. Skarzynski, President of the Industrial Development Agency (IDA), and two advisers of the Ministry of Finance, and a well known lawyer, presently in private business. Foreign shareholders are expected to appoint one voting member and two observers to the SB. Additional members from the Polish private sector might also be appointed.

5. PDB intends to open in the first stage three "windows" for the following activities:
Annex 3-1
Page 2

(a) financing restructuring and investments of large private companies and State-owned companies, primarily those being privatized or commercialized;

(b) financing private SMEs;

(c) some minority equity investments in privatized companies.

B. Capital

6. The major shareholder is the Polish Government (GOP), which has decided to subscribe Zloty 800 billion (approximately US$84 equivalent) of PDB's equity, half already paid-in, half to be paid in April 1991. IDA signed an agreement to subscribe an equivalent of US$21 million in equity. In addition, Credit National of France and Invest Kredit of Austria decided to subscribe US$2 million each, provided certain conditions were met. Instituto Mobiliario Italiano (IMI) of Italy is also likely to invest US$2 million. PDB's equity will thereby total approximately US$114 million equivalent, which consists a strong capital basis, at least for the first years of operations. The three foreign banks will appoint one voting member and two observers to the SB.

7. The EC is considering making available to PDB quasi-equity of ECU 10 to 20 million, out of counterpart funds.

C. Preparatory Work

8. Since the fall of 1990, an organizing team has been working on the preparation of PDB's establishment. It consists of Mr. Wojciech Kostrzewa, an economist who was appointed PDB President, Mr. Matthew Oiex, an experienced banker, Vice President, and two additional Vice Presidents, who altogether constitute the Managing Board (MB). This team has been engaged in hiring staff, both foreign and domestic, in training, in installing hardware and software, as well as in planning activities and preparing operating procedures.

9. PDB prepared a 3 year strategic plan with three scenarios: (a) "base case"; (b) "pessimistic case"; and (c) "low inflation, pessimistic case". Based on discussions during appraisal, a fourth scenario was prepared, considered by PDB as a "revised pessimistic case". The latter projections (summarized in Attachment 1) are considered more realistic as a basis for PDB's appraisal. The basic assumption for the projections is a year-end inflation rate of 51% in 1991, 26% in 1992, and 18% in 1993. The inflation rate assumed for 1991 appears reasonable, assuming deceleration of the much higher inflation rate in January and February 1991, due to a very sharp increase in energy prices. The lower inflation rate assumed for 1992 and 1993 depends on the success of GDP stabilization policy. The inflation rate has a major impact on PDB's income (para. 39).
Lending Targets

10. PDB's major objective is to provide MLT loans to companies, which had been privatized or are intended to be privatized, as well as to private SMEs. The projections assume MLT loans in foreign exchange and in zloty of US$88 million by the end of 1991, an additional US$168 million by the end of 1992, and an additional US$285 million by the end of 1993. By then, the MLT loan portfolio would thus reach US$454 million. These projections have to be appraised in view of expected developments in the Polish economy and in the financial system, as well as of PDB's activities.

11. Until recently, there has been a very limited market for MLT loans in Poland, for several reasons. First, the demand for investment loans has been limited due to the general uncertainty in the Polish economy, to the general recession, and to the so far slow pace of privatization or restructuring of industrial enterprises. Second, the high nominal \(^1\) interest rates for zloty loans (in recent months some 70-80%), though variable, have restricted demand for loans, except for short term credit. Third, the commercial banks provided only short term loans out of their own resources, and most of them have shown little interest in providing MLT loans. Until recently, use of available MLT credit from lines funded by external sources (World Bank, EIB and bilateral) had been growing slowly.

12. On the basis of discussions with banks and business consultants, there are indications that the demand for medium term loans denominated in foreign exchange has been growing lately. For example, the Export Development Bank which has started operations less than four years ago, had a loan portfolio exceeding US$300 million by end 1990, mostly medium term loans, of up to 3 years. Moreover, in the first two months of 1991, the number of loan applications received has been 10 times higher than in the same months of 1990 (a low period). The newly established private Kredyt Bank has many more applications for foreign exchange loans than its available resources. So far it has used its resources only for short term loans, but it has expressed a strong interest in making MLT loans if funding for such loans were available. PDB identified a number of individual projects of enterprises in the process of privatization, as well as joint ventures of foreign companies with Polish SOE, and Polish subsidiaries of well known foreign companies, which are likely to be looking for MLT loans. Some have already held preliminary discussions with PDB.

13. There are generally good indicators of a substantial demand for MLT loans by privatized Polish companies, joint ventures and foreign companies in Poland. It is however difficult to quantify such demand, which depends on several factors, including: (a) the overall recovery of the Polish economy; (b) the pace of privatization and restructuring, which is expected to accelerate; (c) active promotion by the participating banks (PBs); (d) the

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\(^1\) There appears to be little understanding by Polish businesses of the difference between nominal and real interest rates.
pace of organization of PDB itself, as well as its image which it wants to project as young and dynamic.

14. However, notwithstanding the above positive points, there are a number of factors which may render it difficult for PDB to achieve the targets within the time-scale indicated in the projections: (a) lack of practical experience on the part of PDB staff in relation to business generation, project appraisal, completion of loan agreements and disbursement formalities in a free market environment; (b) similar lack of practical experience on the part of the banking intermediaries; (c) normal lead-time necessary to complete all the stages necessary to take a project from the stage of initial identification through to disbursement of the relevant PDB facilities; (d) on larger projects, other possible delays arising for example from compliance with the World Bank procurement requirements. Accordingly, while the growth targets set in the strategic plan could stand in the interest of setting demanding targets, it is likely, particularly in 1991, that they will not be fully achieved, and that PDB will require a longer lead-time to build up to its targeted volumes.

15. Most MLT loans are projected to be in foreign exchange, out of external resources, including World Bank loans (such as the investment component of the Project and the proposed SME loan), as well as from other sources, such as EIB and EBRD. The projected amount of MLT loans from external sources is US$65 million in 1991, an additional US$114 million in 1992, and an additional US$148 million in 1993. A possible constraint could be the absorptive capacity of the Polish economy for loans to creditworthy companies, rather than the availability of funds.

16. PDB also aims at making MLT zloty loans equivalent of US$21 million in 1991, an additional US$30 million in 1992 and an additional US$36 million in 1993, to be financed out of zloty bonds and medium term deposits (para. 28). The likelihood of meeting this target depends to a large extent on lowering the zloty interest rate, following deceleration of inflation. In addition, PDB plans in the first years of operations to make some short term zloty loans, financed out of its own funds, as well as out of short term zloty deposits and commercial paper.

D. Lending Policies

17. PDB is designed basically to be an Apex bank. However, some direct lending to SOEs is expected to be made at its early stages of activities, when commercial banks may be slow to engage in new activities such as MLT lending, even when resources would be provided by PDB. As agreed during appraisal, direct lending by PDB will be restricted as much as possible, and will be limited to no more than 15% of total lending in the next three years. Similarly, direct lending out of the Bank-financed resources will not exceed 15% of the total of such resources. PDB has also agreed not to engage in direct lending to SMEs. These restrictions on direct lending are stated in PDB's letter of operational policies, which was be agreed during negotiations.
18. PDB will be making MLT loans (directly or indirectly) in US dollars and in DM, out of external credits, at market interest rates. For on-lending to participating banks (PBs) under the proposed project, it was agreed during negotiations, that PDB will be borrowing from the Government in either US$ or DM at Libor or Flibor, respectively, plus a margin of 0.25%, with the Government bearing the cross-currency risk between the World Bank basket of currencies and the US$ or DM. PDB will lend to participating banks (PBs) at Libor plus for US$, and at Flibor plus for DM, plus a margin of 1.50%. Lending at Libor or Flibor (rather than on World Bank rate basis) would bring PDB rates closer to market. PBs will lend to the final borrower in US$ or in DM at market rates. For loans made directly by PDB (not through PBs), PDB will charge the borrower the market rate and borrow from the Government in either US$ or DM at Libor or Flibor, respectively, plus a margin of 1.50%. The above structure of interest rates and margins was agreed during negotiations. The interest rates and margins will be reviewed with the Bank every six months. Lending in zloty (from resources other than Bank-financed) will also be made by PDB at market rates.

19. One of the conditions for enterprises to borrow out of PDB resources would be "commercialization", i.e., conversion into joint stock companies (JSC), as a prelude to privatization. This was confirmed during negotiations.

20. PDB will generally provide loans only to clearly creditworthy companies. However, there is likely to be a need for credits to restructuring companies, which may not yet be creditworthy, but which are expected to be viable following restructuring. In such cases, PDB could serve for a fee as an agent for loans out of the Government budget. Such loans would be made at Government risk, and would be recorded "below the line" in PDB’s balance sheet. Thus, "special credits" would be provided out of Government budget, in a transparent manner. To the extent the Government would be willing to provide such credits through PDB, agreements to that effect would have to be made between the Government and PDB, subject to Bank review. This was confirmed during negotiations.

21. As stated earlier, PDB also intends to provide credits through PB’s to private SMEs. In such lending it intends to cooperate closely with the Polish American Enterprise Fund (PAEF), which is providing MLT loans to small private enterprises through banking intermediaries. Specific arrangements with respect to SME lending in general and to the related use of World Bank resources in particular will established within the proposed Private Sector Development Project.

22. The lion’s share of PDB lending would be provided through PBs, which will take the credit risk. Such PBs will have to be pre-qualified by PDB, based on their capability of project appraisal and supervision, on their financial soundness, and on their willingness to actively promote MLT lending. For the use of World Bank resources, such banks would have to meet criteria agreed with the World Bank. PDB intends to qualify in the next few months some of the existing commercial banks, as well as some newly established banks, including private ones.
23. PDB intends to syndicate some of its larger loans to other Polish banks, as well as to subsidiaries of foreign banks being established in Poland. Syndication would be useful in order to reduce PDB's own exposure, which in any case will be subject to the limit of 15% of its risk asset portfolio (para. 17).

24. PDB plans to undertake the following special programs within the framework of energy conservation and environment protection objectives:

(i) Promotion of energy efficient systems and utilization of insulating materials and heat recovery systems. Energy conservation will be introduced in the construction of family housing as well as in the industrial sector. PDB will provide financing to PBs, which will on-lend at market interest rates. In addition to providing financing for energy conservation projects in enterprises, PDB intends to encourage energy saving mechanisms for the entities in which it purchases an equity stake.

(ii) Promotion of environmentally sound projects. PDB plans to participate in the financing of environmentally-oriented projects in the same manner, mainly by on-lending through PBs.

E. Equity Investments

25. PDB intends to make some equity investments, in order to help promote privatization. Equity investments would be made only on the basis of careful evaluation of prospects for capital gains. PDB will be generally taking minority positions in privatizing or in private companies. PDB's total equity investments will be limited to maximum 15% of PDB's equity. This was confirmed during negotiations.

26. PDB has already acquired minority positions of US$3.6 million in two privatized companies. PDB also intends to invest in a Privatization Fund together with EBRD (40% each); management will be provided by a management company which will subscribe 20% of the equity. Another minority investment being envisaged is in a credit rating company, together with a foreign partner. The equity investments will be made through a separate "window", which will be a profit center, or by a subsidiary.

