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Preprints

TRANSITION TO ADVANCED MARKET ECONOMIES

Abstracts

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SESSION 1

TRANSITION TO FREE MARKET: DILEMMAS AND SOLUTIONS

Part 1B

INSTITUTIONAL REFORM AND THE AVAILABILITY OF CREDIT TO SMALL AND MEDIUM SIZE ENTERPRISES IN POLAND - COLLATERAL LAW REFORM

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IRIS Economic Concept:

IRIS is based on the concept that a country's institutions matter to economic development more than natural resources endowment. The lack of appropriate institutions is a principal reason that nations do not develop economically. A thriving market economy depends not only a government's allowing capitalism to exist and on capital, but on institutions which provide secure individual rights to property and the enforceability of contracts. The incentives to save and invest depend on individual rights to marketable assets - on property rights and on all the various institutions present in developed democracies to define and protect those rights from one generation to another. I am talking about such unsexy things as efficient courts, collateral laws to protect creditors, regulations on equipment leasing, bankruptcy proceedings, banking law, ease of incorporation, reasonable estate procedures. In many third world countries, there is a thriving free market retail sector, but this limited capitalism cannot develop to give wealth to the general population owing to the lack of institutions - not because the government is anti-capitalist.

The role of government in providing this framework is crucial, and the irony is that governments are both essential to provide this framework but also the greatest threat to individual property rights. Dictatorships can provide individuals with rights for competitive markets and cause rapid economic growth. But the policies of dictatorships can change at whim or upon the death of the dictator. Only stable, developed democracies have provided institutions where property and contracts are most predictable for extended periods of time. There capital is least scarce and interest rates lowest. Capital nevertheless flees to these societies from capital-poor countries. Thus we arrive at the conclusion that sustained development (which usually takes generations of wealth gathering and transmission) may require governments that are strong enough to last indefinitely, yet so limited and restrained that they cannot use their overwhelming power to abrogate individual rights. Only democratic governments seem to embody these opposites of strength and weakness - they have to support of their populations to enforce rights but are subject to parliamentary barriers before they can make important changes in property rights (i.e. very slowly and after sustained debate). Democracies alone seem to combine these two elements of sustained strength to enforce and weakness to make arbitrary changes.

The Unavailability of Credit to Small and Medium Enterprises in Poland - Why?

Many Polish businessmen tell a similar story. Wlodek Kozlowski has a successful bakery but wishes to expand and to buy new equipment. He goes to his local private Polish bank and meets with friendly loan officer who is happy to make loan. "How much?" he asks. Wlodek thinks that $200,000 will be adequate to buy everything he needs. The loan officer says there is no problem. "As soon as you deposit $300,000 in a cash deposit in the bank, I will process your loan for $200,000". Wlodek thinks to himself, "Why borrow the money if I already have it."

In Western countries, banks are often willing to make commercial loans which are secured by the very property (at least in large part) for which the loan was made. This property in which the bank has this special interest is called the "collateral." Thus, a computer firm obtains a loan to buy computers, and the bank takes collateral interest. The company pays 25%; the bank finances 75% of the cost. If the loan is not repaid as agreed, the bank can take the computers and sell them to buy itself back. Why does this not happen in Poland? It is against the law. Banks know they cannot conveniently collect collateral in Poland except when it's cash already in their hands. So Polish banks ask for the only collateral which has any real value in Poland - cash.

The present lack of credit is not owing to a lack of capital, but to the failure of the present collateral law system in Poland based on the systems of pledges outlined in Articles 306-355 the Civil Code. Under this system, banks make take pledges of things such as equipment (but not inventory or future things). The registration of the pledge is not done in any central public register (as is common in the West), but on the banks' own books. If a dishonest businessman goes to a second bank and uses the same equipment over again to obtain a second loan, the second bank has a superior pledge to the first bank (!) except if the first bank can show that the second bank knew about the existence of the first pledge (Civil Code, Art. 310). If the bank has a good pledge and no one is claiming the property, the bank must first bring a legal action to collect the pledge. This requires a deposit upon filling the case, typically 12%. Thus, the creditor must throw considerable good money after bad. Before the special execution official of the court seizes, sells, and turns over the proceeds (generally about 20-25% of the original value), the creditor must show under Article Sec. 1025 of the Polish Code of Civil Procedure that all taxes, employee wages, alimony of employers, funeral expense of a debtor and banks claims have first been paid in full. Thus the present system is very limited, easily subject to fraud, unverifiable by second creditors, complicated, expensive, and gives the creditor no assurance that the pledged property's value will be available to repay the original loan. It is therefore dangerous to rely upon this system if you are a creditor.

In most Western countries, when a company wishes to acquire a new car, it typically pays 25% of the value of the car with its own funds, and finances the rest using the car as collateral. The bank registers the "collateral interest" in a central register open to inspection by all creditors. No one can acquire as superior interest to the first creditor registered. If the car owner fails to pay its loan after a number of notices, the bank may send someone to pick up the car (if parked on a public street anywhere) and sell it at auction to repay the loan. No court procedure is necessary unless the debtor tries physically to prevent the creditor from taking the car. The registered collateral interest is superior to any other claimant including the government, wages, etc. Interest rates for all borrowers are reasonable since losses from unpaid loans can be kept low.