27. The proposed level of involvement in equity, although relatively small, could imply a significant amount of management time on PDB's part. This would arise if PDB should become involved in the management of those enterprises in which it has a shareholding. PDB has confirmed that until such time as sufficient management resources have been developed, it will not become actively involved in the management of companies in which it has acquired an equity interest. PDB intends to finance half of its equity investments out of its own resources and half from loans from external sources - such as EIB or EBRD.
F. Sources of Zloty Funds

28. As a source of Zloty funds, as well as in order to help develop a capital market in Poland, PDB intends to take medium term deposits from large companies. Such operations will be limited to large amount deposits from a limited number of enterprises, and PDB would not establish a network of branches. It also intends to issue Zloty-denominated bonds (unguaranteed by GOP), at interest rates slightly higher than the inflation rate. Nevertheless, such interest might be attractive since interest on bonds is not taxable under the present legislation. Such activities appear to be consistent with PDB's objectives, and until other financial institutions are ready to be active in this market, they will not compete with the commercial banking system. When regular financial institutions would be ready to sell bonds, PDB would not compete with them. PDB also plans to mobilize short term Zloty deposits from large companies, but will take care not to compete for such deposits with retail banking institutions.

G. Capital Adequacy

29. According to its strategic plan, PDB will have at least in the first three years of operations, a high capital adequacy ratio (defined as paid-in capital plus reserves divided by total assets) of 49% in 1991, 32% in 1992 and 22% in 1993. Such ratio should give PDB a comfortable cushion, particularly since it would operate predominately as an Apex bank, and the credit risk would be taken by the PBs. On the other hand, PDB will provide some loans (up to 15% of its loan portfolio) directly to companies at its own risk, and will also make equity investments, in which the risk is likely to be higher than in loans.

30. The adequacy of PDB capital will also depend on the quality of its assets, as well as on the level of provisions it will hold against lower quality assets. PDB intends to have a reasonable level of provisions of 5% of its loan portfolio, in addition to specific provisions and write downs on doubtful loans, in accordance with generally accepted accounting and auditing practices.

31. On balance, the capital adequacy ratios projected for the first years of operations are prudent, and should help PDB establish itself in the market. It would also be prudent for PDB to maintain a capital adequacy ratio of at least 20% at later years. In the future the ratio might be reviewed and revised, in the light of PDB's experience, and perhaps of the requirements of rating agencies.

H. Income

(1) Margins

32. For its Apex lending activity in US$ or in DM funded out of investment component of the Project, PDB will start with a margin of 1.25%. This margin, relatively high for an Apex institution, is based on the fact
that PDB will have to provide the PBs with intensive training to handle PDB’s facilities. It would be reviewed every six months.

33. For its short term and MLT Zloty lending, PDB’s proposed margin varies from 3.5-4% in year 1 to 2.0-2.5% in year 3. This mainly reflects PDB’s view on the margins obtainable in the Polish market place, and appears achievable.

34. On the whole, the proposed margins appear reasonable. The sensitivity analysis in the strategic plan indicates that the net income is less sensitive to small changes in the margins than to other variables, for reasons explained in para. 39.  

(ii) Salaries and Overheads

35. Salaries amounting to a projected total of US$2.5 million constitute a very substantial proportion of overheads estimated at US$4 million for 1991. PDB’s current staff of 68 is projected to increase to 105 by December, 1991. These staff levels could be considered high for an Apex bank, but in view of the range of PDB’s proposed activities and its proposed (albeit relatively small) involvement in direct financing, these staffing levels are acceptable. Moreover, in view of the need to train staff on the job, since there is a severe shortage of bankers in Poland, such costs might be considered partly as an investment for future years, once the size of operations increases. In addition, included under salaries are the payments to five expatriate staff members. There is a possibility that some or all of these costs would be financed out of grant TA, but the full figure has been included in budgeted costs.

36. Total administrative costs are projected to decline from 1.6% of assets in 1991 to 0.8% is 1993. The relatively high ratio in 1991 reflects a fixed cost element during initial organization. In later years PDB will attempt not to exceed the ratio of 0.8% projected for 1993.

(iii) Provisions

37. PDB intends to set up provisions of 5% of its loan and equity portfolio, a substantially higher level than in earlier drafts of its strategic plan. This level appears reasonable for an Apex bank, in which 85% of the credit risk will be assumed by the PB’s. As an additional security safeguard, PDB proposes to include in its agreements with PB’s a clause whereby in the event of failure by a PB, there would be assignment of collateral from PB in favor of PDB, with respect to PDB-funded loans; this should provide PDB with some additional comfort. Overall, the proposed provisions level appears acceptable, but should be kept under regular review as PDB develops a track record. In addition to general provisions, PDB would make specific provisions or writedowns on doubtful loans, in accordance with generally-accepted audit practices.
(iv) **Net Income**

38. Projected net income would be US$10.9 million in 1991, US$13.3 million in 1992, and decline to US$8.2 million in 1993. Return on equity, defined as net income divided by equity, is projected at 9.0% in 1991 and 9.8% in 1992, to decline to 5.8% in 1993. The net income level is affected by the asset portfolio, the margins assumed, as well as administrative expenses. However, it is particularly strongly influenced by the rate of inflation in Poland. A major source of revenues is interest on money market deposits, in which a large part of PDB equity is invested. As a consequence, the assumed deceleration of inflation to 18% in 1992, together with the increase in the lending activities, tend to reduce net income very substantially. The projected return on equity of 5.8% in 1993 is low. PDB will need to review its planned activities, as well as its income projections, in order to seek ways and means to increase the net income projected for 1993 to achieve a satisfactory return on equity in later years.

G. **Management of Risk Exposure**

39. PDB is currently developing its policies in relation to the management of its risk exposures, relative to its own capital base and the capital base of the proposed PB’s through which it will operate. Where PDB is directly financing a client, its maximum exposure to that client may not be greater than 10% of PDB’s capital base. This limit is reasonable.

40. A PB using PDB’s funds will not be allowed to provide a single client credits, out of PDB’s funds together with the PB’s own funds, of more than 10% of the PB’s capital base. Total credits PDB can provide to a PB will not exceed 30% of PDB’s capital. These criteria in relation to credit risk exposure appear reasonable.

41. As stated earlier, in using World Bank funding, the Government rather than PDB will assume the cross-currency risk. PDB will borrow from the Government and on-lend to PB’s in the same currency (US$ or DM). The currency risk will be taken by the final borrower, in both PDB’s direct and indirect lending. PB’s will ascertain that the final borrower understands well such risk, which should also be covered by adequate collateral.

H. **Credit Approvals**

42. Credits for both direct and indirect lending will have to be approved by credit committees, as follows:

(a) Up to US$0.5 million by a credit committee, composed of the manager and the deputy manager of the credit department, and one member of the managing board.

(b) Credits of US$0.5 million and US$10 million by all members of the managing board.
(c) Credits of over US$10 million by a high level credit committee, composed of all members of the managing board and at least two members of the supervisory board, one representing the foreign shareholders. This committee will meet at least every three months.

(d) Credits from US$5 million to US$10 million (a) for restructuring and (b) for beneficiaries with less than 3 years experience in the activity for which the funds are dedicated, will be consulted with activity or sector specialists, respectively, of a foreign shareholder institution.

43. Staff seconded to the PDB by the foreign banks shareholder in PDB, will be integrated into the credit decision making at an appropriate level relative to their seniority and experience. The credit decision making process, and in particular the involvement of the foreign partners, will be reviewed with for the appropriateness of limits and the efficiency and speed of its functioning. This would be done after actual subscription of PDB's capital by the foreign shareholders.

G. Operational Procedures

44. PDB is currently in the process of developing operational procedures for each of its proposed areas of activity. An advisor, experienced in office management and systems, has been retained to carry out this task. In addition, PDB has access to material and assistance from other banks, in particular, Lloyds. In the short term, PDB is concentrating on installing its basic systems, taking into account the need to develop systems which would provide profit center and related data for individual product types or "windows".

45. PDB's approach to development of its operational procedures appears thorough and logical. Each department initially prepares a draft of its proposed procedures; this is then discussed with those other departments with which it interfaces; the proposals are then reviewed by the Legal Department and Internal Audit; the proposals, as they are being developed, are continuously reviewed by a Procedures Advisor to ensure that they fit into the proposed overall system. Finally, the proposed procedures are presented for review to the appropriate Board member. When approved, the proposals will be incorporated in the PDB's procedures manual, which will be regularly updated to provide for new developments.

46. A review of some initial draft procedures, particularly in relation to the Credit Department, indicates that PDB is moving in the right direction. However, additional refinement will be required. PDB is conscious of this and is keen to ensure that procedures will facilitate the smooth operation of the bank's activities and the safeguarding of its assets.
H. Personnel and Training

17. PDB has so far hired 68 employees. The staff are generally young (average age 35 years), well educated and enthusiastic towards the development of PDB. PDB's personnel policy is geared towards payment based on results rather than seniority. In addition, staff are hired initially for a 3 to 12 months probationary period, during which they must achieve set goals to ensure continued employment.

48. Where PDB staff are at a disadvantage is their lack of extensive practical experience of operating the range of PDB's proposed products in an open market economy. This disadvantage will be ameliorated to some extent by PDB's proposed employment of five expatriate bankers (which may be increased by a further five) experienced in the various areas of banking. At the present time, the director of the Treasury department is an expatriate experienced banker. Two experienced bankers from Canada are presently working in the credit departments for a period of three months. Another expatriate advisor is expected to work for six months particularly on cooperations with PB's. PDB is presently seeking to hire an experienced expatriate banker to head the Credit Department. The foreign shareholders, as well as lending institutions, should assist in recruitment of a few senior managers and advisers to key positions.

49. PDB staff have already attended various banking training courses, both in Poland and abroad, partly provided by the prospective foreign shareholders. Further intensive training is needed for staff of PDB as well as of PBs. One aspect of training missing in Poland is an in-depth course in financial analysis and credit appraisal. PDB will explore the possibility of initiating such course, to be managed by a management training institute.

50. At the request of PDB, the TA component of the proposed project includes financing of US$3 million for training and experts. PDB will preferably use first TA grants from other sources, if available, for these activities.

I. Organization

51. PDB has prepared an organization chart, with seven departments reporting to the managing Board. The two business departments consist of a credit and a capital investment department. Two separate sections will be set up within the credit department—one for large companies and one for SMEs—and will be run as separate profit centers.

52. In the organization chart, the internal audit unit reports to the managing board, rather than to the supervisory board. To maintain an independent view on PDB's activities, it was agreed that an Audit Committee of the Supervisory Board will be formed.
J. **Range of Activities**

53. PDB intends to start lending operations before July 1991, focusing on three types of activities: (a) loans to companies; (b) lending for SMEs; (c) some equity investments. The strategic plan proposes to undertake later several additional activities, including the following: promotion of energy conservation and environmentally-oriented projects; provision of financing through PBs for micro enterprises and workshops; participation in the development of the Polish capital markets by means of underwriting and asset trading; leasing and other financial services.

54. PDB's contention is that if it does not instigate these activities, certain of them will be extremely slow to develop in the Polish market. While this may be correct and PDB's objective in developing these activities may be laudable, PDB's primary objectives are directed towards the provision of MLT credit. As a consequence, PDB will be careful not to spread its scarce managerial and banking knowledge over too wide a range of services. Accordingly, PDB will initially focus its primary attention on developing its skills in the area of credit delivery. Additional activities may be undertaken in later years, when PDB staff will be well trained and capable of undertaking such activities. This was confirmed during negotiations.

K. **Overall Assessment**

55. Despite the fact that PDB was only recently established and will be operating in a rapidly changing economic and social environment, its proposed strategic plan, while ambitious, could be substantially achieved. However, as mentioned above, the timing of achievement of the various objectives may be slower than scheduled. While certain caveats have been mentioned earlier, PDB is on the whole approaching in a reasonable manner the range of tasks necessary to achieve its objectives.
### BALANCE SHEETS

<table>
<thead>
<tr>
<th>Year ending December 31,</th>
<th>1991</th>
<th>1992</th>
<th>1993</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$6,099</td>
<td>$6,764</td>
<td>$7,050</td>
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<tr>
<td>Reserves</td>
<td>1,594</td>
<td>1,992</td>
<td>2,494</td>
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<tr>
<td>Deposits</td>
<td>120,039</td>
<td>121,779</td>
<td>137,013</td>
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<tr>
<td>Net loans</td>
<td>103,744</td>
<td>287,732</td>
<td>460,207</td>
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<tr>
<td>Equity positions</td>
<td>17,381</td>
<td>19,278</td>
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<td>Net fixed assets</td>
<td>618</td>
<td>865</td>
<td>662</td>
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<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>$249,474</td>
<td>$418,411</td>
<td>$627,521</td>
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<tr>
<td><strong>LIABILITIES</strong></td>
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<tr>
<td>Zloty-denominated Deposits</td>
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<td>External MLT Loans</td>
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<td>200,000</td>
<td>350,000</td>
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<td>Bond issues</td>
<td>10,000</td>
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<td>70,000</td>
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<tr>
<td>Equity</td>
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<td>141,008</td>
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<tr>
<td><strong>TOTAL LIABILITIES AND EQUITY</strong></td>
<td>$249,474</td>
<td>$418,411</td>
<td>$627,521</td>
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### INCOME STATEMENTS

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<th>Year ending December 31,</th>
<th>1991</th>
<th>1992</th>
<th>1993</th>
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<tr>
<td><strong>Interest income</strong></td>
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<td>$55,654</td>
<td>$51,870</td>
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<td>Fees and dividends</td>
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<td><strong>Total Revenues</strong></td>
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<td><strong>Depreciation and provisions</strong></td>
<td>6,578</td>
<td>8,934</td>
<td>10,376</td>
</tr>
<tr>
<td><strong>Total Expenditures</strong></td>
<td>24,134</td>
<td>34,718</td>
<td>41,995</td>
</tr>
<tr>
<td><strong>Income before tax</strong></td>
<td>18,203</td>
<td>22,166</td>
<td>13,625</td>
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<tr>
<td><strong>Tax</strong></td>
<td>40.0%</td>
<td>7,281</td>
<td>8,874</td>
</tr>
<tr>
<td><strong>NET INCOME</strong></td>
<td>$10,922</td>
<td>$13,311</td>
<td>$8,175</td>
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<tr>
<td><strong>Dividends</strong></td>
<td>$0</td>
<td>$0</td>
<td>$2,452</td>
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</table>

### RATIOS

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Capital Adequacy</td>
<td>48.9%</td>
<td>32.3%</td>
<td>22.5%</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>7.3%</td>
<td>5.3%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>9.0%</td>
<td>9.8%</td>
<td>5.8%</td>
</tr>
<tr>
<td>Profitability</td>
<td>75.4%</td>
<td>63.9%</td>
<td>32.4%</td>
</tr>
</tbody>
</table>
Notes

Balance Sheet

1. The NBP has required that banks maintain 15% of deposits as a non-remunerated reserve. Other MLT deposits (interbank deposits) are excluded from statutory reserves. Only 25% of PDB’s commercial deposits will apply; therefore, 15% of these commercial deposits will be held in non-interest bearing reserve.

2. Self-funded ST loans represent ST assets financed by PDB ST zloty deposits. Self-funded MLT loans represent MLT assets financed by PDB MLT zloty deposits.

3. External MLT loans represent assets financed by liabilities against other banks, such as the World Bank. They are denominated in hard currencies.

4. Other equity positions represent 50% of total equity positions and are financed by liabilities against other banks. Total equity increases by 20% each year. PDB has already purchased minority stakes in two of the pilot privatizations. Other areas of equity participation are anticipated to include (i) $3-$4 million to set up a Privatization Fund with EBRD, and (ii) $2-$3 million for participation in business information systems.

5. Equity includes the initial US$ 84 million from the State budget, approximately US$ 6 million expected from foreign shareholders and US$ 21 million from IDA. The 1990 budget allocated US$ 21 million and an additional US$ 21 million from the State was allocated at end January 1991. The remainder will be allocated in April 1991.

6. Cash to be maintained at a level of 5% of total equity.

7. Provisions set at 5% of total loans.

Income Statement

1. Interest earned on cash is determined from the average cash balance invested at a rate of 10% in 1991, 7% in 1992 and 5% in 1993.

2. Interest earned on money market deposits is estimated at rates of 54.5% for 1991, 28.5% for 1992 and 20.0% for 1993.

3. The gross spread of ST and MLT deposits and loans in 1991 is assumed to be 3.5% and 4.6% respectively. This spread will decrease as the market grows more competitive to 2.5% and 3.0% in 1992 and 2.0% and 2.5% in 1993.

In 1991, expected rates for ST and MLT deposits are 51% and 52%; the expected rates for ST and MLT loans are 54.5% and 56.0%. In 1992, the expected rates for ST and MLT deposits are 26% and 27%; the rates for ST and MLT loans are 28.5% and 30.0%. In 1993, the rates for ST and MLT deposits are 18.0% and 19.0%; the rates for ST and MLT loans are 20.0% and 21.5%.

4. Interest earned on other MLT loans (non-zloty) is 1.25% of the "Other MLT" loan amount for 1991 and 1.0% for 1992 and 1993.

5. Variable rate interest on PDB MT Bond Issues is estimated for 1991 through 1993 at 53% (+2%), 23% (+3%) and 22% (+4%).

Other

1. Capital Adequacy = Total Equity/Total Assets (unweighted)
2. Return on Assets = Pre-tax Income/Total Assets
3. Return on Equity = Net Income/Total Equity
Dear Sirs:

1. The Government of Poland has embarked on a program for transformation and modernization of the economy supported by the Bank and the International Monetary Fund. With this program in place, a suitable environment exists for privatization and restructuring of the productive sectors.

2. To this end, the Government aims to privatize most state-owned assets. The long-term objective is to have Poland's ownership structure resembling that of Western Europe. It is anticipated that more than half of state assets will be in private hands within the next three years. While immediate privatization is the objective wherever possible, in some cases restructuring will be a necessary prerequisite. Also essential is an effective system of providing responsible and commercially-oriented management for those assets which are still under state control. Finally, insofar as the industrial sector is concerned, the Government proposes to design and implement supportive policies which will foster private sector development and guide the evolution of the sector towards a structure similar to that found in EC economies.

3. To support this far-reaching program of privatization, restructuring, and management of state assets, the Government is seeking assistance not only from the World Bank group, but also from other multilateral and bilateral agencies. This policy letter and the accompanying matrix have been prepared to describe the objectives of the program, the achievements to date, and the actions the Government intends to take. The Government understands that the Bank will review with the Government the implementation of the program and agrees that disbursement of the policy component of the proposed World Bank loan will be conditional on continued satisfactory implementation of the program.
I. Privatization

A. Strategy

4. The Government anticipates that rapid privatization of the bulk of national property will result in major qualitative changes in enterprise behavior by increasing competition and by enforcing the adjustment of enterprises to their new environment. The Government will supervise the process, to ensure that it is transparent, fair, and meets the requirement of social justice. The Government’s approach to privatization is detailed in a policy document ("Privatization Program for 1991") which was approved by the Parliament in February 1991.

5. Recognizing the wide variation in the types of assets to be privatized, the variety of types of new owners, as well as the current limited availability of Polish private capital, the approved program comprises a multi-track approach aimed at accomplishing the task as quickly and efficiently as possible.

6. For state-owned enterprises (SOEs), three main routes to privatization are envisaged:

   (a) Individual transactions, such as public offerings or direct sale to domestic or foreign investors, which is appropriate for viable and generally larger enterprises, the share offerings of which will create the basis for an active capital market. It is anticipated that the conversion of external debt into equity of privatized enterprises will also be utilized;

   (b) Winding-up of SOEs and sale or lease of their assets to private owners, which seems to be particularly appropriate for smaller and medium-sized companies; and

   (c) "Mass" privatization aimed at passing ownership of enterprises to Polish citizens through privatization funds and a voucher distribution system.

7. The Government is taking a proactive role in accelerating these privatization processes. As further detailed below, a number of individual transactions involving winding-up of SOEs with sale/lease of their assets have already been achieved; the proposed mass privatization scheme is still being elaborated.

8. Foreign investment, primarily through the formation of joint ventures, has been the major route to privatization until now but the results have not been particularly impressive. To remove the current real or perceived barriers which have constrained foreign investment in Poland, and to make Poland competitive in attracting such investment vis-a-vis other central European countries, the Government is in the process of replacing its law on joint ventures with a more liberal law on foreign investments covering joint
ventures, privatization and greenfield investments. The Government also intends to promote further direct foreign investment through a number of promotional actions and activities. The revised draft law is now before Parliament. The promotional program is being developed by the Foreign Investment Agency.

9. Privatization of public assets other than SOEs is proceeding along a variety of alternative routes including the auction (for sale or lease) of small shops and businesses which has now been substantially completed. In other areas, such as land ownership, the privatization of cooperatives, and problems related to contingent liabilities such as environmental clean-up costs, a number of policy issues are still being addressed.

B. The Legal Framework

10. The Government is developing a legal framework to ensure efficient transformation of the economy while at the same time ensuring that it functions effectively in the future. Key legislation is already in place, in particular: (i) the "Anti-Monopoly Act" (1990), which mandates the break-up of large monopolistic SOEs prior to privatization; and (ii) the "Privatization Law for State-Owned Enterprises" (1990), which is the fundamental legislative basis for the program described in this letter; (iii) the "Law on Public Trading in Securities and Trust Funds". Other existing legislation supports the process, although a number of necessary revisions are being prepared. In particular: (i) the "Law of Economics of SOEs" (1981) together with a liquidation amendment (1990) is being further revised aimed at ensuring the efficient operation of enterprises which cannot be immediately commercialized; (ii) the "Commercial Code" (1934) with various amendments is being revised; (iii) the "Bankruptcy Law" (1987) was amended in 1990 but additional supporting regulations are being prepared to facilitate the orderly closure of bankrupt enterprises; and (iv) the "Law of Joint Ventures" (1988) has been rendered largely obsolete by the passage of subsequent legislation and as noted above, will be replaced by a new law designed to improve the attractiveness of foreign investment. New regulations in respect of accounting and auditing have been introduced. New legislation now under consideration or in the process of being drafted will ensure the proper legal framework for compensation to original owners, land ownership and transformation of cooperatives.