The lack credit in Poland for SMEs therefore is not caused by a lack of capital but by the absence of a legal infrastructure which makes it efficient and feasible for capital to be loaned and reclaimed by the lender.

Commissions of both the National Bank of Poland and the Ministry of Justice are presently engaged in preparing a new collateral law for submission to the Sejm. When it is enacted, I believe that the supply of credit to SMEs will increase dramatically.

SEVERAL PROBLEMS IN TRANSITION TO MARKET ECONOMIES

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1. Private ownership and transition
2. Plan and transition
3. Inflation and transition
4. Unemployment and transition.

CHINESE ECONOMY SHIFTING TO MARKET

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The starting point appears as the "leading role of the plan and supplementary role of the market".

Drastic turn to the market economy occurs in 1984. The areas of planned economy and market regulation are demarcated.

New shift to market in 1987: economic activities as a whole are to be covered by market regulation, but the market forces are liable to regulation and control through state planning. Reasons for the growing difficultes on the way to market: microeconomic activities are strirring up much more rapidly than the macrocontrol system is developing: former rigid mechanism is loosened, but not removed, the new one is far from being adjusted: so the reduction of the administrative regulation is compensated by the economic methods. The remnants of the administrative bureauratic power system are interlocking with the emerging elements of market economy. That is an unsurmountable obstacle on the way to formation of effective economic regulation mechanism, and also one of the reasons for the political crisis of 1989.

After the events of June 1989 market orientation of economic reform was not rejected, but concerning the combination of planned economy and market regulation the policy has shifted to the absolute priority of the state planning. Shifting to the new system of "planned commodity economy" is undoubtedly a long-term process.

CHINESE EXPERIENCE OF MARKET TRANSFORMATION: INVESTMENT FACTOR

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The basic assumption of the paper is that under any economic system both the sectoral structure of national economy and type of the reproduction process constitute not only the result, but also an important condition of functionning of prevailing economic relations. Proceeding from this, fundamental sectoral disequilibrium and extensive, wasteful mode of development characteristic of command economy represent serious objective limitations to market innovations' productivity. The aim of the paper is to reveal the necessity of dynamic co-ordination and synchronization of institutional changes with adequate shifts in national investment and structural policy in the framework of transition from command to market-type economic system. Chinese experience demonstrates both the advantages of this comprehensive approach, enabling to improve people's living standards during the transitional period, and dangers connected with insufficient determination to transform the state enterprises. The scope of problems, being analyzed, includes: main directions of national economic development strategy; new investment mechanisms' formation; interrelation between national investment policy, systemic market transformations and sectoral shifts in Chinese economy; technological factor of economic modernization; need for real privatization assessed as a long-term factor of keeping up a balanced sectoral structure of national economy.

LESSONS FROM SOUTH - KOREA'S DEVELOPMENT FOR THE TRANSFORMATION OF POLISH ECONOMY

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The object of the paper is to see if one of the Newly Industrialised Countries - South Korea (ROK) can offer any general lesson for Polish economy in transition.

In the early 1950's, South Korea was a relatively poor country and today it is the 5th richest country in Asia and the 18th richest and 10th largest trading nation on the globe. It is therefore not surprising that many of the Eastern economies including Poland, look enviously towards Korea - searching for the "recipe" which would facilitate their replication of her successes. The question thus becomes two-fold: - firstly, was there indeed a "recipe" followed by policy-makers or is the success merely a function of exogenous variables?; - secondly, are the necessary ingredients avaiable within the EE context and in Poland in particular?

In addressing the initial part of the question, exogenous factor will be examined first. As a conclusion of that part it appears that south Korea was initially structured by the state system, of Japan and then the US for an interim period, before being preferentially integrated into the world capitalist system and before economic penetration by private foreign capital. Hence the initial political integration of ROK into the world state system eased its subsequant economic integration into theworld capitalist system.

A number of areas can be identified as being the essential constituents of "the recipe for success" presued by South Korea. These endogenous factors are summarised into six categories: domestic government role, financial control, bureaucratic autonomy, foreign capital and ownership, and microeconomic structure innovation.

In conclusion the author submits, that Korea does have some informative lessons - both positive and negative - for Poland and other East-European countries, not the least of which is the impact of democratisation upon Korea's economic performance.

TRANSFORMATION OF THE POLISH ECONOMY AND THE FACTORS WHICH COULD AFFECT ITS FUTURE DEVELOPMENT

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Since 1986 the Polish economy has declined. After the 1989, when the first Solidarity's government came to power, the process of deterioration of the economy has accelerated. There were many factors which have affected this state of affairs. Many mistakes have been made by the last Solidarity's governments. The ways of changes imposed on the economy had a negative impact has expected of the population to these governments. The population has expected that the reforms will bring not only the political freedom but also will improve the state of economy, and as a result - the standard of live.

It took two very important years until a new program, aimed on recovery of the economy has been presented. It is possible to change the present process of economy deterioration. It is not only capital but also labour and its will which could affect the economic growth. There are many political, economic and social factors which make, that after years of transition period the economic growth in Poland start.

The paper will concentrate on the factors which could have impact on the future growth of the Polish economy.