C. Institutional Arrangements

11. SOEs are responsible to a "founding organ" which may be one of number of Ministries or one of the forty-nine district or "wojewoda" governments. Under the legislation described above, the founding organ is responsible for ensuring that before an enterprise can even be considered for privatization, monopolistic enterprises will be broken up (with the assistance of the Anti-Monopoly Agency) and non-viable or non-performing enterprises will be liquidated. In addition, enterprises which may be excessively vertically integrated may seek help for restructuring into viable separate units.
12. For viable enterprises, the first step in the privatization process is for the founding organ, the enterprise management and the worker's council to mutually agree on a privatization approach with the help, where necessary of foreign and/or Polish consultants. If the agreed approach is dissolution and sale of assets, then representation is made to the Ministry of Ownership Changes (MoOC) which will then oversee the procedure. If, on the other hand, the agreed approach involves privatization of the business as a going concern, the first step must be "commercialization" through the formation of a joint stock company, the shares of which will initially be held by the MoOC on behalf of the Government. MoOC will then be responsible for organizing the privatization of the newly-formed company using external assistance to the extent necessary. The Government has left the primary decision as to whether and when to initiate privatization at the level of the enterprise and the founding organ primarily in order to ensure the involvement of enterprise workers in the process. Tax and other incentives are being introduced to encourage transformation. Nevertheless the Government's primary goal is the privatization process itself and if the response is inadequate, the legislation allows the Council of Ministers, upon the recommendation of MoOC, to require that enterprises enter the program.

13. To assist the privatization process and to accelerate privatization at the local and regional level, the Government intends to decentralize the process by establishing over ten regional branch offices of the MoOC. The privatization of other public assets, including foreign trade companies, banks, and state farms is under the responsibility of the respective agencies representing the Government ownership of these assets, e.g. Ministry of Foreign Economic Relations, Ministry of Finance and Ministry of Agriculture.

14. In addition to the primary institutions involved in privatization, the Foreign Investment Agency is promoting foreign participation in the process as well as reviewing all transactions involving foreign buyers, while the Ministry of Finance reviews all transactions with tax and budgetary implications. Other institutions (the Polish Development Bank, other banks, the Industrial Development Agency, etc) may be involved in specific operations. An inter-ministerial coordinating committee has been established to ensure the efficient implementation of the program. This committee will ensure that the process of privatization proceeds as rapidly and efficiently as possible, and will act quickly to deal with any bureaucratic or other impediments which may emerge.

D. Achievements to Date

15. A large number of enterprises have already been privatized through the formation of joint ventures. In addition, in the ten months since the passage of the "Law on Privatization of State-Owned Enterprises", the Government has achieved substantial progress in the process of privatization as follows:
Establishment of an institutional infrastructure including the Ministry of Ownership Changes.

Development and adoption of a clearly defined strategy for privatization.

Commencement of operations of a stock-exchange within the framework of the new Law on public Trading in Securities and trust funds.

Privatization of 242 enterprises, including five large firms through the methods of initial public offerings; trade sales of a number of enterprises to domestic or foreign investors; and 143 small and medium enterprises through the dissolution route, 48 through the sale of assets and 95 through leasing (with deferred purchases).

In addition, "small privatization" of retail stores and other services (for example, trucking services) has been proceeding (80% of retail outlets; more than 50% of road transportation and more than 40% of construction services are now in private hands).

The adoption by the Ministry of Foreign Economic Relations of a program of privatization of the foreign trade companies, in February 1991.

Commercialization of a further 150 enterprises, half of which are slated for individual privatization. These enterprises are now joint stock companies, operating as autonomous entities under the direction of their Supervisory Boards of Directors.

Established a training institute which has begun training future supervisory board members, stock brokers and Polish consultants in the areas of management and finance.

The Government has also made considerable progress in the design and preparation of the proposed mass privatization program. A preliminary concept has been approved by the Council of Ministers which would essentially involve the establishment of a number of Funds to which Polish citizens would entrust vouchers distributed freely to them. The Funds would use the vouchers to compete for the purchase of shares in commercialized companies. The Government has appointed an advisor to assist us in elaborating the program and in attracting international fund managers to operate the Polish Privatization Funds. The advisor will build on the conclusions of an international accounting firm which has been appointed to determine for us aspects of the implementation of the voucher scheme. The final concept, which will also have to give due consideration to the macroeconomic effects, will be decided upon only after completion of this work.
17. Finally, through an institute established to assist privatization at the municipal level, the Government has issued practical guides and handbooks to assist the municipal councils in privatizing local firms.

E. Next Steps

18. The Government intends to achieve the following in 1991:

- Complete the preparation of new legislation in support of privatization as detailed above (para 10).

- Accelerate the pace of privatization through winding-up and sale of the assets of SOEs. Approximately 600 small and medium sized firms will have been privatized in this manner in the course of this year.

- Complete preparatory work for establishing procedures for the conversions of external debt into equity of privatized enterprises.

- Commercialize 1000 enterprises so that there is a pipeline of firms for subsequent privatization.

- Continue the process of individual privatization. Seven more enterprises are about to be privatized under this program and a further 40-60 firms will be during the course of the year.

- Finalize the program for the mass privatization upon establishment of its feasibility. As presently envisaged, this would include the establishment of a number of Polish Privatization Funds and the elaboration of a program for the distribution of vouchers. It is expected that the first privatizations (some 50 - 100 companies) under this program will be conducted in the last quarter of 1991.

- Initiate the implementation of a program to privatize the banks, which should lead to 1-2 banks being privatized in 1991. The privatization process for insurance companies has also commenced and at least 1 insurance company should be privatized in 1991.

- Further support and accelerate the process of decentralization of privatization at the level of the wojewodas (regional governments) and the municipalities.

- Significantly liberalize the foreign investment legislation in order to attract capital and investment from abroad, and substantially redirect the activities of the Foreign Investment Agency towards promotion.
Implement a program for the privatization of approximately ten foreign trading companies under the program prepared by their founding organ, the Ministry of Foreign Economic Relations.

Develop a program for the cooperative sector which will allow for the transformation of cooperatives into corporations, or otherwise adapt them to a market environment, while at the same time ensuring their full autonomy and self-management.

Establishment of a policy on contingent liabilities for the new owners of privatized SOEs, particularly environmental clean-up costs.

Monitor the overall progress of privatization and take active measures to ensure that it continues rapidly and efficiently.

19. To achieve this ambitious program, considerable institutional strengthening will be required along with the measures necessary to ensure effective coordination between institutions. For this purpose, the Government is seeking World Bank technical assistance proposed under the present project, assistance from EBRD and the EC PHARE program and other bilateral support.

II. Restructuring

A. Strategy

20. The Government recognizes that creation of a competitive environment is necessitating substantial and continuous adjustment in the Polish industrial sector. While enterprise restructuring will normally occur through private initiative following privatization, a number of enterprises will require reorganization or other forms of restructuring prior to privatization. For such cases, a cohesive program of restructuring is essential in order to assist Polish industry to become more competitive and efficient, prevent market failure that would derail the privatization process, and allow orderly exit. Restructuring will also deliver a stock of profitable enterprises to the privatization process.

21. To support the overall restructuring of the productive sector, and in the context of an evolving industrial policy more appropriate to the new environment, the Government will initiate and sponsor the dissemination of sector information in order to provide enterprises with information on their performance versus best practices internationally. The Government anticipates little or no additional role in this process, other than to assure firms a supportive industrial policy, a strengthened financial sector and an active capital market.

22. At the enterprise level, there are a number of unprofitable units or enterprises which have been severely weakened by drastic changes in the economic environment such as import competition, loss of traditional CMEA
markets, higher energy prices and a more stringent enforcement of anti-pollution regulations. In a trial program, the Government is attempting to sell a number of these enterprises. However, it is inevitable that in many cases, even where there is potential viability, no immediate buyers will be found and restructuring will be a necessary prerequisite to privatization. The Government recognizes its responsibility to initiate the restructuring effort, at least to the degree that it will deliver viable entities which will attract commercial attention through one of the available privatization routes. In addition, as foreseen in the Privatization Law, in certain specific instances of enterprises requiring restructuring prior to privatization, in cases clearly of national interest, financial assistance will be provided through transparent budgetary allocations. It must be emphasized, however, that the Government does not intend to undertake major investments in any state enterprise. If enterprises do not have any potential to be restored to viability, they will be liquidated.

23. While in the past, some non-viable enterprises have been sustained through support loans which amounted to indirect budgetary support, the Government reiterates its commitment not to subsidize enterprises directly or indirectly, and intends to develop a clearly articulated, transparent and redirected industrial policy and a reorganized Ministry of Industry (MOI), itself restructured to implement this policy. Financial assistance to failing enterprises will be the exception, limited to clear cases of national interest, and will be provided through transparent budgetary allocations. Financing for restructuring will normally be provided through the financial system, without jeopardizing the health of the financial sector, on the basis of normal commercial and prudential practice.

24. In addition to support for enterprise restructuring, the Government is developing a program of regional assistance where there is at present or there is the potential for regionally concentrated layoffs.

B. Institutional Arrangements

25. Restructuring programs are being supported by a variety of institutions within Poland and, as is the case for privatization, there is movement towards decentralization of the process and intensive use of Polish and foreign consultants. The primary institutions active in the process are: (i) the Ministry of Industry, which has launched and coordinated subsector studies, and is monitoring the operation of the SOEs under its responsibility; (ii) the Anti-Monopoly Agency responsible for initiating the breakup of enterprises with a dominant position on the market, (iii) the Industrial Development Agency, a state-owned joint stock company under the auspices of the MOI, organized to assist firms seeking restructuring assistance; and (iv) the Polish Development Bank (PDB), a public joint stock company with foreign minority shareholders, which will provide medium- and long-term financing on a commercial basis for restructuring, through a network of authorized financial intermediaries. The rapid development of a diversified domestic consulting industry will further support this process. A committee has also been established by the Government consisting of representatives of the Ministries...
of Finance, Ownership Changes and Industry, which meets on a regular basis, and coordinates all efforts for the restructuring of enterprises. On a more long-term basis, the committee will assist in developing a coherent industrial policy.

C. Achievements To Date

26. The major achievement in restructuring comes from the economic reform and liberalization process. In addition to the historically private agricultural sector, there is now a very dynamic formal and informal private sector in the country, particularly in the retail and service sector, but increasingly also in the wholesale sector, notably for consumer goods. By stimulating demand for assets and labor, these developments are also having a positive spillover effect in the state enterprise sector.

27. At the enterprise level, restructuring achievements to date include:

- Improvement of competition by the Anti-Monopoly Agency, which has been active in formulating competition policy and enforcing this policy through break up of monopoly enterprises and sectors. During 1990, the Agency reviewed 1,500 anti-trust cases and ruled that 200 cases represented monopolistic practices and that 200 enterprises required changes in their structure. This usually involved the breakup of multi-plant or multi-location enterprises in agriculture and industry. During 1991 the Agency completed a special analysis of 15 large monopolies in the context of the commercialization/privatization of these enterprises. In addition, all commercialization cases require approval of the Anti-Monopoly Agency.

- The development of enterprise monitoring procedures by MOI which give early warning of financial problems. In such cases, analysis is undertaken of the prospects for the enterprise's future viability. In cases where there is clearly no future, the bankruptcy law and the law on state enterprises can be utilized for an orderly process of liquidation. Three enterprises were bankrupted during 1990. In addition, the Government liquidated sixteen and is initiating procedures for liquidating seven additional nonviable enterprises. For three enterprises which were in serious financial problems, recovery programs were worked out and are being implemented.

- Restructuring actions to restore SOEs to profitability to facilitate subsequent privatization are being developed on a case-by-case basis. Restructuring plans, which include financial restructuring, reorganization, physical restructuring through sale of assets or minor investments, have been prepared for about 12 enterprises. IDA is actively participating in the preparation of
enterprise restructuring plans and has undertaken preliminary
diagnoses in about 150 enterprises.

28. The Government is also developing programs to support sector-wide restructurings and also to identify groups of enterprises which will likely face financial difficulties. In particular:

- A number of subsector studies have been initiated. During 1991, the Government, with the assistance of external consultants completed and widely disseminated a study of the textile industry. It is in the process of completing a study on the cosmetics/detergents industry. In preparation are studies of the construction, packaging, steel, components and pulp and paper industries. Not only will these studies provide a basis for understanding the restructuring needs of the enterprises, but they will provide the basis for assessment of various industrial subsectors in selecting candidates for privatization and for the analysis of anti-monopoly activity.

- Groups of enterprises which might be facing difficulties due to rapid changes of the external environment have been identified. For example such groups include firms that will encounter difficulties due to the past orientation towards CMEA trade especially with Soviet Union; heavy polluters and energy intensive industries. The Government has arranged for preliminary diagnosis to be carried out and has appointed a working group on how best to deal with these firms.

F. Next steps

29. During 1991, the Government will focus on strengthening institutional capacity for restructuring. In particular technical assistance through consultancies and training will be utilized to:

- Improve MOI’s systems for monitoring enterprise performance and speed up and improve the quality of diagnosis of problem enterprises

- Add capacity for helping enterprises to develop feasible plans for breaking them up when they are excessively integrated

- Add capacity in MOI to deal with the growing number of liquidations.

- Accelerate the procedures for assessing monopoly and dominant situations

- Foster the development of indigenous and foreign-owned capital market intermediaries such as stockbrokers, security dealers and investment banks.
30. The role of IDA will be critical in the support to enterprises in trouble. To improve its assistance, IDA will refocus its activity and expand its program for 1991/92, to includes a further 150 diagnostic studies and 100 full restructuring studies. It will also support the implementation phase of the restructuring in liaison with the MoOC.

31. In some of the most affected regions, the Wojewodas in cooperation with the Central Planning Office are in the process of completing indicative strategies for restructuring at the regional level. During 1991, three such programs will be developed. Regional programs are being developed initially for three regions--Katowice, Lodz and Walbrzych. This initiative will assist in job retraining and entrepreneurial development as well as infrastructure modernization necessary to attract new investments into these regions. The programs will also focus on environmental issues.

III. Management of State Assets

A. Strategy

32. Ownership and management of assets which remain in state hands continues to be a critical issue. After the transformation of SOEs into companies with a corporate structure, the owner of shares not held by private owners will be the Government (in most cases for a transitional period). Under the existing law, the Government is represented by sector Ministries or other bodies such as Regional Governors. The Privatization Law stipulates, however, that the Government would be represented by a State Treasury as a central depository for state assets. The concept of the State Treasury as an organization must be suitably developed before the necessary legislation is enacted.

33. While policies for exercising ownership rights of state assets are still evolving, the Government has long recognized the need to address the problem of responsible management of state assets. As early as 1981 a process of decentralization of the decision-making process to the enterprise level was begun, whereby enterprise managers, in cooperation with workers’ councils, have largely been responsible for decision-making.

34. In view of the processes of democratization and the radical change in the economic environment, there remains a clear need to further address the issue of corporate governance for entities which are not easily privatizable and which will remain in state hands for some time. The Government is actively examining all of these questions and is reviewing the experience of EC and other countries in order to develop appropriate means for managing the state assets which remain under its control.

35. In the meantime, hard budget constraints as a result of monetary and fiscal policies, which mandate dividend and tax payments, are the main mechanisms for tightening the controls over SOEs. As enterprises are
commercialized as the first step to privatization, independent supervisory boards of directors are appointed, which oversee the performance of the enterprise.

B. Achievements to Date

36. A major achievement has been the positive impact on enterprise management behavior, of the creation of a competitive environment, based on hard budget constraints and liberalization of the economy. The hard budget constraints have forced the enterprises to focus on their financial discipline.

37. As an initial step in developing solutions to the longer-term problem of corporate governance, the Government has initiated a large-scale program of selection and training of a pool of potential board members which will initially represent the state's interest on the boards of companies partially or wholly owned by the state. The first round of this program received over 4000 applicants, of whom 550 candidates were selected. Training covered the commercial code, financial analysis, accounting, general management and organization strategy in some detail, as well as presentations from Directors and Ministers from MoOC. The course had a success rate of approximately 60%, resulting in a current pool of approximately 300 potential directors. The program is continuing.

C. Next Steps

38. The Government is already undertaking a number of further steps aimed at addressing the problem of corporate governance. These include:

- Continuing to explore options for the proposed State Treasury, aimed at finding an appropriate balance between the objectives of decentralization with improved governance, and then introduction of the appropriate enabling legal framework.

- Definition of appropriate mechanisms for defining and delegating responsibility for state ownership of enterprises by the Treasury

- The creation of new financial intermediaries, the investment/management funds (Privatization Funds) under the voucher scheme, which while primarily the vehicle for mass privatization, will also hold in trust the State's residual shares in the companies privatized under this scheme, and discharge an active management role in these companies.

- The creation of pension funds which will be endowed by the State with shares from newly privatized companies.

- The creation of other privately managed holding companies which would manage the state's interest in groups of enterprises with a
view to improving their performance and attracting further private participation.

39. To conclude, we would like to remind you that Poland has made substantial strides in economic reform over the last two years. It is clear now that the country must make further efforts to restructure and modernize the real and financial sectors of the economy. This can best be done through an accelerated program and at increasing private ownership in all sectors of the economy. This proposal reflects the Government's commitment in this regard. This program cannot be achieved without substantial and continuous external assistance. That is why the financial resources that will be provided by the Privatization and Restructuring Project are essential to assist the Government to implement these policies.

Sincerely yours,

Minister of Ownership Changes, for the Government of Poland

Minister of Industry, for the Government of Poland
### POLAND - Privatization and Restructuring Program

<table>
<thead>
<tr>
<th>Subject/Objective/Approach</th>
<th>Actions to Date</th>
<th>Commissions / Further Actions</th>
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<tbody>
<tr>
<td>PRIVATIZATION</td>
<td></td>
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<tr>
<td><strong>Strategy</strong></td>
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<tr>
<td>Privatize state assets with the long-term objective of achieving an ownership structure similar to that of Western Europe, and an intermediate objective of having 50% of state-owned assets in private hands within three years.</td>
<td>Adoption by Parliament of an overall strategy for privatization and establishment of the Ministry of Ownership Changes (MoOC).</td>
<td>Finalize implementation plans and the legal framework for privatization as further detailed below; develop programs for privatization of such assets as cooperatives, and enterprises governed at the level of the wojewoda or municipality (91/92)</td>
</tr>
<tr>
<td>Three main routes to privatization are envisaged:</td>
<td>Preparation and approval by Parliament of a detailed privatization strategy (March 1991)</td>
<td>Develop: i) criteria/mechanisms for the selection of enterprises for privatization through various mechanisms; ii) plans for decentralization of privatization and establishment of regional offices of MoOC. (Board Condition)</td>
</tr>
<tr>
<td>- Individual transactions (including public offerings, private placements, etc)</td>
<td>Preparation of Government's plan for compensation of former owners of unduly nationalized property, to clarify framework for subsequent privatization of this property (&quot;Reprivatization&quot;)</td>
<td>Finalize implementation plan for mass privatization upon establishment of its feasibility (Board Condition of Policy and Investment Components)</td>
</tr>
<tr>
<td>- Dissolution (liquidation) and sale or lease of assets</td>
<td></td>
<td>Plan for debt/equity swaps in individual privatization of enterprises (Dec. 91)</td>
</tr>
<tr>
<td>- &quot;Mass&quot; privatization aimed at passing ownership of enterprises to Polish citizens; currently envisaged through privatization funds and a voucher distribution system</td>
<td></td>
<td>Statement of policy on contingent liabilities for new owners of privatized SOEs (environmental clean-up costs) (Dec. 91)</td>
</tr>
<tr>
<td>Privatization of 242 enterprises completed, of which:</td>
<td></td>
<td>• Privatize in 91 approximately 40-60 firms through individual privatizations</td>
</tr>
<tr>
<td>- 8 enterprises have been individually privatized;</td>
<td>• Privatize about 600 small and medium enterprises in 1991 through liquidation.</td>
<td></td>
</tr>
<tr>
<td>- 143 enterprises have been privatized through the dissolution route;</td>
<td>Amend, revise, replace or complement. Law on Economics of SOEs, Commercial Code, Bankruptcy regulations. Prepare new legislation for land ownership and privatization of cooperatives. Enact laws on reprivatization and securities exchange regulations. (91/92)</td>
<td></td>
</tr>
<tr>
<td><strong>Legal Framework</strong></td>
<td>Passage of key implementing legislation:</td>
<td></td>
</tr>
<tr>
<td>Establish appropriate legal framework for the transformation of the economy and ensure its efficient functioning in the market economy.</td>
<td>. Privatization Law for SOEs (1990)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>. Anti-monopoly Act (1990)</td>
<td></td>
</tr>
</tbody>
</table>
### Privatization (continued)

#### Institutional Arrangements

Adequate institutional arrangements must be in place to deliver adequate numbers of enterprises and ensure the smooth transformation of the economy.

**Key institutions include:**

- **Founding organs** (ministries, vojewodas, municipalities, etc.) together with enterprise managers and workers' councils prepare privatization proposals for SOEs for consideration by the MoOC.
- **The Industrial Development Agency**
- **The Anti-Monopoly Agency**
- **The Ministry of Ownership Changes**
- **The Foreign Investment Agency**

An Interministerial Committee has been created to oversee the whole process of privatization and ensure the elimination of any bureaucratic or other impediments.

Incentives are in place to encourage enterprises to commercialize as the first step to privatization. 107 enterprises have been commercialized to date.

A comprehensive program of technical assistance has been designed which will add capacity and strengthen the diverse institutions involved in the privatization process.

Statement on coordination between Ministries (MoOC, MoOI) on preparation and implementation of restructuring/privatization of individual enterprises (Board Condition).

Monitor the overall progress of privatization and take active measures, including measures to modify institutional structures and operations as necessary, to ensure that it continues to operate rapidly and efficiently (91/92).

Commercialize a further 1000 SOEs preparatory to privatization during 1991; prepare an additional 1700 enterprises at the municipal level for privatization through commercialization during 1991.

Continue to strengthen all agencies through a comprehensive program of technical assistance financed through Government resources supported by the World Bank and other multilateral and bilateral financial institutions.

#### Foreign Investment

Foreign investment, primarily through the formation of joint ventures, has been a major route to privatization until now but the results have not been very impressive. Object is to remove real or perceived barriers to foreign investment and to redirect activities of Foreign Investment Agency away from regulation and towards promotion.

New law on foreign investment to replace the "Law on Joint Ventures" has been prepared and is currently before Parliament.

Foreign Investment Agency has prepared a promotional program and is currently making arrangements for its implementation.

Enact new law (91)

Implement promotional program (91/92)
Restructuring is envisaged at:

(a) The sectoral level: primarily through the dissemination of sectoral information (such as comparative competitive data) which will be made available to both existing enterprises and potential new investors; and

(b) The enterprise level:
- By new private owners;
- Only in those cases where private investors cannot be found, in commercialized state-owned enterprises where it can be clearly demonstrated that they will be viable (and potentially attractive for privatization) after the restructuring has been undertaken.

There is no intention to use "restructuring" as a vehicle for providing support loans to non-viable enterprises.

Competition has been improved by the anti-monopoly agency which, during 1990:
- Reviewed 1500 antitrust cases and ruled that 200 cases represented monopolistic practices and that 200 enterprises required changes in their structure;
- Completed a special analysis of 15 large monopolies in the context of the commercialization/privatization of the sector.

Restructuring of enterprises is being driven, inter alia, by hard budget constraints which have been in place since January, 1990.

The MDI has set up an enterprise monitoring system to give early warning of enterprise financial difficulties. In 1990, MDI:
- Liquidated 16 enterprises and initiated procedures for 7 more;
- Began recovery programs for 3 troubled enterprises;
- Bankrupted 3 enterprises.

The Industrial Development Agency (IDA) has been set up to provide technical assistance for restructuring enterprises. IDA has already undertaken detailed studies for 37 such enterprises.

The Polish Development Bank (PDB) has been set up to provide long-term refinancing at market terms to the financial sector. PDB will act as an apex institution for World Bank loans.

Interministerial task-force will be established with specific guidelines for speedy decision on critical restructuring cases (Board Conditions).

During 1991, the Government will focus on strengthening institutional capacity for restructuring. In particular: (i) improving systems for monitoring enterprise performance and speeding up and improving diagnosis of problem enterprises; (ii) adding capacity to help overly integrated enterprises to develop feasible plans for break up; (iii) adding capacity to deal with the growing number of liquidations; and (iv) accelerating procedures for assessing monopoly and dominant situations.

Restructuring efforts will be decentralized with creation of regional restructuring agencies (91/92).

Special programs are being developed for sector-wide restructuring and for groups of enterprises which will likely face financial difficulties:
- Sector studies/development of restructuring plans for detergents, construction, packaging, steel and components will start in 1991.
- Diagnostic studies/preparation of restructuring of groups of enterprises which may face difficulties because of CMEA-dependence, high energy use, environmental problem, etc (91/92).
- Regional studies in three hard-hit areas being initiated in 1991.

IDA will refocus its activity and expand its program and in 1991/92 will undertake 120 diagnostic studies and 100 full restructuring studies.
### MANAGEMENT OF STATE ASSETS

**Policies for exercise of ownership rights of state assets are to be defined.** The privatization law envisages a State Treasury which would be the central repository for state assets but there is concern that this could become a giant, centrally-managed holding. Additional work is required before this concept can be finalized.

In program to develop suitable legislation for a "Law on the State Treasury", advice is being sought from the Governments of EC and other countries as to an appropriate model for the management of assets which remain in state hands.

In the meantime, improved management of state-owned enterprises is being driven by:

- Competitive forces in a rapidly opening-up market with minimal protection from import competition
- The additional discipline imposed by a mandatory "dividend" based on the value of assets, in addition to hard budget constraints

In addition, for those enterprises which become "commercialized" on the way to becoming privatized, a supervisory board of directors representing the owners must be appointed. To ensure an initial supply of suitable board members, MoCD has undertaken a selection process followed by a training course and has thus prepared 300 directors.

Review existing incentives and elaborate/implement as needed new incentives/other measures to force SOEs to commercialize in order to bring them under a more tightly managed structure. (Dec. 91)

Review alternatives and eventually develop a comprehensive workable model for the control of state assets which represents a suitable balance between decentralization and improved governance (91/92).

**Elaborate/implement guidelines for directors representing state in supervisory boards of fully or partly state-owned companies (Sept. 91); define mechanisms for delegation of state ownership of enterprises (Dec. 91).**

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### INDUSTRIAL POLICY

**Develop new industrial policy and reorganize MoI to implement it.**

Complete study on industrial policy and review it with the Bank (Dec. 91).

Complete reorganization study for MoI (Dec. 91). Implementation of recommendations (to be completed June 92).
A. Introduction

1. The unprecedented efforts to transform Poland's economy through privatization and restructuring requires massive technical, managerial, institutional and advisory capacity which currently is not available in Poland. Nevertheless, the Government wants to conclude the transformation as rapidly and efficiently as possible. It has thus developed an integrated program of technical assistance (TA) aimed at providing consulting services, institutional support, and training for the main agencies engaged in the process. The estimated overall cost of the proposed program over the next two years is of the order of US$240 million. At least one-third of this cost will be covered by the Polish budget, but the Government is also seeking Bank, other multilateral and bilateral support for the program.

2. The Bank has been asked to help in the design and coordination of the program as well as to finance US$65 million equivalent of key technical assistance in selected agencies. In this context, it has been agreed that Bank funding would only be utilized where grant funding cannot be found; the present financing plan is based on the grant funding which has been identified to date, but loan documents between the Bank and the Government would maintain flexibility and allow for the reallocation of Bank resources designated for TA to other project components if suitable grant financing can be identified during the course of project implementation.

3. This Annex describes the overall technical assistance program and the specific areas proposed for World Bank support. An attachment provides draft Terms of Reference for a proposed Technical Assistance Unit which would help coordinate and supervise the use of Bank funds for the project.

B. Overall Scope of the Program

4. Technical assistance will be focused on providing support to:

(a) The **six key agencies** involved in the restructuring and privatization process: The Ministry of Ownership Changes (MoOC), the Ministry of Industry (MoI), the Anti-Monopoly Agency, The Polish Development Bank (PDB), the Industrial Development Agency (IDA), and the Foreign Investment Agency (FIA); and

(b) A **pilot program for restructuring/privatization** at the level of the wojewoda which will support the agencies concerned with transformation of state-owned enterprises whose founding organ is at that level. Three selected wojewodas with a significant locally-controlled industrial base will initially be supported through this program, but provision will be made for possible extension to provide greater geographical coverage if the initial results are promising.
5. The effort required to manage the procurement and contractual arrangements for a program of TA of this magnitude is considerable. It is thus envisaged that a special TA Unit for this specific purpose would be set up in a centralized location, most likely the Ministry of Finance. Other than providing review capability for Terms of Reference and short lists of consultant candidates, this unit would not have any central administrative role, but would act as a coordinating office for procuring and contracting World Bank-financed TA services in response to requests from the implementing agencies. The European Community (EC) plans to provide similar assistance and this work will be coordinated between the two agencies.

C. Cost and Financing Plan

C. The estimated total cost of the program, and the proposed sources of financing, are summarized below in Table 1.

<table>
<thead>
<tr>
<th>Table 1 - Tentative Financing Plan for Proposed TA Program</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>---</td>
</tr>
<tr>
<td>Polish Agency</td>
</tr>
<tr>
<td>1. Ministry of Ownership Changes</td>
</tr>
<tr>
<td>2. Ministry of Industry</td>
</tr>
<tr>
<td>3. Polish Development Bank</td>
</tr>
<tr>
<td>4. Industrial Development Agency</td>
</tr>
<tr>
<td>5. Foreign Investment Agency</td>
</tr>
<tr>
<td>6. Anti-Monopoly Agency</td>
</tr>
<tr>
<td>Program for Assistance to selected Wojewodas</td>
</tr>
<tr>
<td>Bank and EC TA Units</td>
</tr>
<tr>
<td>Total Technical Assistance Program</td>
</tr>
</tbody>
</table>

7. In preparing the cost estimates, the concerned Polish agencies have focussed on TA requirements for ambitious programs which they consider can be accomplished during 1991. The Bank estimates are based on the same numerical targets, but given the extent of the organizational and administrative task involved, believes that these will not be achieved within that time frame. The above table is thus the Bank's estimate of the cost of TA to support privatization and restructuring through 1992.
8. As indicated in the table, the Government is allocating substantial budgetary resources for TA to assist this program 1/ which is a measure of its substantial commitment to the privatization and restructuring program. The European Community PHARE program has committed ECU 50 million of support. The European Bank for Reconstruction and Development is considering financing a number of key TA components which in total will cost. Finally, the financing of a number of individual experts in the program has also been agreed with several bilateral agencies, notably with the British Knowhow Fund, but also with US and French assistance.

9. Details of the proposed TA program for each agency, including the basis for the cost estimates, are contained in the following paragraphs.

C. Details of TA Programs

1. The Ministry of Ownership Changes

10. The MoOC is the focal point of privatization of all state enterprises in Poland and will utilize by far the most substantial part of the TA funds envisaged for the privatization and restructuring program. The estimated cost and financing plan for TA in this Ministry is as follows:

1/ In addition to the US$80 million equivalent indicated in Table 1, US$100 million has been budgeted to assist with the implementation of the voucher scheme for mass privatization when preparatory studies have been completed and the feasibility of the proposed program assessed.
### Table 2 - Cost Estimate and Financing Plan for TA to MoOC

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
<th>IBRD</th>
<th>EC</th>
<th>EBRD</th>
<th>Others</th>
<th>Total (US$ million equivalent)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Individual Privatization</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Large enterprises</td>
<td>20.7</td>
<td>5.5</td>
<td>14.0</td>
<td>-</td>
<td>-</td>
<td>40.2</td>
</tr>
<tr>
<td>2. Small/medium enterprises</td>
<td>2.3</td>
<td>4.5</td>
<td>4.5</td>
<td>-</td>
<td>-</td>
<td>12.5</td>
</tr>
<tr>
<td>3. Sectoral studies</td>
<td>2.6</td>
<td>10.0</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>12.6</td>
</tr>
<tr>
<td>4. Special cases</td>
<td>-</td>
<td>6.5</td>
<td>1.5</td>
<td>-</td>
<td>-</td>
<td>8.0</td>
</tr>
<tr>
<td><strong>B. Mass Privatization</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Mass Privatization Advisor</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>2. Preparation</td>
<td>-</td>
<td>-</td>
<td>6.0</td>
<td>-</td>
<td>-</td>
<td>6.0</td>
</tr>
<tr>
<td>3. Voucher Scheme</td>
<td>a/</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>a/</td>
</tr>
<tr>
<td>4. Auction</td>
<td>2.0</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>C. Financial/Institutional Infrastructure</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Stock Exchange</td>
<td>4.0</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3.0</td>
<td>7.0</td>
</tr>
<tr>
<td>2. Securities Exchange Commission</td>
<td>2.0</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3.0</td>
<td>5.0</td>
</tr>
<tr>
<td>3. Legislation and Regulation</td>
<td>1.0</td>
<td>-</td>
<td>1.0</td>
<td>-</td>
<td>1.0</td>
<td>3.0</td>
</tr>
<tr>
<td>4. Public Relations and Education</td>
<td>23.8</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.2</td>
<td>24.0</td>
</tr>
<tr>
<td>5. Training</td>
<td>1.0</td>
<td>2.0</td>
<td>0.7</td>
<td>-</td>
<td>0.3</td>
<td>4.0</td>
</tr>
<tr>
<td><strong>D. General Ministry Support</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Consulting Studies</td>
<td>1.0</td>
<td>1.0</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2.0</td>
</tr>
<tr>
<td>2. Personnel</td>
<td>1.6</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>4.3</td>
<td>5.9</td>
</tr>
<tr>
<td>3. Equipment</td>
<td>-</td>
<td>1.5</td>
<td>1.3</td>
<td>-</td>
<td>-</td>
<td>2.8</td>
</tr>
<tr>
<td><strong>E. Allowance for Additional Studies/Actions/Contingencies</strong></td>
<td>-</td>
<td>3.0</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3.0</td>
</tr>
<tr>
<td><strong>Total Requirement</strong></td>
<td>62.0</td>
<td>34.0</td>
<td>29.0</td>
<td>-</td>
<td>16.0</td>
<td>141.0</td>
</tr>
</tbody>
</table>

\[a/\] A provisional allowance of US$100 million has been allocated from the Government budget.

11. MoOC has prepared a detailed plan for each of the activities tabulated above. Briefly, these include:

(a) **Individual privatization of SOEs.** This program is the main activity of MoOC to date. The program envisaged for 1991 is:

(i) for **large enterprises**, to complete the privatization of 45 enterprises (15 through public offerings, 15-20 by sale to Polish investors and 5-10 by sale to foreign companies), and to begin the process for an additional 70-90 enterprises. These enterprises will be selected from among the 500 largest SOEs. Technical assistance (local as well as foreign) will be utilized to preparation and valuation of enterprises, to design privatization strategies, to prepare enterprise prospectuses and to carry out
the privatization. (ii) for small/medium enterprises, the objective is to privatize 1000 enterprises. It has been projected that foreign consultant assistance to prepare these sales would be required for 250 operations, while the remaining 750 would be prepared with local consultants. (iii) sectoral studies, which will be the basis for privatizing some industries. About 15 sector studies should start in 1991, in a program coordinated with the MOI and IDA. (iv) for special cases, which are generally considered as the large and difficult privatizations which may require some special preparatory effort.

(b) Mass privatization of SOEs. Mass privatization will accelerate the process of ownership transformation while also leading to the wide dispersion of share ownership. The program is still being developed but the first step, the appointment of an investment bank advisor to assist in the design and implementation of the scheme is imminent. The advisor will examine all aspects of the program including: aspects of policy, privatization funds, privatization fund managers, enterprises and the auction/bidding process. Subsequent steps which require TA include the preparation of companies for privatization, the elaboration of a feasible voucher scheme, and the auction of enterprises.

(c) Financial and institutional infrastructure, which includes the establishment of a stock exchange and a securities and exchange commission. TA will also be required to assist in drafting and implementing the necessary legislation and to prepare and undertake an educational and public relations campaign. A major training program is included under this category, which would provide courses for directors, consultants, accountants, financial officers, lawyers and stockbrokers.

(d) General support to MoOC including consulting studies on organization and staffing and the installation of information systems, financing of foreign experts to supplement the capacity of the ministry, and the provision of equipment such as computer hardware and software and telefax and telex machines.

2. The Ministry of Industry

12. As the founding organ responsible for the most important portion of state-owned assets, the Ministry of Industry is encountering some difficulty in redefining its role in the reforming Polish economy. On the positive side, MoI is showing effective leadership to the industrial sector by taking the lead in initiating in-depth studies in such important industrial sub-sectors as steel, textiles and packaging. The results of these studies should provide an invaluable tool in guiding the effective restructuring and privatization of enterprises in these sub-sectors. Similarly, MoI has worked closely with the Ministry of Foreign Trade in trying to stimulate an advance program of special attention for that group of enterprises which will be most adversely affected by the dismantling of the CMEA system. Other current
activities of the Ministry, which are appropriate in the current transition situation, include assistance with the breaking up of large and monopolistic enterprises under its control. and in supervising the liquidation of non-viable enterprises. On the other hand, the Ministry does not seem to be able to relinquish its previous role as the provider of resources to enterprises on an ad hoc basis, and in this way its actions counter the efforts of other agencies to effect a rapid and effective restructuring of the industrial sector.

13. There is an appropriate and vital role for a Ministry of Industry in designing and administering industrial policy and this role is particularly important in a country such as Poland which is attempting to rapidly transform its entire industrial sector. The following program of technical assistance for MoI is thus designed to support the appropriate activities of the Ministry within the overall framework designed by the Polish authorities to effect such transformation.

Table 3 - Cost Estimate and Financing Plan for TA to MoI

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Budget</td>
</tr>
<tr>
<td></td>
<td>(US$ million equivalent)</td>
</tr>
<tr>
<td><strong>A. Industrial Policy</strong></td>
<td></td>
</tr>
<tr>
<td>1. Policy guidelines studies</td>
<td></td>
</tr>
<tr>
<td>2. Implementation and monitoring</td>
<td></td>
</tr>
<tr>
<td><strong>B. Sectoral Studies</strong></td>
<td></td>
</tr>
<tr>
<td>1. High material/energy industries</td>
<td>1.0</td>
</tr>
<tr>
<td>2. Branch studies</td>
<td>1.0</td>
</tr>
<tr>
<td><strong>C. Industry Restructuring</strong></td>
<td></td>
</tr>
<tr>
<td>1. Break-up of large enterprises</td>
<td></td>
</tr>
<tr>
<td>2. Liquidation</td>
<td></td>
</tr>
<tr>
<td><strong>D. Ministry Support</strong></td>
<td></td>
</tr>
<tr>
<td>1. Consulting studies</td>
<td></td>
</tr>
<tr>
<td>2. Equipment</td>
<td></td>
</tr>
<tr>
<td>3. Training</td>
<td>1.0</td>
</tr>
<tr>
<td><strong>Total Requirement</strong></td>
<td>2.0</td>
</tr>
</tbody>
</table>

14. MOI has prepared detailed plans for each of the activities tabulated above. Briefly, these include:

   (a) **Support for elaboration of industrial policy.** This component will finance an advisory task force to work with the Ministry to develop an effective industrial policy for Poland within the context of the present direction of economic development, and to
elaborate the appropriate ministerial structure to implement this policy. Extensive reference will be made to the role of similar ministries in market economies, while allowing for the important differences relevant for an economy in transition.

(b) **Strategic studies for key sectors.** There is a vital need for information to support restructuring and privatization operations in at least 25-30 key industrial sub-sectors and branches. Priorities and the nature and content of such studies are being developed in conjunction with the other concerned agencies.

(c) **Industry restructuring.** The break-up of large enterprises requires careful analysis of linkages as well as the ability to make realistic forecasts of the continuing viability of the individual elements following a break up. Support is proposed for this activity through the services of senior advisors and analysts. The liquidation of assets is a specialized and time-consuming process which is currently being handled by ministry staff but which is quickly growing to unmanageable proportions. It will be appropriate to contract this work out to specialized liquidation agencies. Support is envisaged to finance the cost of foreign liquidators for some of the major operations until adequate Polish capacity is developed.

(d) **Ministry support.** MoI has a need for additional senior advisory staff to help implement its redirected industrial policy and to oversee the program of sub-sector studies. In addition, there is a need for additional equipment and software for office technology and information systems. Finally, training programs need to be developed and implemented for personnel in: (i) industrial policy administration; and (ii) liquidations.

3. **The Polish Development Bank**

15. The Polish Development Bank is an embryonic institution which is just now elaborating its objectives and recruiting its staff. The estimated total cost of the TA envisaged in 1991/92 is US$3.0 million equivalent, of which US$2.7 million would finance foreign advisors in PDB and the balance would be the cost of training PDB staff during this same period. The tentative financing plan envisages that all of this TA would be financed by the World Bank. The program would provide:

(a) **General agency support.** PDB has an institutional design comprising nine departments in each of which it perceives the need for a senior foreign advisor at least through 1992. Active recruitment of these specialists has already begun.

(b) **Training.** A detailed training program has been developed covering all aspects of PDB's work. Some training has already been undertaken (at Credit Suisse in Zurich, First Boston in London and Credit National in Paris). The program is being elaborated and
organized by PDB's personnel department; training for 82 persons is envisaged during 1991.

4. The Industrial Development Agency

IDA is the main technical agency charged with the responsibility for providing technical assistance to industrial enterprises requiring help to design and implement restructuring programs. In addition, IDA has been allocated financial resources to help with the restructuring process which it proposes to use for equity investments in selected cases. Bank TA support is proposed primarily in support of IDA's technical activities. The estimated cost and financing plan for TA to IDA is as follows:

Table 4 - Cost Estimate and Financing Plan for TA to IDA

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount (US$ million equivalent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Budget</td>
</tr>
<tr>
<td>1. Diagnostic studies</td>
<td></td>
</tr>
<tr>
<td>2. Restructuring studies</td>
<td>5.0</td>
</tr>
<tr>
<td>3. Overall agency support</td>
<td>3.0</td>
</tr>
<tr>
<td>4. Training</td>
<td>6.0</td>
</tr>
<tr>
<td>Total Requirement</td>
<td>8.0</td>
</tr>
</tbody>
</table>

17. Technical assistance at IDA would support:

(a) **Diagnostic studies program.** IDA is developing an internal capacity to undertake quick diagnoses of enterprises and, where appropriate, to prepare Terms of Reference for more comprehensive follow-up restructuring studies aimed at defining an enterprise strategy for restructuring and transformation. The agency plans to undertake 300 such studies in 1991/2. The assistance of 2 senior advisors to help guide this program through 1992 is proposed, and also funds for financing Polish (and occasionally foreign) consultants to provide guidance in special cases.

(b) **Restructuring studies program.** As noted above, the follow-up to the diagnostic studies is frequently a more substantive restructuring study. In principle, such studies should be financed out of the enterprise's own resources but in many cases this will not be possible. By providing finance for these studies from Government budget resources and grant funds from the EC as well as World Bank funds, IDA will be able to offer a variety of financing packages for enterprise studies which takes into account the enterprise's ability to pay.
(c) General agency support. In addition to support for its enterprise diagnosis activity, IDA has requested senior advisory staff to help manage its other operations and to oversee the detailed restructuring studies which it will manage. In addition, IDA will be directly supervising the restructuring of a number of enterprises and will require supporting advisors to assist. These activities will also need to be supported with appropriate office technology and information systems capacity.

(d) Training. IDA is providing training to its own staff and to Polish consultants to extend the domestic capacity to undertake enterprise diagnostics and simple restructuring studies. This training will continue through 1991/92 and will be supported under the project.

5. Foreign Investment Agency

18. The Foreign Investment Agency (FIA) is the main agency in charge of promotion and monitoring of foreign investment in Polish enterprises. It will support the Privatization Program by a special promotion campaign in Poland as well as selected foreign countries. The estimated cost and proposed financing for this program for 1991/92 is as follows:

Table 5 - Cost Estimate and Financing Plan for TA to FIA

<table>
<thead>
<tr>
<th>Item</th>
<th>Budget</th>
<th>IBRD</th>
<th>EC</th>
<th>EBRD</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(US$ million equivalent)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Overall agency support</td>
<td>2.0</td>
<td>-</td>
<td>3.0</td>
<td>1.1</td>
<td>-</td>
<td>6.1</td>
</tr>
<tr>
<td>2. Design of PR campaign</td>
<td>1.9</td>
<td>-</td>
<td>-</td>
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<td>3. Implementation of PR campaign</td>
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<td>-</td>
<td>-</td>
<td>5.3</td>
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<td>8.9</td>
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<td>4. Training</td>
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<td>-</td>
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<td>-</td>
<td>3.0</td>
<td>10.0</td>
<td>-</td>
<td>21.0</td>
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</table>

19. The proposed TA will support the following:

(a) Overall agency support. It is envisaged that the agency staff would be strengthened through the recruitment of 5-6 foreign experts who would support all aspects of the agencies activities while providing special support for the design and implementation of the proposed public relations campaign. This component also includes computer hardware and software and a satellite-based telephone system to ensure reliable external communications.

(b) Design of PR campaign. Foreign consultants will be needed to assist in the design of a successful public relations campaign.
aimed at promoting foreign investment in Poland. Terms of Reference for this work are being completed.

(c) **Implementation of PR campaign.** Foreign consultants will be selected in a competitive bidding process to implement the PR campaign.

(d) **Training.** FIA requires internal and external training for its staff. Areas identified include joint venture analysis and negotiation, foreign languages, and internships abroad in similar investment promotion agencies.

6. **Anti-Monopoly Agency**

20. The Anti-Monopoly Agency was established in April 1990 and now has a staff of 70 at its head office in Warsaw and another 25 in six regional branches. The Agency has developed a program of TA requirements with the assistance of EC. The estimated total cost of the program is US$3.0 million equivalent and EC has tentatively agreed to finance this amount. The program of TA includes:

(a) **Legal advisors,** including a long-term advisor and a number of short-term consultants to bring West European expertise to Poland and to carry out studies related to complex cases and for establishing appropriate policies and regulations for anti-monopoly control.

(b) **Training,** for agency staff, according to a program now being elaborated.

(c) **Agency support,** with such facilities as computers, simultaneous translation equipment, vehicles, documentation, etc. A feasibility study to determine the appropriate needs and equipment specifications is now under way.

7. **Program for Assistance to Selected Wojewodas**

21. This program is being elaborated. As presently envisaged, however, five wojewoda will be selected to test and demonstrate the potential effectiveness of TA to assist restructuring and privatization at the local government level. This component of the technical assistance program will be further elaborated through consultation with the relevant central and regional authorities.

8. **Centralized TA Unit**

22. Procurement of World Bank-financed consulting services requires adherence to certain procedures designed to ensure the efficient use of Bank resources. While the procedures are relatively straightforward, their initial adoption by new borrowers requires a process of familiarization which initially can lead to delays in the securing of urgently-needed assistance.
The small centralized TA Unit is being proposed to prevent any such delays, particularly in view of the large number of institutions which will be supported under the proposed comprehensive TA program. A staff of three specialists with local support staff is proposed to handle this work. In addition to procurement itself, this unit will have the capability to assist with the preparation of consultant terms of reference and will maintain lists of suitable consultants from which short lists could be developed for particular tasks. Draft Terms of Reference for the unit are attached.

23. The EC proposes to provide similar support for contracts to be financed with EC funding. These efforts are being coordinated.
POLAND - PRIVATIZATION AND RESTRUCTURING PROJECT

Technical Assistance to Support the Privatization and Restructuring Programs

Terms of Reference for TA Unit

Background

1. The ambitious program of privatization and restructuring launched by the Government of Poland will require massive technical assistance (TA), much of it supplied by foreign consultants and consulting firms from outside Poland. The costs of TA will be borne largely by the Government budget, but substantial support is also being provided by the World Bank, the EC, the EBRD and bilateral agencies from the UK, the US, France and elsewhere. TA will be provided to some six agencies of the central Government as well as to a number of the regional (wojewoda) governments, under a coordinated TA program which has been agreed to by the Polish agencies concerned as well as by the external agencies supporting it.

2. Within this overall coordinated framework, the World Bank is proposing to finance specified activities in four of the centralized agencies as follows:

   (a) In the Ministry of Ownership Changes: (i) assistance to the program for the individual privatization of enterprises through the financing of consultants/investment banks to assist enterprises to prepare themselves for privatization and to undertake sectoral or other special studies to support the privatization process where needed; (ii) financing of an investment advisor to help assess the feasibility of a "mass" privatization scheme; (iii) general support to the Ministry through the provision of specialist advisors, training, organizational studies and the financing of data processing and other office equipment.

   (b) In the Ministry of Industry: (i) coordination of studies and action plans to develop and implement strategic objectives for the Ministry; (ii) limited support to sectoral analysis designed to assist, where appropriate, the restructuring process in ailing industries which cannot immediately be privatized; (iii) institutional support and training to the Ministry to improve its capacity to assist with the break-up of overly integrated and monopolistic enterprises, and with the liquidation of non-viable enterprises under its purview; and (iv) general support to the Ministry through the provision of specialist advisors, training, organizational studies and the financing of data processing and other office equipment.
(c) In the *Polish Development Bank*: general support to the bank through the provision of specialist advisors and through training.

(d) In the *Industrial Development Agency*: (i) assistance in financing the program of the development of strategic plans for individual enterprises which require restructuring before they can be privatized; and (ii) general support to the Agency through the provision of specialist advisors, training, organizational studies and the financing of data processing and other office equipment.

**The Need for a TA Unit**

3. The above program of Bank assistance will require the appointment of a rather large number of advisors and specialists. Procurement of World Bank-financed consulting services requires adherence to certain procedures designed to ensure the efficient use of Bank resources. While the procedures are relatively straightforward, their initial adoption by new borrowers requires a process of familiarization which initially can lead to delays in the securing of urgently-needed assistance.

4. A second area which necessitates special attention is the need to maintain coordination among the various providers of TA to the privatization and restructuring process. Bank support will finance only about one-fifth of the assistance envisaged over the next two years, and coordination with other financiers is essential to avoid wastage, duplication and conflict. The Government is anxious to avoid any grand "master plan" which may unnecessarily bureaucratize the process of providing TA, but is rather aiming for a flexible program, decentralized to the level of the various agencies charged with implementing its different components. Thus the coordination activity envisaged is merely first, to ensure the unimpeded exchange of information, second, to add flexibility and responsiveness to the system by enabling the transfer of tasks from one financing agency to another where this may be appropriate, and third, to ensure that when cooperation is needed, such as for the cofinancing of a single activity, the necessary mechanisms can be quickly adopted.

5. Bank staff normally provide this necessary procurement and coordination assistance through the project supervision process, but the scope of the activities envisaged under the present project is unprecedented, and supplementary assistance is required to ensure that the Bank processes do not become an impediment to the rapid provision of effective assistance.
**Scope of Work Envisaged**

**Phase One**

6. An experienced TA Advisor should be appointed as quickly as possible (not necessarily only after further processing of the proposed Bank loan) in order to:

(a) Provide immediate assistance to the Borrower and the beneficiary agencies in the procurement of Bank-assisted TA, in particular through:

- Review of terms of reference for advisors and studies, and provision of advice to ensure their clarity of objective, suitability for the proposed purpose, and likely acceptance by the World Bank.

- Assistance in the preparation of short lists of specialists and/or consultants, and assessment of their likely acceptance by the World Bank.

- Review of draft contracts between the Polish agency and the specialist/consultant, and assessment of their likely acceptance by the World Bank.

(b) Establish liaison/coordination links with World Bank staff in Washington and Warsaw, and with the other financiers of TA for the privatization and restructuring program, in particular by:

- Ensuring that the co-financiers are aware of TA activities being financed by the Bank and vice versa, with a view to avoiding duplication of effort or conflict of objectives.

- Assisting with the arrangements for cofinancing TA where this is envisaged under the overall TA program.

(c) As the work proceeds, develop a program for the appointment of additional expatriate and local staff to provide similar services on a wider scale as the pace of project implementation accelerates. In particular, the TA Advisor will:

- Prepare terms of reference for additional staff for the proposed TA Unit, and develop an appropriate schedule for their hiring and the length of time for which they will be required.

- Ensure that suitable office space is made available, and prepare a plan for communications, data processing and other supporting infrastructure.
Present the foregoing in terms of a costed program with detailed implementation schedules for review by the Borrower and the Bank.

7. The TA advisor would be an expert familiar with the preparation of Terms of Reference for, and contracting of, consulting services, and should also be familiar with World Bank procedures. His initial appointment would be for six months, at which time he would have prepared the program for the full unit, based on his experience and assessment of the situation.

Phase Two

8. The work envisaged for Phase Two is exactly as for Phase One, but on a larger scale as the pace of activity accelerates. At this stage, it is envisaged that the total group would consist of a maximum of three expatriate advisors and three Polish counterparts, and that the unit would disband by mid-1993. Nevertheless, the final definition of the scope of work for this activity would be prepared by the TA Advisor as detailed above. This proposal would be reviewed and approved by the Bank and the Borrower to allow actual needs to be reassessed prior to any final implementation decision.
### Estimated Disbursement Schedule of Bank Loan

<table>
<thead>
<tr>
<th>Calendar Year and Semester</th>
<th>Fiscal Year and Semester</th>
<th>Estimated Schedule</th>
</tr>
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<tr>
<td></td>
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<td>Cumulative Amount</td>
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<tr>
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<td>Amount (US$ million)</td>
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<td>1996 I</td>
<td>FY97 II</td>
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**Note:** The high levels of disbursement during the first three years are due to the quick-disbursing component (US$75 million) which is assumed to be disbursed fully during FY92, as well as the technical assistance component which is a two-year program and assumed to disburse during FY92-94. For the line of credit (US$140 million) the profile for the region has been followed.